THE 1975 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

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THE 1975 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, MARCH 5, 1975

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

The committee met, pursuant to recess, at 10:10 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, and Kennedy; and Representatives Bolling, Reuss, Hamilton, and Long.

Also present: John R. Karlik, senior economist; Richard F. Kaufman, general counsel; Sarah Jackson, professional staff member; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. I am just checking to see if all of our witnesses are here this morning, and I understand that they are. May I say to Mr. Bergsten and Mr. Bernstein that you have attracted a substantial number of members of the Joint Economic Committee here, particularly on the House side. I will uphold the Senate side here for a moment.

This morning the Joint Economic Committee continues its annual hearings on the Economic Report of the President with a discussion of the international economic situation.

We feel that any evaluation of the annual report must have a good input from the international side. We have before us today three distinguished witnesses, Fred Bergsten of Brookings, Mr. Edward Bernstein, president of EMB, and Mr. Ronald Müller, professor of economics at American University. All three men have specialized particularly in international economics, and we want to assure you that we look forward to your insights into the current world situation and its impact upon any economic program that we propose here in the Congress.

The economic situation we face today is one of recession, not only in the United States, but worldwide. Not long ago one of our witnesses said that he thought the American recession was contagious and that it was spreading to all parts of the world. The gloomy outlook for prices, employment and output projected in this year's budget does not inspire confidence that the administration intends to provide adequate sitmulus to end the present recession quickly. We have heard a great deal of testimony in these hearings for the need for more effective programs.

Because of the size of the U.S. economy and the relative dependence of other countries on its markets, what we do or do not do here to get our economy moving, will have a profound impact on economic prospects of other countries, both in the industrialized and the developing areas.

Simultaneously, we must be concerned with the economic outlook of the rest of the world, no longer is the United States so independent of external economic events that it can afford to ignore them. In the past 2 years OPEC's quadrupling of world oil prices, massive sales of wheat to the Soviets, and skyrocketing demands for raw materials all had serious inflationary impact on our domestic economy. Today, unless other industrial countries, particularly Japan and Germany, begin to deflate their economies, the drop in demand for U.S. exports could result in further economic slowdown and loss of jobs. Unless these anti-recessionary policies are coordinated with our own, they could further fuel worldwide inflation.

In the area of energy policy there is also a need to coordinate our own policies. Secretary of State Kissinger, in an effort to promote consuming nations solidarity has proposed emergency oil sharing, joint efforts in energy conservation and production, and a $25 billion oil finance safety net. I might add he has also proposed a commodity agreement of $7 a barrel.

We will be interested in your observations on that in another committee, our committee on multinational corporations of the Senate Foreign Relations Committee. Senator Frank Church has been holding hearings on this subject, which, I do believe, would be very good for this staff of the JEC to examine for purposes of cross-reference and any analysis we wish to make.

Let me just say first, we will examine in these hearings the administration's stringent energy program which is necessary to achieve its goal of a million barrels a day in import cutbacks by 1975. It seems clear to me—and I think to others of us—that the cost of achieving these severe cutbacks is not worth the possible gain. We must, therefore, examine closely the rest of the administration's international program, particularly its oil safety net, to determine the real cost and whether we can afford these proposals.

There is also growing concern in our country today that the OPEC nations with vast accumulating surpluses, may seek to buy out American industry and to use their new economic wealth as a political lever. We must review our policy toward foreign investment in the United States and examine closely what will be its effect on our economy.

These are just some of the issues that we will ask you to respond to. I would just like to check them off again. I think one of the things we need to get your counsel on is investment policy, particularly OPEC countries in the United States. Secondly, the proposals of Secretary Kissinger that relate to the OPEC countries and the solidarity of the oil-consuming countries as related to the producing countries cartel. Of course, we are very interested in your overall observations on the international economic developments as they affect our economy and, also, what the U.S. domestic policy will mean to other economies.

With that we will proceed with our first witness, Mr. Fred Bergsten of the Brookings Institution.

STATEMENT OF C. FRED BERGSTEN, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. BERGSTEN. Thank you very much, Mr. Chairman.

The hardest thing about testifying before a committee with this breadth of interest is trying to choose what to talk about.

In my prepared statement, I tried to pick two issues which have not been widely appreciated, but which, in my view, relate very directly to the questions that you have raised this morning. They raise both immediate and longer term problems for the international economy, and for the U.S. interest in that economy.

Let me quickly go through the points in my prepared statement and then address even more directly the questions you have just raised.

The two points that I want to talk about relate to major problems in the international financial system. Neither is addressed by the President's current program, and both are ignored in the President's Annual Economic Report and the Report of the Council of Economic Advisers.

The first has to do with a very critical political factor which is determining, in large part, the current precipitous decline in the exchange rate of the dollar. The exchange rate of the dollar has become very important to the U.S. economy. By 1971 its overvaluation was costing us half a million jibs, and in the last couple of years its depreciation has significantly added to the inflationary pressures in this country.

Yet the international value of the dollar is subject to steady and downward pressures and erratic fluctuation, both largely unrelated to the current economic position of the United States because of the dollar overhang. The overhang is the huge stock of dollars held outside the United States, ranging somewhere between $100 billion and $200 billion, essentially the legacy of the balance-of-payments deficit the United States ran between 1950 and 1972.

As long as that overhang is outstanding in the world financial system, the United States will never be able to determine its own exchange rate through its own policies.

In my view, massive shifts in this dollar overhang explain most of the recent weakness of the dollar.

Because of the increase in oil prices, the dollar overhang is shifting from the traditional balance-of-payments surplus countries—Western Europe, Japan, and Canada—to the oil exporting countries. As the CEA annual report pointed out, globally the liabilities of the United States to foreign official institutions have risen very little over the last 2 years, but the official holdings of the OPEC countries have risen very rapidly, in fact, by over $20 billion. So there has been a marked shift in these dollar balances from the old surplus countries to the new surplus countries. What is significant about that to me is that the dollar balances are moving from the political allies of the United States to its potential political adversaries, the OPEC countries and, particularly, the Arab members of OPEC.

So the portfolio adjustment that has been going on, out of dollars into other currencies is now being rapidly accelerated by political factors. The Arab oil-producing countries are obviously reluctant to hold their growing reserves in dollar form, particularly in the United States but even in the Eurodollar market. They understandably fear that Middle East hostilities, coupled with another oil embargo, could lead the United States to freeze their assets. They must also be concerned that the increased talk about the possibility of direct U.S. intervention in Middle Eastern oilfields, whether or not connected with issues concerning Israel, could be coupled with, if not preceded by, such financial action.

If Secretary Kissinger and the President talk about invading the Middle East, even hypothetically, they are talking down the dollar in the exchange markets, because they are making absolutely sure that the surplus oil countries that are earning dollars in international trade are going to convert those dollars into other currencies. They will simply not take the risk of holding the dollars.

By contrast, the previous surplus countries never feared U.S. sequestration of their holdings. The fact that most of the dollar's weakness now comes against the deutsche mark and the Swiss franc, the new safe-haven currencies, further supports the view that much of the shift out of dollars is motivated by security concerns.

Hence the new surplus countries are much less likely to hold their earnings in dollar form than were the old surplus countries. It should be no mystery why the rush of petrodollars into the United States has never materialized. This condition will prevail at least as long as there remain high tensions over Middle East policies and oil prices, which may mean the indefinite future. The result will be secular downward pressure on the dollar, with erratic swings over possibly extended periods. This will maintain inflationary pressures on the U.S. economy and, indeed, require the United States to run sizable surpluses in its basic balance-of-payments position to avoid steady dollar depreciation.

Some observers have portrayed a possible use by the Arab countries of a money weapon, á la the oil weapon, through which they would pull their funds out of a given country in an effort to weaken its currency and thereby either weaken its support for Israel or, to deter the threat of such action, convert it into a supporter of the Arab cause. In some senses, the recent move out of dollars by the oil countries represents a subtle and skillful deployment of the money weapon.

As just indicated, I believe that the motivation for the shifts is more defensive than the term "money weapon" implies—it is primarily an effort to avoid exposure to politically motivated retaliation by the United States. But its effect on the dollar is probably more harmful than an overt, one-time shift, both because it is basically political, rather than financial, motivation is harder to detect and because—as the recent neglect of the issue by virtually all national authorities demonstrates—it is far less likely to lead to an effective response.

There is only one constructive response to this problem: Elimination of the dollar overhang via its conversion into special drawing

rights, SDR's, at the substitution account already proposed for creation at the International Monetary Fund. This is an idea, which Mr. Bernstein began proposing well over 10 years ago, whose time should have come long before now. But its urgency is much greater now because of the new aspect of the dollar overhang problem that I have mentioned.

Such consolidation of the overhang has always been a major topic of international monetary reform. It figured prominently in the discussions of the Committee of Twenty in 1972–74, and detailed plans for its implementation have been developed. Under the scheme, dollar holders which preferred to hold SDR's would simply deposit their dollars in the substitution account and receive SDR's in return. The United States would negotiate with the IMF the terms on which the Fund's new dollar holdings would be based.

Consolidation of the dollar overhang was originally pushed by the old surplus countries, who had become disenchanted with holding so many of their reserves in dollar form. When oil prices rose, however, the primary concern of the old surplus countries suddenly became whether their reserves were adequate to finance the inevitable deterioration in their balance-of-payments positions. They stopped worrying about the composition of their reserves, and looked only at the magnitude. Hence, concern about the overhang appeared to disappear.

But, the disappearance of the issue was, predictably, quite temporary. The new surplus countries have exactly the same concerns as did the old about the composition of their reserves, plus the major additional concern stressed here which derives from their political position vis-a-vis the United States. Iran has already begun to peg its currency to SDR's instead of the dollar. OPEC has discussed the possibility of demanding payment for oil in currencies other than dollars, or at least denominating its oil exports in SDR's rather than dollars. Even if the dollar remains the main vehicle currency through which oil trade is financed, these developments provide further evidence that the eventual disposition of OPEC, or at least Arab, oil earnings will move steadily away from the dollar.

Hence, the United States has a major national interest in an international consolidation of the dollar overhang. So do the other industrialized countries, both because doing so would remove a major source of international economic and political instability and because most of them continue to hold large dollar balances. So do the OPEC countries, because they could get SDR's in exchange for their dollars without depressing the value of large portfolios of dollar assets which they now hold. Creation of a substitution account at the IMF, and consolidation of the dollar overhang, should thus become a priority focus of U.S. international economic policy, and should be negotiable internationally.

The second issue that I mention in my statement, which is closely related and I think has not been appreciated very widely at all, is the current revaluation of the official price of gold from its previous level of $42 an ounce to a market-related level of about $170 an ounce.

Through a series of very skillful French salami tactics over the last year and a half, the opposition to avoiding a large increase in the official price of gold, which the United States had maintained for over 20 years, has been steadily eroded to a point where France, with international permission, has already raised by a factor of four the value of its official gold holding. Other countries, I think, will emulate it very quickly.

Official gold holdings would then be valued at $180 billion. This will push them past the level of foreign exchange reserves which now total only about $150 billion despite increasing more than threefold in only 4 years. Hence gold will once again become the principal component of international monetary reserves.

There are a number of other extremely serious consequences flowing from this development. First, the orderly evolution of the international monetary system toward relying on rational international creation of reserves via the SDR—instead of relying on the inherently erratic financial base of gold, dollars or any other national currency—has been decisively set back. There is simply no prospect for creating more SDR's when world reserves are being written up by about $135 billion by the strokes of a few pens.

As a result, the likelihood of international monetary instability is greatly increased. This is partly because gold revaluation would assure the continuation of an erratic and unstable financial basis for international monetary arrangements.

Second, gold revaluation will trigger major international political problems. It is clearly the most regressive possible way to increase world reserves, in terms of its effect on the distribution of those reserves among countries. The industrialized countries hold almost 90 percent of world gold reserves, and would get that share of the value of the increase. The six leading holders alone account for 60 percent of the total.

The developing countries have been insisting for several years that the expansion of world reserves be made increasingly progressive through linking the creation of SDR's to development assistance. So gold revaluation is a step precisely opposite to the direction they thought the world was headed, and will further heighten tensions between the North and South. Several OPEC countries have already protested the move along precisely these lines. And major industialized countries which helped the United States by holding dollars throughout the long era of U.S. deficits in lieu of demanding gold, notably Japan, have every right to feel betrayed by the massive revaluation.

Third, gold revaluation is obviously inflationary for a variety of reasons.

It may be too late to head off gold revaluation. To do so, the United States would have to repudiate any notion of revaluing its own gold, refuse to participate in any gold transactions at revalued prices and, most importantly, sponsor a major restoration of the pre-1970 trend toward relying on SDR's as the future financial base of the international monetary system. I firmly advocate such a set of policies.

The implication of the two developments outlined in this statement is that the international monetary system is headed rapidly

toward becoming once more an unmanaged multiple reserve asset system. The role of the dollar is declining. So is the role of the SDR. The roles of other national currencies, particularly the Deutschmark, are rising rapidly. Gold is reestablishing a primary position in the international monetary hierarchy.

The painstaking evolution of the 1960s and early 1970s toward a rational international monetary system based on (a) a single reserve asset, and (b) managed internationally thus appears to have been reversed. The multiple reserve asset system which looks like taking its place was widely analyzed a decade ago, and unanimously rejected as the most unstable possible approach. Indeed, it was limited versions of this approach which collapsed in ruins both in 1931 and 1971. Yet, it is reappearing through the efforts of a few and the inaction of most, including the United States.

The international monetary system has been tremendously improved in the past 2 years through the adoption of managed flexibility of exchange rates. But the system cannot provide a stable basis for a prosperous and peaceful world economy if it does not develop an effective monetary base. U.S. policy should devote priority attention to that objective in the period immediately ahead.

[The prepared statement of Mr. Bergsten follows:]

PREPARED STATEMENT OF C. FRED BERGSTEN

The international monetary system faces two new sources of major instability. Taken together, they could severely disrupt both the world economy and overall relations among nations, both in the short and longer run. They will clearly affect U.S. national interests adversely. Yet each is virtually ignored in the Economic Report of the President and the Annual Report of the Council of Economic Advisers. Each requires major changes in the current policy of the United States.

THE POLITICAL EROSION OF THE DOLLAR OVERHANG

The international value of the dollar is now of major importance to the U.S. economy. Its growing overvaluation in the late 1960s was depriving the U.S. economy of at least 500,000 jobs by mid-1971. It was thereby raising our national rate of unemployment by about 20 percent (from about 5 percent to almost 6 percent), and was in fact nearly doubling the rate of unemployment above the policy target of 4 percent. The depreciation of the dollar since that time has been responsible for at least 25 percent of the increase in our rate of inflation, and perhaps a good deal more, primarily by raising the cost of imports.[1]

Yet the international value of the dollar is subject to (a) steady downward pressure and (b) sizable and erratic fluctuations, both largely unrelated to the current economic position of the United States, because of the "dollar overhang." The overhang is the huge stock of dollars held outside the United States, which ranges somewhere between $100–200 billion.[2] Sales of these dollars from one foreign holder to another depress the value of the dollar, without

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[1] The United States exported, through an increasing overvalued dollar, a significant part of the inflationary pressures generated by Vietnam war expenditures in the late 1960s; accelerating imports held prices at least somewhat in check, the reduction in our international competitiveness restrained foreign demand for our exports, and U.S. firms stepped up their overseas production in lieu of investing domestically. At least part of the inflationary impulse resulting from the dollar depreciations of 1971–75, which became necessary when the overvalued dollar could no longer be sustained, thus represents our delayed payment for the costs of Vietnam.

[2] Existing data on these dollar balances are wholly inadequate. The latest U.S. data show U.S. liquid liabilities to official and private foreign dollar holders of $114.4 billion at the end of November 1974. However, this figure excludes the effects of credit creation through the Eurodollar market, which BIS data suggest might by itself reach $100 billion. The latest IMF data show official holdings of foreign exchange alone at $152.5 billion, of which 60–70 percent is probably held in dollar form. Foreigners hold another $70 billion in longer term claims on the United States, including $37 billion in stocks and bonds which could be liquidated fairly quickly.

any participation by U.S. residents. The main U.S. objective in pursuing international monetary reform to date has quite rightly been to install an exchange-rate system which enabled the United States itself to determine the exchange rate of the dollar, or at least to keep others from being in a position to determine it without the participation of the United States—but the United States will never be able to determine its own exchange rate as long as the dollar overhang remains outstanding.

In my view, massive shifts in this dollar overhang explain most of the recent weakness of the dollar.[3] Most of the overhang has traditionally been held by the industrialized countries, whose balance-of-payments surpluses from 1950 through 1972 mirrored the U.S. balance-of-payments deficits which created the overhang. It was already creating steady downward pressure on the dollar by that time, because the world financial role of the dollar derived from a period in which the United States was the dominant force in both world economics and world politics. With the rise of Germany to the status of an economic superpower,[4] however, it was only natural that the Deutschemark would seize an increasing share of international financial relationships—as it has been doing since the late 1960s, to a point where it is clearly the world's second key currency; is the center of a fairly extensive Deutschemark zone in central Europe; and probably accounts for about 20–25 percent of both the foreign exchange holdings of monetary authorities and private Euromarket transactions. Other national currencies, notably the Swiss franc but several others as well, were also eroding the position of the dollar. In technical economic terms, this represents a "portfolio adjustment" out of the dollar into other national currencies as a result of the fundamental change in the relative economic strength of the major countries.[5]

Because of the increase in oil prices, however, the overhang is now shifting from its traditional locations to the oil exporting countries. As pointed out in the Annual Report of the CEA (page 206): "globally the liabilities of the United States . . . to foreign official institutions have risen little since March 1973 (when flexible exchange rates were widely adopted), but official holdings by the OPEC countries . . . have risen rapidly." [6] So there has been a marked shift from traditional holders to OPEC countries.[7]

This means that foreign dollar balances are moving from the political allies of the United States to its potential political adversaries. So the portfolio adjustment out of dollars is now being rapidly accelerated by political factors. The Arab oil-producing countries are obviously reluctant to hold their growing reserves in dollar form, particularly in the United States but even in the Eurodollar market. They quite understandably fear that any renewal of Arab-Israeli hostilities, especially if coupled with another oil embargo, could lead the United States to freeze their assets. They must also be concerned that the increased talk about the possibility of direct U.S. intervention in Middle Eastern oil fields, whether or not connected to issues concerning Israel, could be coupled with—or more likely, preceded by—such financial action. By contrast, the previous surplus countries—mainly in Europe, Japan and Canada—never feared

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[3] To be sure, the usual economic factors are also involved: changing interest-rate differentials, perceptions of the relative outlook for inflation and economic growth in the United States and other major countries, periodic reports on trade balances and balance-of-payments positions. But the thesis of this paper is that the factors cited in the text are the primary cause of the recent exchange-rate movements.

[4] As indicated, for example, by the fact that its monetary reserves are double those of the United States, its exports of manufactured goods are higher, and it now has a higher per capita income. See C. Fred Bergsten, "The United States and Germany: The Imperative of Economic Bigemony" in Toward A New International Economic Order: The Selected Papers of C. Fred Bergsten, 1971–74 (Lexington, Mass.: D.C. Heath and Co., 1975).

[5] For a detailed analysis see C. Fred Bergsten, The Dilemmas of the Dollar: The Economics and Politics of U.S. International Monetary Policy (Denver: Frederick A. Praeger, for the Council on Foreign Relations, forthcoming 1975). See also the similar view expressed in Walter S. Salant, "The Post-Devaluation Weakness of the Dollar," Brookings Papers on Economic Activity 2:1973.

[6] Table 47 of the CEA Report, p. 206, shows that OPEC foreign exchange holdings rose from $9.8 billion in March 1973 to $35.6 billion in September 1974. Recorded U.S. liabilities to foreign monetary authorities rose by only $1.2 billion over this period. OPEC holdings have clearly risen further since September 1974.

[7] To some extent, the oil deficits of the consuming countries have been matched by an increase in reported world reserves. This occurs when oil importers transfer dollars held previously in the United States to oil exporters, who then lend them back to the oil importers via the Euromarkets. This "carrousel" effect still produces a sharp increase in OPEC countries' share of world reserves, however, and enables them to generate the effects outlined in the text.

U.S. sequestration of their holdings. The fact that most of the dollar's weakness has come against the Deutschemark and the Swiss franc, the new "safe haven" currencies, further supports the view that much of the shift out of dollars is motivated by security concerns.

Hence the new surplus countries are much less likely to hold their earnings in dollar form than were the old surplus countries. It should be no mystery why the expected rush of petrodollars into the United States has never materialized. And this condition will prevail at least for as long as there remain high tensions over Middle East politics and oil prices—which may mean the indefinite future. The result will be secular downward pressure on the dollar, with erratic swings over possibly extended short-term periods. This will maintain inflationary pressures on the U.S. economy, and indeed require the United States to run sizable surpluses in its basic payments balance to avoid steady dollar depreciation.

Some observers have portrayed a possible use by the Arab countries of a "money weapon," a la the "oil weapon," through which they would pull their funds out of a given country in an effort to weaken its currency and thereby either weaken its support for Israel or, to deter the threat of such action, convert it into a supporter of the Arab cause. In some senses, the recent move out of dollars by the oil countries represents a subtle and skillful deployment of the "money weapon." As just indicated, I believe that the motivation for the shifts is more defensive than the term "money weapon" implies—it is primarily an effort to avoid exposure to politically motivated retaliation by the United States. But its effect on the dollar is probably more harmful than an overt, one-time shift, both because its basically political (rather than financial) motivation is harder to detect and because—as the recent neglect of the issue by virtually all national authorities demonstrates—it is far less likely to lead to an effective response.[8]

There is only one constructive response to this problem: elimination of the dollar overhang via its conversion into Special Drawing Rights (SDRs) at the "substitution account" already proposed for creation at the International Monetary Fund. Such consolidation of the overhang has always been a major topic of international monetary reform. It figured prominently in the discussions of the Committee of Twenty in 1972–74, and detailed plans for its implementation have been developed. Under the scheme, dollar holders which preferred to hold SDRs would simply deposit their dollars in the substitution account and receive SDRs in return; the United States would negotiate with the IMF the terms on which the Fund's new dollar holdings would be based.[9]

Consolidation of the dollar overhang was originally pushed by the "old" surplus countries, who had become disenchanted with holding so many of their reserves in dollar form. When oil prices rose, however, the primary concern of the old surplus countries suddenly became whether their reserves were adequate to finance the inevitable deterioration in their balance-of-payments positions. They stopped worrying about the composition of their reserves, and looked only at their magnitude. Hence concern about the overhang appeared to disappear.

But the disappearance of the issue was, predictably, quite temporary. The new surplus countries have exactly the same concerns as did the old about the composition of their reserves, plus the major additional concern stressed here which derives from their political position vis-a-vis the United States. Iran has already begun to peg its currency to SDRs instead of the dollar. OPEC has discussed the possibility of demanding payment for oil in currencies other than dollars, or at least denominating its oil exports in SDRs rather

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[8] At the time of the Six-Day War in 1967, several Arab countries overtly liquidated all of their sterling investments in an effort to pressure Britain to abandon its support for the pro-Israeli policies fo the United States. Sterling was extremely weak at the time, and had to be devalued five months later after three years of effort by the British Government to avoid doing so, so certainly seemed vulnerable to such an attack. But, immediately after the Arab money went into Switzerland, it was recycled back to London by the Swiss National Bank with absolutely no effect on exchange rates or the British economy. The amounts of money potentially involved are much larger today, but so are the swap networks among central banks which could cope with them. Hence there is little reason to fear the crude use of the "money weapon" which is often hypothesized.

[9] For precise proposals concerning these terms—essentially the maturity of the U.S debt, interest payments on it, and a maintenance-of-value guarantee—see C. Fred Bergsten, *Reforming the Dollar: An International Monetary Policy for the United States*, Council on Foreign Relations Occasional Paper on International Affairs No. 2, September 1972, esp. pp. 64–74.

than dollars. Even if the dollar remains the main vehicle currency through which oil trade is financed, these developments provide further evidence that the eventual disposition of OPEC (or at least Arab) oil earnings will move steadily away from the dollar.

Hence the United States has a major national interest in an international consolidation of the dollar overhang.[10] So do the other industrialized countries, both because doing so would remove a major source of international economic (and political) instability and because most of them continue to hold large dollar balances. So do the OPEC countries, because they could get SDRs in exchange for their dollars without depressing the value of large portfolios of dollar assets which they now hold. Creation of a substitution account at the IMF, and consolidation of the dollar overhang, should thus become a priority focus of U.S. international economic policy—and should be negotiable internationally.

THE PRICE OF GOLD

A closely related issue is the current revaluation of the official price of gold from its previous level of about $42 per ounce to a "market-related" level around $170 per ounce.

For over a decade, from the late 1950s through the early 1970s, the United States tenaciously opposed any revaluation of the gold reserves of monetary authorities—both because it (rightly) viewed gold as a wholly inappropriate financial base for the international monetary system, and because it (erroneously) saw gold revaluation as weakening the international financial roles of the dollar. The first dents in that U.S. position came in 1971 and 1973, when the two formal devaluations of the dollar produced small increases in the official price of gold. The major changes occurred in late 1973 and especially 1974: under pressure of the deterioration in the balance-of-payments positions of virtually all industrialized countries caused by the increase in oil prices, the United States agreed to a series of piecemeal steps which have now culminated in de facto gold revaluation.[11]

As soon as other countries emulate the French revaluation to $170 per ounce—and there is little reason to think that they plan to hesitate very long—official gold holdings will be valued at about $180 billion. This will push them past the level of foreign exchange reserves, which now total only about $150 billion despite increasing more than three-fold in only four years. Hence gold will again become the principal component of international monetary reserves.

A number of extremely serious consequences flow from this development. First, the orderly evolution of the international monetary system toward relying on rational international creation of reserves via the SDR—instead of relying on the inherently erratic financial base of gold, dollars or any other national currency—has been decisively set back. There is simply no prospect for creating more SDRs when world reserves are being written up by about $135 billion by the strokes of a few pens.

As a result, the likelihood of international monetary instability is greatly increased. This is partly because gold revaluation would assure the continuation of an erratic and unstable financial basis for international monetary arrangements. It is partly because the step, by greatly strengthening the reserve position of the United States, sets the stage for renewed market pressures and national efforts to again base the monetary system on a "gold exchange standard"— which was intellectually demonstrated by 1960 to be inherently unstable, which is extremely costly for the United States,[12] and whose latest incarnation finally collapsed in 1971 as its earlier incarnation had collapsed in 1931.

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[10] There are no effective national responses to this problem available to the United States. Since August 1971 it has eliminated the risk of losing its reserves through conversions from the overhang by declaring the dollar inconvertible into U.S. reserve assets. But it cannot stop foreign dollar holders from selling the currency and thereby reducing its value in world markets.

[11] The steps included agreement among the members of the former "gold pool" in November 1973 that monetary authorities could henceforth sell their gold on the private market (thereby abrogating the two-tier gold agreement of 1968); in June 1974 that official gold could be used as collateral against international borrowings at a price determined by the borrower and lender (as it soon was, at about $120 per ounce, for a German loan to Italy); and bilateral U.S.-French announcement in December 1974 approving revaluation of official gold to market prices. European countries are now reportedly developing systems of gold settlement for payments imbalances based on the higher price.

[12] See the conclusions reached in Bergsten, The Dilemmas of the Dollar: The Economics and Politics of United States International Monetary Policy, cited.

Second, gold revaluation will trigger major international political problems. It is clearly the most regressive possible way to increase world reserves, in terms of its effect on the distribution of those reserves among countries. The industrialized countries hold almost 90 percent of world gold reserves, and would get that share of the value of the increase. The six leading holders[13] alone account for 60 percent of the total.

The developing countries have been insisting for several years that the expansion of world liquidity be made increasingly progressive through linking the creation of SDRs to development assistance. So gold revaluation is a step precisely opposite to the direction they thought the world was headed, and will further heighten tensions between the "North" and "South." Several OPEC countries have already protested the move along precisely these lines. In view of the growing importance of the Third World to the United States (and other industrialized countries) on a wide range of economic issues, and some security issues, this affront could have extremely serious consequences.[14] And major industrialized countries which "helped" the United States by holding dollars throughout the long era of U.S. deficits in lieu of demanding gold, notably Japan, have every right to feel betrayed by the massive revaluation.

Third, gold revaluation is obviously inflationary. It adds directly to monetary bases in all revaluing countries. It confirms the prognostications of gold speculators, and hence fosters future speculation in both gold and other commodities. It thus further weakens confidence in paper currencies and the economic management of national authorities.

It may be too late to head off revaluation.[15] To do so, the United States would have to repudiate any notion of revaluing its own gold, refuse to participate in any gold transactions at revalued prices and, most importantly, sponsor a major restoration of the pre-1970 trend toward relying on SDRs as the future financial base of the international monetary system. I firmly advocate such a set of policies.

THE INTERNATIONAL MONETARY OUTLOOK

The implication of the two developments outlined in this statement is that the international monetary system is headed rapidly toward becoming once more an unmanaged multiple reserve asset system. The role of the dollar is declining. So is the role of the SDR. The roles of other national currencies, particularly the Deutschemark, are rising rapidly. Gold is re-establishing a primary position in the international monetary hierarchy.

The painstaking evolution of the 1960s and early 1970s toward a rational international monetary system based on (a) a single reserve asset (b) managed internationally thus appears to have been reversed. The multiple reserve asset system which looks like taking its place was widely analyzed a decade ago, and unanimously rejected as the most unstable possible approach. Indeed, it was limited versions of this approach which collapsed in ruins both in 1931 and 1971. Yet it is reappearing through the efforts of a few and the inaction of most, including the United States.

The international monetary system has been tremendously improved in the past two years through the adoption of managed flexibility of exchange rates.[16] But the system cannot provide a stable basis for a prosperous and peaceful world economy if it does not develop an effective monetary base. U.S. policy should devote priority attention to that objective in the period immediately ahead.

Chairman HUMPHREY. Thank you very much.

Mr. BERGSTEN. I stress that, Mr. Chairman, because the monetary system is at the root of the entire international economy. All the

[13] United States, Germany, France, Switzerland, Italy, Netherlands. South Africa and the Soviet Union, as the two largest gold producers, are of course the primary beneficiaries from the income (as opposed to the wealth) effect of gold revaluation.

[14] For elaboration on the importance of the Third World and the failures of U.S. policy in this area in recent years see C. Fred Bergsten, "The Threat From the Third World," Foreign Policy 11 (Summer 1973) and "The Response to the Third World," Foreign Policy 17 (Winter 1974–75).

[15] France revalued immediately after the Martinique Agreement of December 1974 in an effort to make the process irreversible. This gold revaluation via stealth in fact represents a brilliant—if misguided—victory for the "salami tactics" of the French on international monetary reform.

[16] Though that management now needs to be multilateralized, instead of permitting individual countries to intervene in the markets purely to promote their national interests.

issues you have raised derive from it. Perhaps I will stop there, and comment on those other issues later.

Chairman HUMPHREY. Very good. We will just proceed with our witnesses, then we will go to some questions.

Mr. Bernstein.

STATEMENT OF EDWARD M. BERNSTEIN, PRESIDENT, EMB, LTD.

Mr. BERNSTEIN. The world economy is in a state of greater disruption than at any time since the Great Depression. There is very little chance of much improvement until there is a recovery of output in the United States and other industrialized countries, and a considerable slowing of inflation. We see this in world trade and we see this in the exchange markets.

Total world trade, measured by the volume of exports, rose about 4 percent in 1974, the smallest increase in about 15 years. This year the outlook is for a decline of 2 or 3 percent. Of course, with the continued inflation, the dollar value of world trade will rise, but much less this year than last. In every recession from 1949 to 1961, U.S. imports fell and this pulled down total world trade. In 1969, despite the recession, our imports rose but that was because the dollar was seriously overvalued.

This year the volume of U.S. exports and imports will both fall. The U.S. trade deficit which was about $5.7 billion in 1974 may increase to about $7.5 billion. This is bound to have repercussionary effects on the level of output and employment in all of the industrial countries and cause a real hardship in the raw material producing countries.

The present imbalance in international payments is enormous. It has never been experienced before. The biggest imbalance, of course, has been in payments with the oil-exporting countries who had a current account surplus of about $60 billion in 1974. The current account deficit of the rest of the world with these countries will be considerably smaller in 1975. Last year our exports, U.S. exports to the OPEC countries increased by 87 percent. Exports to Germany and Japan increased by nearly as much or more, measured in dollars. Other industrial countries increased their exports to OPEC by about 50 percent.

With their very much larger receipts, the imports of capital equipment and consumer goods and the purchases of military equipment by OPEC will rise considerably. Their exports will probably go down in volume, but probably not much in value in 1975. Still, the current account surplus of the oil countries will remain very large and create a serious payments problem for many years.

Because of the urgency of the oil payments problem, we overlook the fact that there are large imbalances in international payments, apart from those with OPEC. The troubles of the United Kingdom and Italy, which are the principal deficit countries, are well publicized, but there are other countries that have serious payments difficulties. The counterpart of these deficits, nonoil deficits, is the position of Germany, and to some extent, the United States. Excluding imports and exports of oil. The United States had a trade

surplus of $8 billion in 1973, and over $19 billion in 1974. If the oil deficit had remained the same, about $7.5 billion, we would have had a trade surplus in 1974 of nearly $12 billion. With the receipts from services, this is about what the United States would need to finance private investment and government aid when the balance of payments with the oil-exporting countries, say 5 or 6 years from now, it is reduced to a manageable level.

The German problem is much more acute. Germany had a crude trade surplus of 50 billion D-marks in 1974, compared with 33 billion in 1973. If you exclude trade with OPEC, the crude trade surplus increased from 37 billion deutsche marks to about 64 billion deutsche marks. On a balance-of-payments basis, the trade surplus would even be larger. This is a surplus which is inconsistent with a long-run balanced pattern of international payments, no matter how much Germany has to pay for oil in the future.

The other disturbing aspect of the world economy is the dollar exchange rate. Between January 1974, and February 1975, the dollar exchange rate for the deutschemark rose by 25 percent, that is, it took 25 percent more dollars to buy the same number of deutschemarks. The dollar rate for the Swiss franc rose 40 percent. Changes in the exchange rate for the Canadian dollar and the yen, the currency of our main trading partners, changed very little. As the U.S. current account with nonoil countries improved considerably in 1974, and that includes our current account with Europe, the cause of the sharp fall in the exchange rate for the dollar was the huge capital outflow.

I am going to differ with my friend, Mr. Bergsten, on whether the overhang had very much to do with the depreciation of the dollar. I prefer to look at what was happening in current developments, rather than the potential for imbalance that lies in the enormous holdings, now $94 billion that foreigners, private and public, have in this country, as reported by banks.

U.S. private capital outflow was about $16 billion more in 1974 than in 1973. Why did we have such an enormous increase in capital outflow? One reason is we ended the controls on direct investment, so our corporations did not have to borrow in the Eurobond market, and more important, we took off our controls on foreign credits of our banks. The outstanding credits level of our banks to foreigners increased by $18 billion last year compared with less than $6 billion in 1973.

Chairman HUMPHREY. At the very time that they were not having money available for domestic needs?

Mr. BERNSTEIN. That is right. I do not want to push this too far. There was an inflow of funds too, Senator, liquid funds into the United States that also helped finance the increased private capital outflow, mainly from our banks, put pressure on the dollar in the exchange markets.

The main reason for the big increase in this outflow of bank funds was that we were financing the deficits of a part of the rest of the world with the oil-exporting countries. The biggest borrower from our banks was Japan. The next biggest was Latin America. The other borrowers came from all over the world. The dollars they

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borrowed were directly and indirectly used to finance the oil deficit. That is to say, countries that would ordinarily pay us out of their current earnings, instead borrowed the money from our banks with which to pay us. What they earned currently in dollars they paid over to the oil-exporting countries.

Now, some of these dollars that came to the oil-exporting countries were sold for Swiss francs and deutsche marks, and this pushed down very sharply the exchance rate of the dollar. The Europeans, I might add, did not borrow very much from the United States. This is not the whole explanation of the drop in the dollar, though it is a considerable part of it.

Our deficit with the oil countries also put pressure on the dollar. The oil countries put $11 billion into the United States in 1974. The increase in our oil deficit was on the order of $15 billion, so they did not in fact finance the increase in our own oil deficit. Simultaneously, we were financing the oil deficits of other countries.

The oil deficits are an important reason, but not the only one, for the fall in the dollar. The very system that we have is conducive to large fluctuations in the dollar exchange rate—not just down but also, although less frequently, up.

Let me, for example, give you changes in the exchange rates for the Swiss franc and the deutsche mark during several periods. Between May and July 1973, the deutsche mark rose by 26 percent and the Swiss franc rose 20 percent against the dollar. But between July 6, 1973, and January 1974, the dollar rate for the deutsche mark dropped by 22 percent and the rate for the Swiss franc by about the same.

Again, in the next 4 months the dollar rate for the deutsche mark rose by 19 percent and the rate for the Swiss franc by the same. But again, between May and September, 1974, the dollar rate for the deutsche mark dropped by 10 percent and the rate for the Swiss franc by 5 percent. Finally, since September 6, 1974, the deutsche mark has risen by 17 percent, and the Swiss franc by 26 percent, against the dollar.[1] It is not simply that we have had a downward trend in the dollar relative to a few European currencies. Because there have been three periods in which the dollar dropped and only two that it has risen, the net effect has been a considerable decline. I think that the system itself is inherently conducive to such large fluctuations in exchange rates. We have a system in which an outflow of funds causes the dollar to drop. Once the dollar drops, wise speculators and others dealing in dollars, are supposed to conclude that it has reached too low a point. They would then buy the dollars because they are going to need them. That is how a model fluctuating exchange rate system is supposed to work.

Instead, because the speculators have a very short time span, their attitude is that tomorrow's weather will be the same as today's. Because the dollar has dropped, it will drop again. This continues with each drop intensifying the short position of the dollar until it has fallen so low that either the monetary authorities intervene or the speculators admit that the dollar has fallen much lower than it ought to be.

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[1] See table, "Dollar Exchange Rates, Selected Currencies," p. 976.

I agree with Fred Bergsten that the dollar is grossly undervalued by all long-run economic tests and even by the test of the market, that is, the willingness of speculators to take shorter dollar positions and to buy deutsche marks, Swiss francs, and gold with dollars. That is not what should determine the exchange rate for the dollar but it is the harsh test that the market applies as the system operates today. The large exchange fluctuations are disruptive to the United States because of inflation. It is very disruptive to the rest of the world because it undermines all sense of confidence in currency.

I am not going to go into a question on which I have been battling a good many distinguished economists. That is what I regard as the mistaken view, that the oil surpluses provide the rest of the world with the basis for a great increase in capital formation. That simply is not true. The total of the oil surpluses, the money that the oil countries acquire, is matched exactly by a demand for funds to finance the oil deficit. The increase in the savings of the oil countries is matched by a decrease in the savings of the United States.

The real resources that have been freed because our consumers do not have the real income to buy as much domestic goods and services are now going to waste in unemployment. In the long run they will not be available for producing capital equipment for our own use because we shall have to use these resources to produce goods and services for export to them. It is a fallacy that there is a benefit, even though unintended, in the use of the oil surpluses for providing real capital for the rest of the world. The ones who could use the money are not going to get it anyway—the developing countries.

I want to speak briefly, too, about inflation. Our inflation is disruptive, not just domestically, but internationally. If you measure the inflation by the rise in the Consumer Price Index last year, it was 12 percent, roughly, from December to December. This is a larger inflation than in Germany, which was a little under 6 percent, and more than it was in Switzerland, where it was 9 percent, but considerably less than the inflation in the United Kingdom, Italy, Japan, and France.

It may be interesting to note this observation because very few people have made this analysis. Why did we have more inflation than Germany? Was it because that they had better monetary policies during the expansion? Was it because they had better fiscal policies? Well, actually that is not the reason. Our fiscal policy automatically became very restrictive by the third quarter of 1974, not by design, but by action of the inflation in overtaxing the lower income groups through the progressive income tax, and in taxing fictitious inventory profits of corporations. I need not add that monetary policy was very restrictive in 1974.

The real explanation of the difference of 6-percent inflation in the United States and Germany is roughly this: First, the depreciation of the dollar relative to the Deutsche mark. Because of that the rise in the price of oil and other import goods in Germany in Deutsche marks was much less than in dollars in the United States. We had a 40-percent increase in the average cost of all import goods. That added nearly 3 percent to the Consumer Price Index.

The other reason for our larger rise in prices in 1974 is that while wages in Germany rose about as much as or slightly more than in

the United States, they had an increase in productivity, and we had a decrease. The consequence was that unit labor costs in the United States rose sharply, whereas they rose more moderately in Germany.

Chairman HUMPHREY. To what do you attribute that?

Mr. BERNSTEIN. The drop in our productivity?

Chairman HUMPHREY. Yes.

Mr. BERNSTEIN. A small drop in productivity is typical of a recession, although now we have had seven quarters of falling output per man-hour. In the 1969–70 recession I think productivity decreased for three quarters and much less than in this recession. There are two reasons for decreased productivity in a recession. One reason is employers do lag in dropping people from the payroll when output goes down, just as they lag when adding to the payroll when output goes up. The second reason is purely statistical. We measure productivity by the output per man-hour valued in constant dollars. That means if output drops sharply in automobiles, where the value of a man's work is $6 an hour, and drops very little, say, in textiles, where it is $4 an hour, that would of itself lend to a drop in output per man-hour. In a recession, the big drop in output is in the durable goods industries and construction. These are the high-wage and high-productivity industries.

Now, there is not going to be any solution to the problems we have, Mr. Chairman, until the United States and the other industrial countries resume growth of output and employment and until they make significant progress in controlling the inflation. I hope the Joint Economic Committee will find a way to help this country do that.

[The prepared statement of Mr. Bernstein follows:]

PREPARED STATEMENT OF EDWARD M. BERNSTEIN

The world economy is in a state of greater disruption than at any time since the Great Depression. It is faced with the following problems: (a) A world-wide recession that is the deepest of the postwar period and that will probably intensify before there is recovery; (b) An unbalanced pattern of international payments, with surpluses and deficits on a scale for which there is no precedent; (c) Unstable exchange rates and a dollar that has depreciated enormously relative to the principal European currencies in the past year; (d) A high rate of inflation, although it is moderating in most countries, including the United States.

These problems are closely related to each other and this inter-relationship accounts for the severity of the recession and the instability of exchange rates. Because of its major role in world trade and finance, the incidence of the disruption in the world economy has been greater on the United States than on other countries. For the same reasons, the solution to these problems will depend mainly on what the United States is willing and able to do.

RECESSION AND WORLD TRADE

The recession is, of course, the most urgent problem. One factor in the decline of output and employment in the United States has been the fall in consumer spending. Real disposable personal income fell by 4.5 per cent and real consumer spending fell by 3.5 per cent between the fourth quarter of 1973 and the fourth quarter of 1974. In a country where real disposable personal income increased at a trend rate of about 3.5 per cent per annum from 1951 to 1973, a fall of 4.5 per cent in the course of one year can be shattering to the economy.

The reasons for the fall in real disposable personal income are complex. One reason, but not the most important, was the large and sudden increase in the price of imported oil. The United States paid $26 billion for imports of

petroleum and products in 1974 compared with $8 billion in the previous year. This extra $18 billion for 3.4 per cent less oil was equivalent to 1.3 per cent of the gross national product and over 2 per cent of consumer spending. The effect of the higher cost of oil on the real disposable income and spending of consumers was felt in varying degree throughout the economy. It was devastating for the automobile industry which is in deep depression throughout the world.

The world-wide recession is ominous for world trade. In every recession in the United States from 1949 to 1961, U.S. imports declined. In the recession of 1969, U.S. imports increased considerably and that was an indication that the United States was no longer competitive in world trade. In 1974, U.S. imports increased by $33 billion in value but decreased slightly in volume. The increase was entirely due to a 46 per cent rise in the unit value of imports. This was mainly because of the higher price of oil, but also because of the rise in prices of other basic commodities, the inflation in industrial countries, and the depreciation of the dollar.

Despite the decline in U.S. imports and the reduction in oil exports, the volume of world trade continued to increase in 1974, but the increase was the smallest in many years. The outlook for this year is for a fall in the volume of world trade, although in dollar value world trade may rise somewhat. If so, the main reason will be that prices of manufactured goods exported by the industrial countries will be higher. For basic commodities, the volume of exports will be less and the average level of prices will be lower in 1975 than last year.

In the United States, the trade balance is expected to deteriorate this year. Exports of foodstuffs and crude materials will be down in volume and average prices will be lower than in 1974. Exports of manufactured goods will probably decrease in volume because they are heavily weighted with capital equipment, but average prices will be somewhat higher. Imports of oil may be the same or higher, even with minor concessions in price and a small reduction in volume. Imports of foodstuffs will probably rise slightly in volume, but prices will be lower. Imports of raw materials will decline in volume and values. Imports of manufactures may not fall in volume because of the high elasticity of supply in a recession in other industrial countries; and prices will be higher, although the rise will be considerably less than in 1974. As a first estimate, the trade deficit will be about $2 billion more than in 1974—perhaps just over $7.5 billion.

INTERNATIONAL PAYMENTS

The pattern of international payments is marked by enormous current account surpluses and deficits. With very few exceptions, the surpluses are almost entirely those of the major oil-exporting countries. As a group, they probably had a current account surplus of about $60 billion. This is less than had been anticipated because of the smaller volume of oil imports and because of the larger increase in exports of goods and services to these countries. U.S. exports to OPEC increased by 87 per cent in 1974 and other industrial countries also had a very large increase in exports to them—Japan about as much as this country, Germany about 68 per cent, and other industrial countries about 50 per cent. The current account surplus of the oil-exporting countries will fall considerably this year.

One of the consequences of the dramatic increase in the current account surplus of the oil-exporting countries is that it has overshadowed a disturbing imbalance in the current account of the oil-importing countries with each other. There is a general awareness, for example, that the United Kingdom and Italy have huge deficits apart from their payments for oil. Other countries, too, have non-oil deficits that under different circumstances would be regarded as requiring prompt correction. The surpluses that are the counterpart of these non-oil deficits are mainly those of Germany and the United States. Excluding imports and exports of petroleum and products, the United States had a trade surplus of $8.0 billion in 1973 and $19.3 billion in 1974. If the oil deficit had remained what it was in 1973—$7.5 billion—the trade surplus would have been nearly $12 billion. In Germany, the crude trade surplus was about DM 50 billion in 1974 compared with DM 33 billion in 1973. Excluding OPEC, the crude trade surplus increased from DM 37 billion in 1973 to about DM 64 billion in 1974. On a balance of payments basis the trade surplus would be considerably larger.

The trade surpluses of the United States and Germany must be put in perspective in order to see what they signify for the rest of the world. Prior to the

last increase in the price of oil, the United States would have needed a trade surplus of about $8 billion to $10 billion to supplement its net earnings from services, including investment income, in order to finance its foreign investment and Government aid. When the current account surplus of the oil countries is reduced to a manageable level, the U.S. trade surplus needed to finance foreign investment and Government aid may be somewhat larger at present prices, because of the need to service the debt to the oil-exporting countries. In Germany, the trade surplus is clearly very much larger now, even with its oil payments, than is consistent with a balanced pattern of international payments.

EXCHANGE RATES

Between the beginning of January 1974 and the end of February 1975, the dollar exchange rate for the principal currencies in the European common float rose by an average of 25 per cent and for the Swiss franc by over 40 per cent. The dollar exchange rate for other leading European currencies rose somewhat less—ranging from 19 per cent for the French franc and 9 per cent for sterling to less than 1 per cent for the lira. For the currencies of its two main trading partners, the U.S. dollar rose by somewhat less than 1 per cent relative to the Canadian dollar and fell by nearly 5 per cent relative to the yen.

The decline in the foreign exchange value of the dollar is disruptive, not only for its effect on world trade, but even more for its effect on U.S. prices and on confidence in the international monetary system. It is difficult to pinpoint the precise reasons for the sharp decline in the foreign exchange value of the dollar relative to the principal European currencies. Excluding the oil-exporting countries, the current account balance of the United States was much better in 1974 than in 1973 and that applies to Western Europe as well as the rest of the world. This would indicate that the decline in the exchange rate for the dollar was entirely due to capital flows—not just to Europe but to the entire world.

In 1974, the reported net outflow of private capital, excluding liquid liabilities of banks to foreigners, was about $16 billion more than in 1973. This was offset by an increase in the net inflow of liquids funds of foreigners, other than official institutions, of about $10.8 billion. In addition, there was an unrecorded capital inflow in 1974 compared with an outflow in 1973, although precise estimates are not as yet available. There are several reasons for the increased capital outflow in 1974. The control of capital movements was eliminated and that made it possible for direct investors to reduce their Eurodollar borrowings and for banks to increase their foreign credits. Most of the increase in bank credits to foreigners was probably directly or indirectly related to the oil deficits of other countries.

Although the oil-exporting countries placed about $11 billion of their surplus in the United States last year, that was much less than the increase in the U.S. oil deficit. This would itself have placed pressure on the exchange rate for the dollar if it had not been for the increase in the current-account surplus of the United States with other countries. But these countries, confronted with oil deficits of their own, borrowed funds from U.S. banks either to make payments to the United States or to make payments to the oil countries. The funds acquired by the oil countries were mainly placed in the Eurocurrency market and in various currencies in national markets, including sterling, D-marks and Swiss francs. The sale of dollars for other currencies by the oil countries was one reason for the weakness of the dollar in the exchange market in the past year.

No doubt, the fact that the United States had a higher rate of inflation than Germany or Switzerland affected the dollar exchange rate for these currencies. But the rise in U.S. prices was less than that in France and much less than that in the United Kingdom, and yet these currencies appreciated relative to the dollar. The fact that the U.S. consumer price index rose by about 6 per cent more than in Germany and by about 3 per cent more than in Switzerland was to some extent the consequence rather than the cause of the depreciation of the dollar. In any case the differential rate of inflation should result only in an equivalent decline in the dollar. Money market rates were lower in the United States than in Germany, but higher than in Switzerland, where foreign funds supposedly bear an interest charge. The differential interest rate, too, should result in no more than an offsetting depreciation of the exchange rate for the dollar.

Apart from the impact of oil payments and bank credits to finance the oil deficits of other countries, the main reason for the large fall in the foreign exchange rate for the dollar relative to European currencies is speculation. With a fluctuating exchange rate system a decline in the exchange rate for the dollar will stimulate capital outflow and the decline in the exchange rate will continue until there is an offsetting capital inflow. Under ordinary conditions, it would be expected that the offsetting capital inflow would be stimulated by a modest decline in the exchange rate. Under present unsettled conditions, however, with the short time-span of speculators, a fall in the exchange rate for the dollar calls forth more capital outflow and intensifies the fall in the exchange rate. Ultimately, the decline is halted when it becomes generally apparent that the exchange rate for the dollar has fallen to an untenable level. With the monetary authorities committed to avoid intervention, except *in extremis*, the exchange rate can fall very far and very fast before the speculators are convinced that it has reached a bottom. In my opinion, that is the main reason for the enormous fluctuations of 1973–74, when the exchange rate for the dollar alternately fell, rose and fell again by 20 to 25 per cent against some of the major European currencies.

FINANCING THE OIL DEFICITS

Much of the discussion of the financing of the oil deficits has focused on general principles without adequate attention to the practical problems. In a world in which foreign exchange is not convertible into final reserve assets, formerly gold and now SDRs, it is true that the oil-exporting countries will have to hold their surpluses in foreign assets in international money and capital markets. That is to say, the oil-exporting countries will have to hold in dollars in the United States, in sterling, D-marks, Swiss francs and other currencies in these countries, and in Eurocurrencies in London and elsewhere the precise amount of their surplus. In principle, therefore, the rest of the world would find an increased supply of loanable funds in international money and capital markets precisely equal to the deficits with the oil countries. In the jargon that has become established in discussing the oil payments problem, it is only necessary to recycle the oil funds.

In practice, the problem is far more complex. There is a whole series of problems in matching the supply of oil funds with the needs of deficit countries. Some countries, particularly the very low income developing countries, do not have the credit standing that would enable them to borrow the funds to meet their oil deficits in the private money and capital markets. The currencies that the oil countries want to hold will not match the credits in these currencies that the money and capital markets are able and willing to extend. For example, some countries will be unable to borrow in Switzerland and Germany, although they may be able to borrow in the United States. Finally, the oil countries may prefer short-term liquid assets, while the borrowers prefer long-term debts. Bankers who have little difficulty in adjusting the maturity of their loans to the maturity of their deposits cannot do this when they are suddenly confronted with an enormous increase in deposits.

In fact, the large industrial countries had little difficulty in financing their oil deficits in 1974. The United Kingdom, France and Italy were very large borrowers in the Eurocurrency and Eurobond markets last year and Japan and Latin America, as well as other countries, were large borrowers from U.S. banks. The low-income developing countries, however, have not had such access to the international money and capital markets, because their credit standing is not high enough and the costs are much too heavy for them. They need finance on concessionary terms, both for their oil deficits and for financing their development programs. In 1974, the developing countries drew over $1 billion from the oil facility of the International Monetary Fund.

The problem of financing oil deficits will become more difficult as time goes on. Some countries that have borrowed heavily will find Eurobankers more reluctant to increase their loans. The problem will become more acute the larger the proportion of their funds the oil-exporting countries place in Switzerland and Germany. U.S. banks may be concerned about increasing their foreign claims on the same scale as in 1974. The private money and capital markets will still be the most important means of financing the oil deficits in 1975, but they cannot perform the task as well as they did last year. That is

why there is so much interest in expanding the facilities for official financing through the International Monetary Fund, the World Bank, and the special fund that the large industrial countries have agreed to establish for mutual aid. It should be noted that the difficulty of financing the oil deficits was considerably eased by the large sums that the oil-exporting countries lent directly and that they provided the International Monetary Fund, the World Bank, and regional banks.

OIL FUNDS, INTEREST RATES, AND CAPITAL FORMATION

There is a good deal of misunderstanding regarding the effect of the huge oil surpluses on interest rates and capital formation in the oil-importing countries. The Economic Report of the President, 1974, contained this statement: "Among the interest-reducing influences, the prospective capital inflows resulting directly or indirectly from current account surpluses of the oil exporting countries also need to be taken into account [p. 32]." Similar views of the effect of oil money on interest rates were expressed by economists of some foreign central banks and international financial institutions.

In my opinion, the view that the current-account surplus of the oil-exporting countries represents a net increment of loanable funds is not correct. The principle that these funds are available to finance the oil deficits implies that there will be an increased demand for loanable funds precisely equal to the surpluses of the oil countries. The higher cost of oil will reduce the real income of consumers. If they maintain the same pattern of real expenditure, their personal savings will be reduced by precisely the amount of the increased cost of oil. The savings of the oil countries will merely replace the deficiency of domestic savings. If consumers reduce their real expenditure, output will fall and with it the profits and savings (undistributed after-tax profits) of business firms. The tax revenues of the Government will also fall and the budget deficit (negative savings) will increase. Interest rates will fall in the recession, but that will be because of the reduced domestic demand for funds to finance investment and the easier cyclical monetary policy. That is the explanation of the recent decline in interest rates in the United States, not the inflow of $11 billion from the oil countries. As a matter of fact, the world-wide oil deficit put pressure on interest rates in the United States, as the banks were confronted with an enormous increase in the foreign demand for loans.

The question whether the oil funds can contribute to capital formation in the oil-importing countries as a group is somewhat more complex. In an article in *Foreign Affairs*, January 1975, four distinguished economists say:

"* * * [Consumer] payments for higher-priced oil in the importing countries represent a diversion from other forms of consumption, in effect a form of forced saving, with the proceeds of these payments becoming, at least in part, investible funds in the hands of the OPEC countries. If the OPEC countries in turn had the proper outlets and were ready to employ their investible funds, they could make a crucial contribution to the capital formation that the world so urgently needs [p. 204]."

The first part of this statement contains the fallacy discussed above. The consumer payments for higher-priced oil do divert funds to the oil-exporting countries, and most of these funds are saved. But the higher price for oil also reduces domestic savings to the same extent. There is no net increment of savings to finance investment in the oil-importing countries.

The relation between the surpluses of the oil countries and capital formation can be better seen by looking at the effect of the higher cost of oil on the employment of productive resources. In the short run, the higher cost of oil will cause a reduction in the consumption of other goods and contribute to the recession. So long as the recession continues, the unemployed resources simply go to waste. Ultimately these resources will have to be used to produce goods and services for export to the oil-producing countries. In the intervening period, however, these resources will be available for producing goods and services for domestic consumption and investment. Once the recession is over, it is reasonable to assume that most of the resources will be used for investment.

If that proves to be so, domestic investment will be greater than it would otherwise be. This will include investment in industries to increase exports of goods and services to the oil countries and investment in industries to increase

domestic production of energy. It may be assumed that additional investment in the export industries will be offset by a lower level of investment in the domestic consumption industries—to some extent they are the same industries. The investment in domestic production of energy, however, is a net increment of investment that would not have to be undertaken if it had not been for the higher cost of imported oil. The resources that will be absorbed in such investment will be far greater than the surplus of the oil-producing countries with the United States. This would indicate that the availability of resources for other investment will be decreased rather than increased because of the higher cost of oil.

INFLATION

The high rate of inflation has been one of the contributing factors to the present recession. The rise of 12.1 per cent in the consumer price index in the United States from the fourth quarter of 1973 to the fourth quarter of 1974 was due to two major factors. First, the rise in import prices, and second, much more important, the rise in unit costs of production in the private nonfarm economy. The much larger rise in unit factor costs in 1974 reflected a somewhat larger increase in labor compensation per man-hour and a fall of 3.6 per cent in output per man-hour compared with a slight increase in 1973. Farm prices were not a factor in the rise of consumer prices last year. Although retail food prices rose just as much as the index of all items, farm prices at wholesale fell by 2 per cent. The rise in food prices was due to higher unit factor costs of processing and marketing foodstuffs.

The outlook is for a considerable decline in the rate of increase of consumer prices in the course of this year, omitting the effect of new taxes on oil and gas. In the three months to January 1975, the consumer price index rose at an annual rate of 9.2 per cent, the smallest increase in over a year. From the end of 1974 to the end of February 1975, the spot market price index of nine foodstuffs fell by 11 per cent. This is a very narrow index, but it is indicative of what is happening. Prices of raw materials in world markets are still falling and may continue to fall for a time. There is a long lag between changes in basic commodity prices and their effect on consumer prices, but after an interval, they are passed through in consumer prices. Unfortunately, if the fall of basic commodity prices continues much longer, it will create difficulties for producers, in this country and abroad. It should also be noted that if the exchange rate for the dollar improves, import prices will rise much less than in 1974.

The main determinant of the rate of price inflation this year will again be unit factor costs, particularly labor costs per unit of output. The increase in labor compensation per man-hour may be about the same as in 1974. Productivity, however, may be expected to improve in the course of this year. We have now had seven consecutive quarters in which output per man-hour has declined and the fall has been particularly severe since the fourth quarter of 1973. This is usual in a recession, but the decline is quickly reversed in the recovery. If output per man-hour remains flat in 1975, with the same increase in labor compensation as last year, this would of itself slow the rate of inflation by 3.6 per cent. If output per man-hour begins to increase again in the second half of 1975, the slowing of the rise in prices will be even greater. That of itself would be enormous help in expanding real consumer spending and in facilitating a recovery of output and employment.

As long as the United States has a high rate of inflation, the international monetary system will be plagued by instability of the exchange rate for the dollar. The first task now is to have stimulative fiscal and monetary policies, but not on a scale that will result in a resumption of excessive demand soon after the economy begins to recover. The favorable effects of a recovery in this country will be felt throughout the world. The role of the United States as a prime mover in the world economy is not what it was before the remarkable growth in Europe and Japan; but it is still by far the largest economy. A recovery in the United States accompanied by a slowing of the inflation would provide the stimulus necessary for the resumption of a rapid growth in world trade from which the developing countries as well as the industrial countries would benefit.

DOLLAR EXCHANGE RATES, SELECTED CURRENCIES

	U.S. cents per foreign currency unit					
	May 7 1973	July 6 1973	Jan. 7 1974	May 10 1974	Sept. 6 1974	Feb. 28 1975
Belgium	2.482	2.905	2.309	2.675	2.529	2.943
Germany	35.058	44.300	34.700	41.380	37.440	43.925
Netherlands	33.805	40.225	33.845	39.130	36.745	42.700
Swden	22.105	25.230	20.650	23.605	22.300	25.715
Switzerland	30.763	37.200	29.205	34.825	33.140	41.625
France	21.918	26.130	20.120	20.655	20.720	24.010
United Kingdom	249.150	256.000	222.800	243.050	231.090	243.050
Canada	99.770	100.230	100.760	103.955	101.300	100.190
Japan (100 yen)	37.675	38.250	33.330	36.030	33.050	34.920
Italy (100 lire)	16.935	17.360	15.815	16.030	15.095	15.925
		Percent change from preceding date				
Belgium		17.04	−20.52	15.85	−5.46	16.37
Germany		26.36	−21.67	19.25	−9.52	17.32
Netherlands		18.99	−15.86	15.62	−6.10	16.21
Sweden		14.14	−18.15	14.31	−5.53	15.31
Switzerland		20.92	−21.49	19.24	−4.84	25.60
France		19.22	−23.00	2.71	.27	15.88
United Kingdom		2.75	−12.97	9.09	−4.92	5.18
Canada		.46	.53	3.17	−2..5	−1.10
Japan		1.53	−12.86	8.10	−8.27	5.66
Italy		2.51	−8.90	1.36	−5.83	5.50

Chairman HUMPHREY. I thank you very much for a most enlightening and provocative testimony.

Mr. Müller.

STATEMENT OF RONALD E. MÜLLER, PROFESSOR, DEPARTMENT OF ECONOMICS, AMERICAN UNIVERSITY

Mr. MÜLLER. Thank you, Mr. Chairman.

I too, like Fred Bergsten, find difficulty in summarizing the written testimony in 10 minutes since the type of analysis with which I approach the problem is somewhat different than the various people that you normally listen to. I would like to continue very quickly then and start out with a very, very brief background statement on the necessities for discussing directly the energy problem here at home because of the obvious global interdependence and how it then affects the foreign payment and balance of payments in the United States.

Let us look at the administration program. The most basic flaw of this program and its packages are that they overlook the fact that since World War II the U.S. economy has undegone a fundamental transformation which means today it no longer responds to standard stabilization policies as assumed by most economists and policymakers alike. I have no time here for a detailed explanation. Let me just say that the characteristics of this transformation are twofold and inter-related.

The first is the globalization of our largest 700 industrial and financial corporations, all of which we will call multinational corporations.

The second, and intimately related, is the historic and unique increase in industrial and financial concentration since World War II. The same 700 or so corporations are almost all conglomerates working not only in one industry but across many industries and con-

trolling roughly 60 to 70 percent of the total private sector of our economy.

What does this transformation mean? Most of all it means competitive market forces of supply and demand can no longer be relied upon as the instrument for realizing the goals of standard anti-inflation and employment stimulation policy, particularly in the energy and transportation sectors, a fact totally overlooked in the administration's current programs. The fact of the matter is that these policies set forth a vicious cycle of further feeding concentration and thereby destroying further competitive market mechanisms which in turn are the reasons for the policy's ineffectiveness in the first place.

Another consequence of this transformation is that it has led to a significant erosion of our corporate tax base, while bringing increasing social cost to the Government in terms of, for example, unemployment and public employment spending programs, welfare programs, ecology programs, to name a few.

As an inside here, in reference to Mr. Bernstein's commentary with Senator Humphrey, you may want to ask me in the question period the relationship between private foreign investment by multinationals and the decline in U.S. productivity.

In short, the continuations of policies, which do not take into account that our economy is now different than in days past when the theoretical basis of these policies were first formulated, will find increasing deficits at all levels of government, but not only the governmental increasing deficits will occur. The new mode of corporate behavior also necessitates ever greater amounts of deficit financing than ever. It may well be that we can once more revive our economy through the same old policies of the past by the end of 1976. I feel it quite likely that we will find ourselves by about 1978 right back in the same place as today, but with higher rates of inflation and unemployment than we now have.

I believe it incumbent that we begin the task of recognizing that our economy is structurally different and that aggregate policies have different and unpredictable impact on one sector as opposed to the next—housing is a good example—and differential impacts on large global conglomerates that largely bypass competitive market mechanisms, as opposed to smaller national firms that continue to operate within these competitive markets.

With this all too brief background analysis in mind, I shall now give a summary of the proposals for tax and expenditure and other policies for dealing with energy and its interdependent transportation sector. I will cut that short because of time. I will then summarize the interrelated aspects of the energy question as regards foreign proposals on recycling, domestic corporate liquidity and international monetary stability, and the U.S. balance of trade and particularly the question Mr. Bernstein has raised on the deteriorating exchange rate of the dollar.

In the energy field, my chief premise, the experience of the past 20 years, shows that we can no longer rely on our large, internationally operating energy conglomerates to provide us with a stable and balanced development of our most vital social sector ecology. The task has been to revitalize the checks and balances of this sector,

particularly while that is still possible, domestic onshore oil drilling, and then go on to the field of looking at large-scale energy development, which only the conglomerates now have the capacity to develop.

Here in the large scale, future energy development has to introduce new forms of public sector checks and balances on a particular kind of operation, energy which no longer has the checks and balances of competitive market mechanisms in it. This can be accomplished through a system of differential tax and expenditure policy and by a set of steps for additional involvement by the public sector.

Effective in 1976 I recommend a tax change for international conglomerates to bring the income tax rates up to parity with the rest of American industry. As you know, the effect of the corporate income tax of energy conglomerates is 10 to 15 percent, as compared to national onshore independent producers.

Chairman HUMPHREY. Would you repeat that again? I am sorry.

Mr. MÜLLER. The effective corporate income tax rate paid by energy conglomerates is between 10 and 13 percent, depending on the year you look at, as compared to for example the rest of American industry which is running 28 to 33 percent, or looking particularly at independent small producers of oil, domestic, running anywhere at about 34 percent.

I would do this by the following method: complete removal of the domestic oil depletion allowance for conglomerates only and the continuation for nationally operating domestic producers. This proposal is aimed at generating needed tax revenues from those who will be least hurt, while stimulating effective competition in the only part of the energy sector where that is still possible, onshore domestic supply markets.

I would also adopt the provisions of the bill now before you in the Senate, S. 651, that deals with removal of basic loopholes in U.S. taxation of foreign-earned income by all American based companies. We should know our current tax laws, referenced in a remark by Mr. Bernstein earlier, its incentives to continue private foreign investment even at a time when we desperately need those investment funds here at home.

In addition, for energy conglomerates only, I would remove the current tax incentives for energy conglomerates to locate refining and other kinds of investment overseas by taking away from them the foreign tax credit and substituting in its place the straight deduction method.

The adoption of only the first two proposals provide additional tax revenues of some $6 billion. The energy derived portion of these revenues plus other energy-based taxes recommended in my testimony can be the source for financing tax incentives and other means for stimulating energy expansion, conservation, and the interrelated task of restructuring the transportation sector.

I will not go over the tax measures that deal with the transportation sector because of a lack of time.

Now, let us turn very briefly to the other side of the energy program, and this is vitally important although you are here today to talk about the international payments position of the country because energy is pivotally involved in our future balance-of-payments position. The large—future large-scale projects like offshore drilling,

shale extraction, and oil development by independent market forces is no longer feasible or that efficient. In these areas the size of technical planning capacity of conglomerates is needed. The need is greater than ever for a system of checks and balances to protect the public interest as regarding these kinds of investments.

Keeping this in mind, there are a number of proposals contained in my testimony. The first is the recommendation to adopt U.S. Petroleum Import Administration as proposed in S. 505. The basic objective of this unit is to restore import competition while securing for the United States the cheaper sources of planned petroleum import. This, of course, begins to alleviate the balance-of-trade deficit.

Side by side with this is a proposal for insuring the standby energy price and distribution set of controls. The chief objective here is to monitor pricing policies, particularly as it concerns the possibility of implicit collusion of practices widespread, and rampant among energy conglomerates and to insure that the transfer of import permits from original purchases to other parties does not lead to increasing domestic concentration in the energy or other sectors of the economy.

Finally, there is a proposal for a public energy corporation which basically does not eliminate the role of private enterprises or the energy conglomerates, but insures competitive forms of development of future large-scale energy projects. It gives the power to decide when, where, and by what method the energy should be extracted, and it gives that power to the public sector. It is a project also, a proposal that becomes rapidly self-financing over a period of 4 years.

Finally, before I go directly to the international set of problems—and I think this is an important point to point out—because of the interdependence of our economy, because of the basic change due to the transformations I mentioned earlier, there will be desperately needed in the years ahead a function that serves energy and transportation adjustment assistance. The objective of this function is to anticipate the types of labor and business assistance needed to facilitate the restructuring of energy and transportation. It is regretably inefficient that current public employment programs do not have a planning input that would permit certain of the funds to be used for retraining and relocating the unemployed, so as to meet anticipated restructing needs in energy and transportation industries.

I would like now to switch to proposals on recycling as it concerns U.S. corporate investment funds on agriculture and the balance of payments and the deteriorating position of the U.S. dollar. Although fears about an excessive overhang in foreign exchange reserves held by OPEC nations through the 1980's, there will still be significant amounts of these petrodollars that can and should be used to alleviate economic problems in oil importing nations, including the United States and other countries.

The proposals outlined here have as their objective first to take advantage of these petrodollars to alleviate what may be the legitimate fear of the administration of weakening private domestic capital markets' capacity to service needed U.S. corporate investment demands because of a drawing away of moneys by the Treasury in order to finance Government deficits.

The second objective is to take advantage of the current reserve requirements in Eurocurrency markets and at the same time, attack

the task of stopping to subsidize foreign investment by U.S. companies at the cost of U.S. domestic investment.

Third, and finally, a differential set of tax- and credit-underwriting policies for encouraging a rapidly noninflationary increase in agricultural exports. To accomplish these objectives, I have outlined a set of three proposals: The first is the adoption of the Rossa, et al. recycling proposals that appeared in the January 175, issue of Foreign Affairs. The Treasury Department particularly should pay attention to the proposed OECD–OPEC investment funds for the purchase of U.S. Treasury government securities. In this regard, Treasury should aggressively market U.S. Government securities to petrodollar holders for the portion of its deficit financing that it determines could weaken private U.S. capital markets. If this were done, we could easily sustain a tax reduction bill of some $25 billion at the minimum.

A second particular aspect of these proposals takes a look at the OECD solidarity fund and safety net measures. To me it is both surprising and unfortunate that the United States and OECD countries have not demanded that there be a swift agreement of new regulations on Eurocurrency banking practices. These practices are among the prime reasons for the need for such a fund in the first place. The lack of reserve requirements in the Eurocurrency deposits have been a significant contributor to inflation in the United States and elsewhere. The practice of these banks to borrow short and lend long is a major cause of the present instability. While the current two-tiered system of London interbank interest bank rates has reduced some of the danger, it is fostering further concentration of a already overconcentrated world banking industry. Congress should vigorously recommend to the Federal Reserve Board that it extend its regulatory authority to the foreign branch offices of U.S. multinational banks in order to promote stability while not ignoring the concentration issue, and particularly to begin the process of the role of these banks in exporting capital from the country.

Now, looking at the balance-of-payments position, particularly in the next 5 years, there is a dilemma here that Mr. Bernstein has already outlined, and I agree with his remarks.

One of the things that I would like to point out is part of the transformation process ushered in by the globalization of our largest corporations and the concentration phenomena is that we no longer have a set of checks in halting these downward spiralling devaluations of the dollar. Let me give you an example of what has changed in this area.

One is that the U.S. business cycle, which in the past was out of phase with Europe's, would always act as a natural buffer against this downward spiral. Today, those business cycles are in place, and this natural buffer can no longer perform. Now, what does this mean in terms of deteriorating exchange rates today? It means that the Federal Reserve, as you well know, finds itself in a dilemma. Should it raise interest rates to halt the deterioration of the dollar abroad and thereby reduce investment and employment generating benefits for the home country, or should it continue to ease domestic credit and thereby contribute to a further decline in the U.S. terms of trade, and as Mr. Bernstein well pointed out—and I wish to emphasize my agreement here—what the decline in U.S. trade means in

deterioration of the dollar abroad is to accelerate the transfer of real U.S. responses abroad for bargain prices.

It is important to note that the adaption of the recycling proposals I mentioned earlier will help, but there are limits of the amounts of petrodollars that the Treasury can safely attract, namely the needs of such countries as Italy.

Now, there are only two other offsets available to halt the deterioration in the value of the dollar. One is to begin to consider a rather rapid revamping of our tax system so as not to subsidize further foreign investment by U.S. multi-internationals. This may include a return to a temporary balance of payments restriction. The only other offset, second, other than direct interest rate manipulation by the Federal Reserve, is to raise sharply the relative surplus on the U.S. trade account in the years ahead. This will be partially accomplished by a noninflationary reduction of energy imports through the proposals that I outlined earlier. In addition, and most importantly, it will be necessary to increase exports in the one sector where we have potential excess supply—agriculture—and the rest of the world will be experiencing excess demand.

Even though there is presently a downturn in commodity foodstuff prices, this is temporary. The longrun secular price trend is definitely upward.

In contrast, the past year's increased exports of our foodstuffs will have to be affected—again, I wish to emphasize this—in a noninflationary manner. This requires stimulation, direct stimulation of supply capacity, and here we come to another dilemma. Agricultural stimulation policies are, however, a tender topic since they can easily lead to further concentration in that sector. Such concentration means that as demand bounces back, agricultural prices will rise faster as competitive market supply and demand markets dictate, and thereby induce higher inflationary forces.

To overcome this difficulty, I recommend differential tax and credit underwriting of small- and medium-sized farms as opposed to large agribusiness concerns. The effort to see as well as the feasibility of such proposals, I think are one way of becoming to overcome these types of vicious circles, that is, between concentration and inflation.

Now, one last point on the agricultural export problem—that is, that the very countries that would be our highest potential importers of food are those who are suffering greatly now from the problem of recycling. Therefore, to go back to my earlier proposals on recycling, I wish to emphasize that part of the Rossa scheme that sets up an OECD-OPEC recycling fund for particularly poor countries which are large food importers. This, of course, is a problem and an approach that the United States should bring foreign policy pressure to bear upon, but one that we can neither solve alone or implement alone.

[The prepared statement of Mr. Müller follows:]

PREPARED STATEMENT OF RONALD E. MÜLLER

I am pleased and honored to appear before this Committee and discuss my opinions on the current economic problems of the United States and world economy, and to present certain proposals which, in my view, can assist in alleviating this situation.

There is no doubt that President Ford's proposed economic program promotes inflation while penalizing employment to a degree technically not necessary.

But he does have sincere, if mistaken, reasons for making these sacrifices in order to achieve what are believed to be higher priorities of the national interest. Understanding these mistaken reasons allows the formulation of alternative economic proposals as outlined in this presentation. These alternative proposals include two interrelated parts or packages. They are necessarily interrelated because of the obvious global, sectoral and temporal interdependence of our economy. These two parts include (1) a tax and expenditure plan for restructuring the energy and transportation sectors to bring about orderly energy expansion and conservation; (2) a package on international monetary stability, recycling, corporate investment funds, and agriculture as it relates to the balance of payments.

Introduction and Background

First, the President's immediate-term policy on energy can only be explained by his belief that his energy-tariff program is the only means by which OPEC can be influenced to lower crude petroleum prices—this, despite the fact that, on grounds of foreign policy, domestic economic recovery and equity, there are more feasible and efficient alternative programs available.

A second consideration is the Administration's emphasis on limiting total tax reductions, primarily because of the fact that the Treasury's financing of too large a short-run deficit will significantly draw monies from capital markets, and thereby impinge upon corporations' ability to finance new investments. However, had the Administration's proposals included a more definitive statement on the use of recycled petrodollars as well as on the closing of certain tax loopholes, then a tax-reduction package of at least $25 Billion would be feasible without threatening corporate ability to finance new investments.

Finally, the President's priority fear of perpetuating inflation should government policies result in "overstimulating" the economy, is based upon a simple and unproven assumption: that there is no alternative program to alleviate this fear of inflation because an additional degree of government economic planning is either not desirable or not feasible. On the contrary, however, available evidence indicates that it would be feasible for the government to add additional planning functions to those it currently pursues. One additional necessary function, to be implemented through tax and expenditure policies, is the government's more direct restructuring of sectors which have high inflation or high unemployment multiplier impacts on the rest of the economy: energy, transportation, food, and housing. A second back-up (and already existing) function is a stand-by monitoring program for prices, wages and possible rationing, which, when and if necessary, can be converted to the task of supplying actual controls and/or rationing for one or more sectors of the economy.

But the most glaring discrepancy in the Administration's economic program, however, is its failure to take into account the fact that the U.S. economy has undergone a fundamental tranformation. The rhetoric of Administration spokespersons and certain economists aside, the recent history of the American economy demonstrates that competitive market forces of supply and demand can no longer be relied upon as the mechanism for insuring the success of government policies for bringing about economic stability. It is unfortunate that the Administration's proposals have as their chief basis the assumption of functioning market mechanisms, when in fact, these have largely disappeared. This breakdown in the market mechanism is explained by two interrelated aspects of the economy's current transformation.

First, there has occurred since the 1960's, an historical increase of conglomerate concentration in the mineral, industrial and financial sectors of the U.S. economy. Whatever one's equity and political assessment of concentrated economic power may be, it is of paramount importance to understand that the negation of the market mechanism accompanying such concentration is one of the two major causes of the growing instability in employment, prices, income distribution and balance of payments. These four instability measures are the basis of the declining economic security being experienced by a significant majority of the American people since the late 1960's. The second basic cause of this instability, and the second distinguishing characteristic of the Post World War II transformation of the U.S. economy, is the unprecedented increase in our foreign dependency, ushered in by the "globalization" of our largest corporations. The some 700 or so largest industrial and financial corporations which dominate approximately 70% of our private domestic economy are equally dominant in the foreign investment, finance and trade flows of our

nation. Just as in the case of the domestic market, so here too this aspect of transformation led to the negation of the international market mechanism. But it is not only concentration within each industry which has undermined the checks and balances of the market. Equally important is that almost all of these pivotal enterprises are now conglomerates operating not only in scores of countries, but also across many different industries. These U.S.-based global conglomerates have replaced to a significant degree what formerly were market transactions between independent buyers and sellers, with non-market, intra-corporate transfers of goods, services and finance.

In such a world, it is regional and international tax differences, absorption of small business firms, and other means for increasing oligopoly power which determine prices, not the competitive market forces of supply and demand. On the one hand, the trans-industrial, trans-national operations of our largest corporate actors have meant the cumulative disappearance of small domestic business, and the erosion of labor's bargaining power. On the other hand, this negation of the market has caused the undermining of government's standard monetary and fiscal policy tools for maintaining the nation's economic stability.

Given this transformation into a "post-market economy,"[1] one notes some significant structural lags in governmental regulatory institutions and policies. For example, anti-trust laws primarily emphasize horizontal and, secondarily, vertical integration, with a relative neglect of conglomerate mergers. (Of the some 14,000 mergers between 1953 and 1968, the government challenged 199 cases, won 90 of these, and required divestiture in 48 instances.) In addition, as concentration proceeded over the post- World War II period, there became apparent a set of "vicious circles" arising out of the impacts of Keynesian monetary and fiscal policy, and leading to increasing political inefficacy. A recent quantitative analysis by Professor John Blair, of actual policy impacts verifies the mounting evidence of other econometric investigations. During the boom phase, stabilization policy is aimed at reducing inflation via a reduction in aggregate demand. The findings of Blair and others are revealing, however: the more concentrated the industry, the greater has been the occurrence of continuing relative price increases, i.e., the opposite of intended policy impacts.

Examining the vicious circles inherent in fiscal and monetary policy is helpful in understanding these unintended impacts. For fiscal policy, it has been shown that tax reductions to stimulate the economy are disproportionately absorbed by the largest firms. (Internal economies of scale can explain much of this result.) On the expenditure side, studies also reveal disproportionate amounts going to the largest firms. In both cases, the effect is to give large corporation as greater expansion capacity than smaller firms, thereby promoting further concentration. In the next round, the increased concentration leads to policy's increased ineffectiveness. This vicious circle is complete. A similar phenomenon takes place with monetary policy. On the borrowing side, during periods of credit restriction, the largest industrial firms do not (or only with a long time delay) respond to higher financing costs, since their oligopoly positions permit them to pass on increased credit costs to their buyers. Smaller firms, because of their relatively weaker oligopoly power, must respond immediately and lower their investment demands. As in the case of taxes and expenditures, these differential structural impacts of aggregate policy promote further concentration. Similarly, on the lending side, there are vicious circles at work. Take, for example, George Budzeika's recent findings on the behavior of the large New York City banks, published by New York University's Institute of Finance. "New York City bank behavior in the past two decades has shown that it is very difficult to control large banks whenever the demand for credit is heavy." The reasons for this again is revealed to be the internal economies unique to the large but not the smaller banks which, because of a "lack of information and skills prevent them from adjusting quickly to changing levels of monetary restrictions." For large banks, "the only way to restrain

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[1] The most recent analysis of the transformation process and its impacts on government monetary and fiscal policy is found in Ronald E. Muller, "Global Corporations and National Stabilization Policy: The Need for Social Planning," Journal of Economic Issues (forthcoming, June, 1975). A simplified version of this paper appears in Business and Society Review (Autumn 1975, No. 11), under the title, "Global Corporations and National Instability: Must They Grow Together?" The market negation thesis was first set out in Richard J. Barnet and Ronald E. Muller, in Global Reach: The Power of the Multinational Corporations, New York: Simon and Schuster (1974), chapters 9 and 10. See also this writer's paper appearing in challenge (forthcoming, April, 1975).

efficiently is to reduce the overall liquidity of the banking system." But since the costs in unemployment of such a strong measure are politically unacceptable, only mild monetary restraint has been pursued. This leads to further bank concentration and makes the next phase of policy restraint that much more ineffective.

Such are the vicious circles which arise from the combination of aggregate stabilization policies with the waning of competitive market forces. In our current globalized and concentrated economy, traditional market responses reappear only when we reach unacceptably high levels of unemployment. Even then, inflationary pressures continue for too long, owing to an excessive corporate debt burden in strategic inflation-multiplier industries like petrochemicals. The past ability to generate what are now excessive debt burdens is itself the result of concentration. Thus, in the present circumstances, we are faced with a systemic dilemma where social priorities of price stability, full employment and balanced growth must yield to the understandable private need to avoid risk.

The uniqueness of the U.S. Constitution was its designers' frank recognition of the need to establish checks and balances over the power of the major actors in the public sector. For the private sector, the institution of the competitive market was seen to provide the necessary checks and balances over concentrated economic power and its inevitable political implications. For the present economic problems of the nation, the virtual disappearance of the competitive market for all but a small proportion of the economy means that the impacts of standard stabilization policies are at best uncertain, and quite likely, even perverse.

PART 1. PROPOSALS ON ENERGY—TRANSPORTATION—THE NECESSITY FOR RESTRUCTURING

Objectives: To provide an anti-inflationary, employment-inducing energy and conservation program for dealing with the short-run (1975–77), while recognizing the interdependence of short-run actions on the medium- and long-term (1980–85).

Energy and Transportation

The experience of the past twenty-years has shown that U.S.-based internationally operating Energy Conglomerates cannot be relied upon to make the necessary investment decisions for a stable program of energy expansion and conservation of our most vital social sector. This is true because of the contradiction which has emerged between the Energy Conglomerates' goal of global profit maximization, on the one hand, and the U.S. national interest, on the other. The following proposals are designed to increase significantly the public sector's participation—particularly the Congress'—in energy expansion and conservation, while maintaining the role of private enterprise, with special emphasis on the role of small, independent Domestic Producers.

1. These proposals include a system of differential tax treatment of Energy Conglomerates and Domestic Producers, combined with the continuation of energy price controls and a stand-by monitoring function should rationing become temporarily necessary. The price controls are designed to avoid inflationary multiplier effects, stem the regressive trend in income distribution, and maintain the international competitiveness of U.S. manufacturing firms. The differential tax program is aimed at increasing market competitiveness in domestic energy expansion, while the resulting tax revenues from Energy Conglomerates will be used as the basis of investment funds for large energy projects—e.g., off-shore drilling—implemented via competitive contract bidding once the public sector has decided when, where and how much projects should evolve, given energy needs resulting from a restructuring of our transportation sector. These proposals include the following:

a. Effective FY 1976, I recommend a change in the tax treatment of major U.S. Energy Conglomerates to bring their effective corporate income tax rate up to parity with the rest of American industry by:

(i) the complete removal of the domestic oil depletion allowance for Energy Conglomerates only, and its continuation for nationally-operating Domestic Producers. This proposal is aimed at generating needed tax revenues from those who would be least hurt, while stimulating effective competition in the part of the energy sector where that is still possible—i.e., on-shore domestic

supply markets. The point was well made in a recent address by the FEA Administrator, Frank Zarb, to the Independent Petroleum Association: "Eliminating the depletion allowance would cause some pain to the major oil companies, but it would really hurt you independents."

(ii) adoption of S. 651, placed before the current session of the Senate by Senators Church, Haskell and Ribicoff, which deals with the removal of the basic loopholes in U.S. taxation of foreign-earned income by all American-based companies.

(iii) an addition to S. 651, to be applied only to major Energy Conglomerates, which, in a two-year incremental process, would remove the use of the foreign tax credit, and replace it with the straight deduction method. This, in effect, would remove the current tax incentive for Energy Conglomerates to locate refining, distribution and other facilities overseas, rather than investing in the domestic economy.

(iv) continuation of price controls on crude oil, with special emphasis to insure that these tax increases on Energy Conglomerates are not passed on to end-users.

b. The adoption of only proposals (i) and (ii) above should provide tax revenues of some $6 Billion. The energy-derived portions of these revenues, plus other energy-based taxes recommended below, can become the source for financing tax incentives and other means for stimulating energy expansion, conservation and (the interrelated task of) restructuring the transportation sector. However, the provisions of S. 651 will undoubtedly lose much of their intended impact unless Congress authorizes FTC, IRS, SEC and other agencies to propose changes in corporate disclosure laws that allow effective regulation of transfer pricing, "profit-loan swaps," and other practices unique to global corporations, and which permit them a significant reduction in their tax burden.

c. Effective FY 1976, I recommend a program of tax and other incentives which effectively deal with energy conservation, recognizing explicitly the sectoral interdependence of transportation and energy demand. The program I recommend includes:

(i) To accelerate the restructuring of the transportation sector towards energy conservation, I recommend a differential tax credit to transport producers of two percentage points above the all-industry investment tax credit, but only for investments in new vehicles and transportation systems which are both energy-conserving and responsive to environmental constraints already established by Congress. This proposal is intended to apply not only to personal vehicle manufacturing, but also to inter-urban rail and urban mass transit systems. The proposal should be implemented for an initial three years, with provisions for its continuation following Congressional evaluation.

(ii) Whereas the above proposal attacks the supply bottleneck in energy-conserving transportation, demand side inducements should be provided for through enactment of Title V of Bill S. 505, introduced by Senator Church in the current session. It provides for a graduated sales tax on automobile purchases as an inverse function of fuel performance, and a graduated tax credit on new cars with superior fuel performance. This provision, however, should be modified to base the level of tax or credit upon a percentage of the selling price, and not upon absolute dollar values, as it is now formulated. This modification would guarantee the same level of incentive, regardless of upward or downward changes in automobile prices.

(iii) I also support a Federal Sales Tax of five cents per gallon of gasoline, as a further revenue source for energy and transportation programs.

(iv) As a further and obvious inducement to consumer energy conservation, I also recommend enactment of Title IV of Bill S. 505, to transfer portions of Federal Highway funds to Public Urban Mass Transit uses, and, I would add, to interurban regional railroad systems as well.

d. For all industries, a general energy conservation measure is to adopt President Ford's proposal to restructure electric utility rates on the basis of use: "the more you use, the more you pay"—the opposite of most current rate policies.

2. The above set of proposals reflects the opinion of a growing number of technical and political experts of the necessity for the public sector to insure new checks and balances over the development of our most important social sector, energy. One means for inducing checks and balances is to restore competitive market pressures in the one area where that is still possible—on-shore

oil extraction—by giving domestic independent producers the means to compete with the Energy Conglomerates. This is the reason for a differential tax policy giving preference to independent domestic producers as opposed to Energy Conglomerates. Another means for restoring competitive pressures involves government intermediation in the import process of petroleum from OPEC countries.

But for future large scale projects like off-shore drilling, shale extraction, and coal development, restoring strictly private competitive market forces is no longer either feasible or necessarily that efficient. In these areas, the size and technical planning capacity of the Energy Conglomerates is definitely needed. And yet, the need is greater than ever for a system of checks and balances to protect the public interest as regards these kinds of investment decisions. Thus, in current circumstances, there is an apparent dilemma since Energy Conglomerates can correctly argue that their high oligopoly profits are the only source for providing the investment funds to undertake large-scale energy projects. The dilemma disappears, however, when we recognize that the taking away of these high profits becomes a source of investment funds. In a planned and competitive fashion, these funds then can be transferred back to private enterprise by the public sector, via a system of competitive bidding for exploration and management contracts. Here the U.S. can learn from the innotive experiences of Norway, increasingly of England, and ironically, of some of the OPEC nations: the pursuit of the singular goal of private global profits in a strategic sector like energy no longer necessarily coordinates with or services the needs of other sectors and of constituency groups such as small business, organized labor, consumers, ecology and tax reform groups which make up the vast majority of our democracy.

As noted, it cannot be disputed that the Energy Conglomerates possess the requisite technical skills to explore for energy and manage its extraction. The proposals here offered acknowledge that fact while also recognizing what economists have long known: that when market forces fail, a "tax-cum-competitive subsidy" is a more efficient policy tool than, say, a tariff, for inducing expansion. "Subsidy" itself is an inappropriate term, since these proposals envision competitive bidding by Energy Conglomerates in order to win exploration contracts and then management contracts for on-going extraction. In fact, this program would use "government intermediation" to restore the one form of competition that for too long has not existed between Energy Conglomerates—namely, price competition. At the same time, the program negates the only other Energy Conglomerate justification for high profits: the high risk associated with major energy investments due to the uncertainty of future prices. The overall results of the below-outlined program should therefore be:

(1) Increasing competition on the supply side of the energy sector;

(2) Normalizing the profit rates of Energy Conglomerates, while not diminishing their competitive attractiveness to provite equity and bond investors as a stable low-risk investment opportunity;

(3) Restoring to the American people consumer sovereignty over the amount and kind of energy development they want, by establishing a long-needed, integrated planning approach to energy, transportation and their related adjustment mechanism for restructuring these sectors over time, and,

(4) Assuring the maintenance of a democratic system of checks and balances over a vital sector of our society. These necessary social planning functions are placed in the hands of the only actor—the government, and particularly, Congress—which possesses the necessary incentives to represent adequately both regional and national interests.

a. To accomplish these goals, it is recommended that Congress enact legislation for the implementation and on-going evaluation of the following interrelated social planning functions for the energy and transportation sectors:

(i) A United States Petroleum Import Administration (as outlined in S. 505 placed before the current Congress by Senator Church). This function would implement the various provisions of S. 505 and the so-called Adelman Plan for charging the Federal government with the exclusive right to import crude oil and derivative products into the U.S. The basic objective of this unit is to restore import competition, while securing for the U.S. the cheapest sources of planned petroleum imports, in coordination with:

(ii) A function for Stand-by Energy, Price, and Distribution Controls. The objective here is to monitor pricing policies particularly as concerns the pos-

sibility of implicit collusion among competing purchasers of imported petroleum, and to assure that the transfer of import permits from original purchasers to other parties does not lead to increasing domestic concentration in the energy or other sectors of the economy. The second basic objective is to design and implement, when and if necessary, the so-called "white" rationing system of gasoline coupons, and/or end-use rationing with recognition of differences in geographical-regional needs, as specified in S. 505.

(iii) A Public Energy Corporation somewhat similar to various proposals made by Representative Moss, Senator Stevenson, and Senator Jackson. Its basic objective is to provide public ownership and control over large-scale energy sites and the resulting unrefined energy products from these sites, without creating a large engineering and managerial bureaucracy for performing the exploratory and extraction aspects of energy expansion. At the same time, the public sector is given the charge of deciding when, how and which sites should be exploited, as well as deciding how much energy should be extracted, and in what time-frame. With the exception of determining which sites, the present system of Federal leasing gives this decision-making power to the private energy conglomerates, and it is this power to decide how much exploitation should take place when, that provides them with a basic source of their present near-monopoly control over our energy sector. A further objective of this proposed Public Energy Corporation is to become rapidly self-financing.

To fulfill these objectives, a major function of the Corporation would be to design and conduct a system of competitive bidding for the awarding of exploration contracts to private enterprises. After exploration findings are known and extraction sites determined, the Corporation would then conduct a system of competitive bidding for deciding which extraction method is to be employed and to whom management contracts for that extraction are to be awarded. Contracts should be awarded based on a comparison of fixed-fee bids, and by taking into account the maintenance of competition in the bidding industry. Cost overrun disputes between the Corporation and contractors should be adjudicated by an independent board appointed directly by Congress, and to include representatives of industry, organized labor, and consumer groups. The crude energy product resulting from extraction will be "owned" by the Corporation in behalf of the Federal and State governments. Similar to the above-proposed Petroleum Import Administration, the Corporation would sell its crude energy products by a system of sealed competitive bids, after recognizing differences both in geographical-region needs and end-user needs.

Initial financing for the establishment of the Corporation should come from two sources. Initial funds can be taken from energy-related tax proposals outlined earlier in this statement; increasingly, however, financing should come from the sale of bonds and preferred stocks issued through the Treasury Department. Over time, the Corporation's sale of its unrefined energy products will generate revenues to pay off its debt obligations and provide operating capital.

It is my personal opinion that the chief mechanism for maintaining checks and balances over such a Public Energy Corporation should be the manner in which its Board of Directors is selected. My own suggestion is that half of the Board of Directors should be appointed by Congress, with equal representation afforded organized labor, industry, and consumers. The other half of the Board should be appointed by some number of regions, each of which would, in turn, represent a group of states—e.g., northwest, northeast, mid-west.

(iv) An Energy and Transportation Adjustment Assistance function. This function is complementary to existing legislation and current proposals which recognize the need for the development of alternative energy and transportation technologies. Alternative technologies mean the restructuring of affected sectors. Restructuring means the shifting of occupational skills and/or geographic movement of labor, as well as the retooling and/or relocation of private firms. The objective of this function is to anticipate the types of labor and business assistance needed to facilitate this restructuring process. It is regretably inefficient that current public employment programs do not have a planning input that would permit certain of their funds to be used for retraining and relocating the unemployed, so as to meet anticipated restructuring needs of the energy and transportation industries. This adjustment assistance function finds its precedent in our existing foreign trade legislation. It differs from that legislation significantly, however, in that its intent is to avoid the actual occurrence of hardship before remedial action is taken.

PART 2. PROPOSALS ON RECYCLING AND U.S. CORPORATE INVESTMENT FUNDS, AND ON AGRICULTURE AND THE BALANCE OF PAYMENTS

Objectives: Although fears have eased about an excessive overhang in foreign exchange reserves held by OPEC nations through the end of the 1980's, there will still be significant amounts of these petrodollars that can and should be used to alleviate economic problems in oil-important nations—including the U.S., other advanced countries, and those of the underdeveloped world. The proposals outlined here have as their objective first, to take advantage of these petrodollars to alleviate what may be the legitimate fear of the Administration of weakening private domestic markets' capacities to service U.S. corporate investment demands, because of a drawing away of monies by the Treasury in order to finance government deficits. A second objective is to take advantage of the current situation to bring about much needed regulations, particularly reserve requirements, for Eurocurrency market, private banking operations. A third objective is to stimulate U.S. agricultural production through differential tax and credit underwriting policies, while encouraging a flow of recycled petrodollars to high food importing nations, particularly in the underdeveloped world. To accomplish these objectives:

A. I recommend the speedy adoption by the U.S. and other OECD nations of the Roosa et. al. recycling proposals which appeared in the January, 1975 issue of Foreign Affairs. The Treasury Department should pay particular attention to the creation of their proposed OECD–OPEC Investment Fund for the purchase of government securities. In this regard, Treasury should aggressively market U.S. government securities to petrodollar holders for that portion of its deficit financing that it determines could weaken private U.S. capital markets' role in providing investment funds to private business. In addition, adoption of the Roosa et. al. proposals for creation of a joint OECD–OPEC investment fund for private bond and equity issues in oil-importing nations, would further alleviate the possible problem of inadequate capital funds here in the U.S. The design of the Roosa et. al. proposals also reduces the fears of excessive foreign control of U.S. industries. Even if the Administration's views about a possible shortage of investment funds are correct, these proposals, if enacted, would negate its conclusion that such shortages limit government deficit financing, and therefore limit tax reductions. Aggressive short-term use of petrodollars for government securities and private equities should permit a tax reduction of at least $25 Billion, allowing, for example, a personal income tax reduction of $19–$20 Billion, and for business, from $5–$6 Billion. (See also Paragraph "C" below.)

B. I support establishing the OECD Solidarity Fund (Safety Net scheme). However, it is both surprising and unfortunate that the U.S. and other OECD nations have not demanded that a condition of the Fund's operation be the swift agreement on new regulations for Eurocurrency private banking practices. These practices are among the prime reasons for the need for such a fund in the first place. The lack of reserve requirements on Eurocurrency deposits has undoubtedly been a significant contributor to inflation in the U.S. and elsewhere. The practice of these banks to borrow short and lend long is a major cause of present instability, and could trigger banking system failures in one or more of the involved nations. Should such failures occur, there is a significant likelihood of precipitating a world-wide chronic depression. This, of course, is what the fund is intended to guard against. It is remarkable, therefore, that new private banking regulations are not an inherent part of its operation. The U.S. should use its bargaining power in the Fund to bring about such regulations, particularly the deposit reserve requirement. While the current tier system of London inter-bank interest rates has reduced some of the danger, it is fostering further concentration of an already over-concentrated global banking industry. Congress should vigorously recommend to the Federal Reserve Board that it extend its regulatory authority to the foreign branch offices of U.S. multinational banks, in order to promote stability, while not ignoring the concentration issue.

C. In order to improve our balance of payments situation, I also recommend a concerted effort to stimulate U.S. agricultural production. Concerning our balancing of payments, the real problem is the deterioration in the value of the U.S. dollar as opposed to other major currencies where continuing higher commercial interest rates overseas attract an outflow of dollars which are beginning to "flood" foreign capital markets. This process is cumulative, basically

because foreign dollar holders, including U.S. multinational corporations, attach a growing risk to holding liquid assets in dollars. In the past, this downward spiral could eventually be offset by a number of factors. First, the U.S. business cycle was out of phase with Europe's, which acted as a natural buffer against this downward spiral. Second, Eurodollars did return to the U.S. during the boom phase here, even though that meant higher credit costs. Large corporations, however, could afford to borrow these because of their oligopoly power to pass on increased credit costs as long as the economy was growing, and even during the initial phase of decline. Today these conditions no longer exist. Thus, the Federal Reserve finds itself in a dilemma: should it raise interest rates to halt the deterioration of the dollar abroad and thereby reduce investment demand multiplier benefits at home? Or should it continue to ease domestic credit, and thereby contribute to a further decline in the U.S. terms of trade? That is, to accelerate the transfer of real U.S. resources abroad at bargain prices. It is important to note that adoption of proposal A.2. above will help to ameliorate this problem. But there are limits to the amounts of Petrodollars the Treasury can seek to attract—namely, the needs of such countries as Italy.

The only other offset available, other than direct interest rate manipulation by the Federal Reserve, is to raise sharply the relative surplus on the U.S. trade account in the years ahead. This will be partially accomplished via a non-inflationary reduction of energy imports as proposed in Part 1 of this statement. In addition, it will be necessary to increase exports in the one sector where we have potential excess supply—agriculture—and the rest of the world will be experiencing excess demand. Even though there is presently a downturn in commodity foodstuff prices, this is a temporary phenomenon owing to worldwide recession. The long run secular price trend is definitely upward. But in contrast to past years, increased exports of our foodstuffs will have to be effected in a non-inflationary manner, thus requiring stimulation of supply capacity. Agricultural stimulation policies are, however, a tender topic since they can easily lead to further concentration in that sector. Such concentration means that as demand bounces back, agricultural prices will rise faster than competitive market supply and demand conditions would dictate, and thereby induce higher multiplier inflationary forces. To overcome this difficulty, I recommend differential tax and credit underwriting of small and medium size farms as opposed to large agribusiness concerns. The efficacy as well as feasibility of such a proposal still requires further study. Nevertheless, the concentration phenomenon in such a vital sector as food can no longer be ignored.

To further compound the agricultural export problem, there is the question of whether foreign food importing nations, particularly in the underdeveloped world, can generate the requisite amounts of foreign exchange. A medium-term expedient to offset this problem could be the adoption of the Roosa et. al. proposals for a joint OECD-OPEC recycling fund (as well as those of the IMF arrangements), modified to take account of poor countries' food import needs. This, of course, is a problem and an approach which the U.S. should bring foreign policy pressure to bear upon; but it is one we can neither solve alone nor alone implement its solution.

Chairman HUMPHREY. Gentlemen, we thank you very, very much for your testimony. I must say that the testimony presents to me one of the most perplexing periods of interrogation. You have now brought to our attention information and observations that go beyond what we have been dealing with to date. What amazes me is that Government witnesses who have been down here have not talked on these matters, as you have.

It seems we have had most of our discussion about the American economy in terms of a very parochial outlook. Namely, what we could do here by public service jobs, what we could do here in the United States by a tax adjustment or a tax rebate or tax deduction. We have had little or no discussion as to what has happened in the international scene and its effect on the United States. I guess what has flashed into my mind as I listened to you gentlemen; is that those who are the economic advisors to our Government today are either

not telling us what they know, or they do not know what to tell the President that he ought to know.

There obviously is a void here. It is an amazing thing. I call it to my colleagues' attention here that in all the testimony we have had, from Mr. Greenspan and Mr. Burns and Secretary Simon and the director of the Office of Management and Budget, we have had not 3 minutes out of all of that testimony on the international aspects of the economic situation and very little discussion about what has been happening to the dollar. The only time we have had any discussion at all was when Congressman Reuss, for example, has raised the question with Mr. Burns at one time. We have had very little discussion about structural changes needed in tax laws either to bolster the dollar on the one hand, or to deal with the massive outflow of American dollars into the foreign markets.

I am just appalled, as I listen here this morning, how little we have learned in the past from people who are supposed to be advising us. I regret to say that the American public has no understanding of what you are talking about, and there is a reason for it. You look around this morning. Here are men who are talking to us, maybe about life and death matters in our economy, because we are a very basic part of the world scene. Insofar as any communication with the public is concerned, you are communicating with several members of Congress here, and a few visitors in the back of the room. The media is not present, and I think I know why. They just do not understand these issues. I will lay it right on the media, and if they do understand it, it goes into a page in the finance pages, just beyond the sports section. By the time the people get through reading the sports section, they have read what they want to read; starting out with the first section covering the national and international news, the second section with the metropolitan news, the third section with the society and the want ads, and then the fourth section which takes care of the comics and the sports page. That is it.

Economic matters are only interpreted in terms of disasters. I mean, if people are unemployed, that is news. If the revenues are down, that is news; Federal deficits, that is news. If the Arabs raise the price of oil, that is news. That is about as much as we understand, and I sit here and listen to you gentlemen and say to myself, how little we know. And is it any wonder that the country is in such a fix as it is? Because, if we do not know very much about it, you can well imagine that the general public, which does not have this opportunity to listen to men of your intelligence and your background and knowledge, and hopefully your wisdom; you can imagine how-ill-formed the rest of us are.

And we have representative government. You know, that is the problem. It is also the great secret to our success, in one sense. Representative government represents what is there, and we do not get much more out of the community than is there. You do not get much more in the Government than you can draw out of the community.

Well, let me ask a few questions, after having given you my comments, even though I must say I am very disturbed as I listen to you, because I really think we are just running off here on a side road by what we are attempting to do on the domestic front, unless we can deal with some of these international aspects. If there has ever been

anything that has been brought to our attention, it is that we live in an international community. We appropriate $100 billion for national security. We have a $6 billion or $7 billion foreign aid program that very few people understand, including some in Congress. Now you come in here with statements about what is happening to the dollar, and why the relationship of the dollar to the deutschmark and the Swiss franc—which I am sure is not exactly a topic of ordinary table conversation with the voting public—has changed. You come here and discuss with us the role of the multinational corporation, and what has happened in taxation of a multinational as different from the domestic corporation—when we talk about taxation and corporations, some people say lower it, other people say increase it.

We are finding ourselves dealing with simplicities on complex subjects, and I consider that a sure way to trouble and ultimate disaster. Now, having given you my report, let me just ask a question or two here.

Mr. Bernstein, in your statement, you refer to the decline in the exchange value of the dollar, particularly versus some European currencies, in 1974. On the other hand, you also note a large trade surplus that the United States has, if you could exclude the impact of the oil transactions. Therefore, has the slide in the external value of the dollar been an undesirable event or not? Should the value of the German mark have increased? In your estimation, what configuration of exchange rates among industrial countries is consistent with sustainable balance of payment positions among one another, and also collectivity with the oil producers? That is a big order; you are the man to handle it.

Mr. Bernstein. That is actually the question we ought to ask ourselves when we discuss exchange rates. We have to ask this question: If we look at 1980, when the overall balance of payments of the rest of the world with the oil countries is manageable, when we are as a group able to pay for nearly all of our oil imports with our exports of goods and services—at that time, what would the pattern of payments be among the oil importing countries? Some countries are going to have a great capacity to increase their exports to the oil countries. We happen to be one of those countries. We are now the largest exporter to them, and if they are all very eager to build up their arms, we will even be a larger exporter relative to other countries. Germany and Japan will also be relatively large exporters to them.

On the other hand, countries like Italy have a small share now in exports to the oil countries. It means, therefore, that in the payments among these countries with each other, there will have to be a strengthening of other countries relative to the United States and a very big strengthening relative to Germany. There is no use trying now to set out the exchange rates that will be suitable then, because there will in the meantime be differential rates of inflation and changes in the real demand for various export products.

For example, we really do not know how much exports of foodstuffs we will have in 1980. That is a critical factor in what the dollar should be valued at later and it should be a consideration in the exchange rate for the dollar now. In my opinion, that cannot be done wholly by the free market because of its very short time span. It will

have to be done partly through the free market, but also through an understanding among the industrial countries, as to where exchange rates are going. We do not want someone suddenly complaining that the Italians are devaluing their currency competitively, because they are improving their position, say, in European trade. Ultimately, they are going to have to have a better position in inter-European trade if they are going to pay for their oil imports in 1980 or later.

In the present state of the world, there is not very much that can be done to change the present fluctuating exchange system. I do not think that we ought to worship it, or even describe it as being good. It is really bad. There cannot be any economic sense to a system in which the D-mark falls by 25 percent in a few months, and then rises by 25 percent. There is even less sense in the rise in the Swiss franc by 43 percent since the beginning of last year. Nothing on earth except the search for a safe haven can possibly explain such a change in exchange rates. My own feeling is that it would be better if the monetary authorities—meaning the Federal Reserve, the Bundesbank and the Swiss National Bank—did not wait until the patient is in extremis. If they were to intervene with a few hundred million dollars at an earlier stage, they would turn the market.

Chairman HUMPHREY. Are they not doing that? Is not the Fed intervening now?

Mr. BERNSTEIN. Yes, it is, and at intervals we get a regular report on their operations. I think the intervention was on the scale of a few hundred million dollars last wear. Until these periodic reports are published, we have only signals of this intervention. One indication is how much foreign countries have built up their holdings of dollars and U.S. Government securities with the Federal Reserve banks. That is reported week by week. When we intervene to support the dollar, other countries lend us their currencies, and they temporarily put the counterpart in U.S. Government securities.

I am not arguing against what they have done. I am suggesting it would have been just as well to do it sooner. I think that the speculation would move around much faster, and with smaller fluctuations. As Fred Bergsten pointed out to me, the system we have is one in which exchange rates move up and down by 20 percent around what appears to be a trend rate, maybe a trend rate that is declining very slowly for the dollar. I think that is correct. These 20 percent up and down movements are disruptive; they cause trouble in our markets; they cause inflation in this country, too.

Mr. BERGSTEN. Could I add one point to that, which brings out a somewhat different point than Mr. Bernstein made. I do not think that it is within the wit of man to choose a stable set of exchange rate relationships. Therefore, I favor the very flexible exchange rate regime we have. The objective of that system should be to determine exchange rates between currencies, based upon the relative economic positions of the underlying countries and their underlying economies. It is my view that this is impossible as long as we have outstanding this dollar overhang, which is the legacy of 20 years of past history of U.S. deficits. Even if the United States were running a very noninflationary economy relative to the rest of the world and doing very well with internal economic matters, but we have political difficulties vis-a-vis the Middle East, there would still be, in my view, tre-

mendous downward pressure on the dollar and tremendously erratic fluctuation in the market because of the existence of these hundreds of billions of dollars which are the legacy of the past. Unless we get rid of that in some stabilizing way, I simply do not see how we can expect to have the desirable degree of stability within the system of flexible exchange rates, which in principle is clearly the best approach.

Chairman HUMPHREY. Mr. Müller.

Mr. MÜLLER. One thing I would like to add. Mr. Bernstein is unhappy with the present system, the exchange rates. He seems to talk as if, in the past, there were no massive speculatory movements, when we had relatively fixed exchange rates. In fact, what ont finds in the past, particularly with the development of the Eurodollar market and the nonmarket transactions of global banks and corporations, is the tremendous capacity under a fixed exchange rate regime—and I think this is what Fred Bergsten is referring to—is to move currencies to one country out of another relatively quickly, overnight and unbeknownst, in many cases, to the central bank, due to these new kind of nonmarket transactions. I agree with Fred that the central problem is the overhang which is the legacy of the past. I am not sure whether or not our discussion only around free exchange rates versus fixed exchange rates deals with the basic problem. What I am thinking; we have to figure out means for recycling, not only petrodollars, but recycling those outstanding Eurodollars, back into our economy.

One of the big things we are hearing today, with the whole issue of private foreign investment, not by U.S. multinationals overseas but by foreigners into the United States, are in my opinion overly dramatic fears of what that means. I think it is quite feasible, within the next year, to figure out what kind of industries we can utilize foreign investment and remember, foreign investment is one means for reducing this overhang overseas. In certain industries where we feel there are national security priorities, obviously not only in defense—I would also add perhaps agriculture and certain aspects of energy and transportation—if we would wish to limit or restrict completely foreign investment. But there is still a whole other host of sectors in our economy that can utilize private foreign investments. One of the reasons that I emphasize the Roosa package was primarily because it does, in fact, include this very tender political topic of making sure that foreigners, to put it bluntly, do not overcontrol strategic industries. In fact, even in nonstrategic industries, it takes care of the fact that foreigners do not gain managerial control. That is one way to reduce this overhang problem.

Chairman HUMPHREY. We will go back to that. I have some experts on the Committee. That is one of the problems here in Congress. Because you are Chairman does not mean you are an expert.

I will yield. As you think about these things, I wish you would address yourself to this inflation problem. We have been getting a full report here for a long time that the whole matter of inflation in the United States is due pretty much to wage demands and to our own affluence, et cetera. I gathered from this morning's discussion that you gentlemen feel that the inflationary forces in the United States are somewhat generated internationally, and also by what is

happening in terms of the movement of currencies and the movement of dollars in the other markets.

Congressman Bolling.

Representative BOLLING. Thank you, Mr. Chairman. I am a non-expert. Once upon a time I thought I knew something about general economics, but I spent 10 years in another area. I am really coming back to work on this Committee because I have a strong sense that most of the economists, even those of great fame, have gotten completely out of touch with the reality relationship of the American economy to the world, and the world to the American economy. I think that really explains why the points you made are so true, and why we have heard remarkably little from the advisors of the President as to what is going on in the world as a whole.

The reason that I know very little about it is I have not done more than some reading and a good deal of listening in the last few years. But since 1965—and I pick that date on a personal basis—there has been this enormous change in the relationship of the American economy and all its parts as best as I can figure it out, to the world as a whole, and I no longer think that we have any real independence. We have an enormous power but almost no independence.

As recently as 1965 we had a considerable amount of independence. There have been at least a couple of things mentioned that had a major impact on that change in our relationship to the world economic level. One is the growth of the conglomerate multinationals. It seems clear, and everybody agrees that it is a significant factor. Another obvious one is first the embargo on oil, and then the multiplication of price.

I would like to ask all the panel a very simple and very naive question.

What are the other factors that have taken place in the last 10 years which have so changed the relationship of the American economy to the world? They do not have to be of the same order of magnitude, but I am very curious as to what your views are as to what they are.

Mr. BERGSTEN. I would like to mention two in particular to capture the effect that you mentioned, which I fully agree with. One is simply the ratio of trade to our overall economy. That ratio has more than doubled in the last 15 years. In fact, if you look at the ratio of exports to our gross national product, it is now not very different from that ratio for Japan or for the Common Market taken as a group. It is slightly lower but not much lower, and the difference has been narrowing.

If you add the fact that our private firms are so much more heavily dependent on foreign investment for their earnings than are Japanese and European firms, then I think the real openness of the United States economy to the world economy is at least as great in this quantitative sense, looking at broad aggregates, as Japan and the Common Market as a whole.

There obviously are some qualitative differences, such as in terms of dependence on energy imports, but the difference between the three big economic areas is not very great. This is a big change for the United States.

The second thing that I would like to mention is the fundamental change in the monetary system. Until 1971, the world monetary sys-

tem could be characterized as a dollar standard in which there was absolutely no external pressure on the United States through its balance of payments because other countries would simply build up dollar balances when we ran deficits. One effect was that we were able to export our inflation; even though we had a great deal of inflation in the late 1960's, we were able to export a large part of it because, instead of our having to devalue the dollar, the dollar became overvalued in the exchange market. We got imports cheaply relative to world prices. There was less pressure on our exports, and American firms invested abroad increasingly instead of at home—which had some adverse effects, to be sure, but reduced inflationary pressures internally.

Then when the dollar was devalued, but more so when the world went onto a system of flexible exchange rates, the United States lost the power that it had had in the past to export its internal inflation. That is one reason why we can never again, I think, expect to see the United States run inflationary rates that are much less than the world average. The United States did that all through the 1950's and 1960's, much of which was due to the dollar-based monetary system. For reasons that I think were good, that monetary system has been changed to one of flexible exchange rates. But it does greatly reduce the capability of the United States to export its internal economic problems to the rest of the world.

Those facts go very much in the direction that you have indicated.

Representative BOLLING. Thank you.

Mr. Bernstein or Mr. Müller.

Mr. BERNSTEIN. Mr. Chairman, the first point we ought to bear in mind is that there was great exaggeration of the strength of the dollar and of the determining role of the United States in world trade long ago. In 1959 I wrote a report to your Committee which started with that proposition: We are overestimating the importance of the United States in the world economy and underestimating Europe and Japan.

The United States was at one time earlier in the 1950's the sole source, so to speak, of extra resources for the rebuilding of Europe and Japan. The dollar shortage was not due to any inherent capacity of the United States to outcompete the other countries, but to the fact that they could not provide enough of their own capital to restore their war devastated areas. At the International Monetary Fund, I was preaching all through the 1950's that Europe is a natural capital exporting area and will be one again. But we were all so taken by the temporary predominance of American economic strength that we forgot to look at the future.

Europe and Japan, Germany particularly, are simply back where they would have been if they had not been destroyed by the war. It is not that we have become a lot weaker in absolute terms. It is that we were never quite as strong as we seemed. Nevertheless, our apparent weakness was exaggerated by a series of mistakes on our part which caused a large and persistent balance of payments deficit, and led to the piling up of dollars by foreign governments, which is so much on the mind of Fred Bergsten. The end result was complete loss of confidence in the dollar as the basis for the international monetary system. I think that we lost a lot——

Representative BOLLING. What are the dates for that? When did that shift take place from confidence to lack of confidence.

Mr. BERNSTEIN. I think we can put it in particular stages, if you wish. First of all, up to 1958 it can be safely said that the world, although it had difficulty in accumulating other reserves, was quite satisfied to accumulate dollars.

Let me give you an objective test of it. If you take the gold reserves of the United States at the beginning of 1951—after Europe had a chance to respond to the depreciation of the European currencies in 1949—and again at the end of 1957, you will find that we had slightly more gold in our monetary reserves at the end of the period than at the beginning. Nevertheless, Europe and other regions were building up surpluses which were used to increase their dollar holdings.

Now, from 1957 to around 1967 you find a very different picture. Europe began to be afraid that their dollar holdings were getting too big. The increase in the reserves of Europe became predominantly in gold rather than in dollars. After 1967, countries saw they could not really convert dollars into gold freely and in 1971 we made this official. So the decline of the dollar began, maybe at the end of 1960. It became very bad by 1966 or 1967 when our inflation made it apparent that the dollar was no longer a safe reserve currency.

I have on my desk a report on what has happened to the reserves held in dollars. We can make a very good case on the adverse effect of our inflation and the depreciation of the dollar on the real value of the reserves of Latin America, as this paper does. Here are Mexico and other Latin American countries keeping their reserve in dollars, and these dollar reserves have lost purchasing power very significantly, not only in the United States, but even more in Europe and Japan because of depreciation. That is true, although it overlooks another element in the picture, which is that these countries owe abroad in dollars an awful lot more money than their reserves, and that the cost of debt service, paying the interest and amortizing the debt from the proceeds of their own exports has dropped even more.

Actually, the losses are much larger in the rich countries who hold most of the dollar reserves. In Germany, for example, the bookkeeping losses on their dollar reserves must be measured in billions of deutsche marks. This is not conducive to wanting the dollar as the reserve currency of the world. It is not conductive to having confidence in the United States as the leader of the world economy.

Representative BOLLING. Thank you, sir.

Mr. Chairman, I am out of time, but Mr. Müller has not had a chance to comment.

I would like very much to give him that chance.

Mr. MÜLLER. I would like to go back to the point that you brought up, a very significant year, 1965, in terms of the kind of work that I have been doing. It indeed is a significant year to explain this growing instability that we are now experiencing. Number one, Fred mentioned that we have become very much more international in the economy, exports and the earnings. We should put a quantitative number on that because it is a crucial number.

If we look back to the year 1955 and 1956 at the ratio of profits being earned by corporations to their total profits, all corporations

in this country, it is running somewhere in the area of 7-cents-per-dollar total earnings. If we bring that ratio to 1965, the net here starts to exponentially explode upward so the ratio of the total amount of earnings that we are getting overseas versus all earnings is upwards of 20 percent at the minimum if we rely on just corporate disclosure information that we currently have, and if we take into account all of the other various kinds of financial transactions open to these corporations. The estimate we have come up with is 30 percent of our total corporate profits are now being earned overseas.

A second aspect that occurs around 1965 is we begin to experience the traces of deterioration of income equality. We begin to see it significantly occurring in 1969. The direct relationship between income distribution and income equality and how much of our total income is now being earned overseas, when you invest overseas, the returns go to foreign labor and to domestic capital or domestic profits. When you invest here at home they go both to domestic labor and to domestic profits; that is, the more you invest overseas, the greater the likelihood for further exascerbating income concentration in the economy.

The third thing that occurred starting around the year 1965–67, I have already referred to it, is the response by European corporations and Japanese corporations to the globalization process was for themselves to globalize, and as they did they set up new competitive forces for our own corporations worldwide.

At this point we begin to see a deterioration in the United States in terms of trade, not only in exports and imports, but also in the rate of return of our foreign finance capital because of the increased competition of the German and Japanese overseas.

I think the phenomenon that we see in OPEC is not only the beginning for other raw material sectors, but our studies are showing it is more and more becoming a phenomenon in controlling our global corporations in places like Brazil as well as manufacturing, banking, and services. This will mean a further determination in terms of trade in these areas.

Finally, Senator Humphrey before talked about productivity. We are also finding in the years 1960 and 1965 a downward trend in the rates of increase in productivity, and at the Yale Economic Growth Center they are beginning to trace this very significantly. One of the things that we forget when we invest overseas as compared to investing here at home is that if you do not create new capital stock through investment at home for American workers, productivity is bound to go down; as you more and more invest overseas, you are increasing the productivity of foreign nations to the relative decline of U.S. productivity.

Let us take a look at the figure on the ratios of foreign investment to total investment by our corporations. If we go back to the early 1950s, that ratio is about 7.6 of a total dollar of investments. Around 1965, Congressman Bolling, it explodes, so by 1972 it is over 25 cents of the total investment dollar of our corporation now going overseas.

Finally, to analyze somewhat extended remarks here, let us look at the whole question of anti-inflationary policies and stimulation policies for employment. Here I think we do have to come back to the whole question of what is the structure of our economy today. Some

of you already know that for instance when you try to fight inflation, one of the things you do is you restrict credit. You restrict credit because you hope that you would reduce investment demand, thereby level of total demand in the economy, and thereby bring pressure off prices.

What do we find in the period 1968 through 1971 as these kinds of policies were being implemented, and earlier? We find that the only corporations that can respond to this in the intended manner of the policy are the smallest corporations which make up less than 40 percent of our economy in terms of employment, assets, sales and investments, and that the largest corporations, because of their ologopoly power in the market, continue their investment rates because they can pass the credit cost increases on to consumers given that oligopoly power. What we find is a much, much further extension of the investment demands than the Fed anticipated, and thereby exacerbating again the programs to fight inflation.

It is only when industries became oligopoly, industries like automobiles, up to 25 and 35 percent unemployment that the market mechanism, the free market, the competitive market mechanism as we envisage, and our policies once again take over at rates of 30 percent unemployment in the industry and 8 to 9 percent nationwide.

I would suggest, gentlemen, that that is extremely high political and social cost to finally rediscover that competitive market forces are alive, but up until that point, they are not alive.

Chairman HUMPHREY. Do you ever talk to anybody in the Government besides us?

Mr. MÜLLER. I have talked to a number of other committees.

Chairman HUMPHREY. How about the executive branch?

Mr. MÜLLER. The current administration does not talk to me too often, Senator Humphrey.

Chairman HUMPHREY. I wish that they would. Congressman Long.

Representative LONG. Mr. Müller, you obviously are greatly concerned about the transnational, or what could be called the superinternational economic capabilities of the multinational corporations. Both of the questions that I have relate to that, the first one of which is in the energy field. Are you seriously enough concerned about that that you would completely break the link between the domestic and the international transactions in the energy field by establishing a completely independent governmental agency to purchase all the imports of oil and gas by the United States?

Mr. MÜLLER. I think, to answer that part of the question. I think it is essential that the public sector takes charge of inducing competition in oil prices. I think one means for doing that is, in fact, the petroleum import administration that has been proposed. This concerns itself—it does not eliminate private enterprise overseas, energy conglomerates overseas. It does not eliminate them domestically. All it does is, it sets up Government intermediation to assure that we get the cheapest kind of oil through the most competitive kind of process, given the fact that there is no real market existing in international oil today. On the buyer side, there is a cartel called the energy conglomerates, and on the selling side, you have the OPEC cartel. When you have two such cartels facing each other, you cannot have competition and competitive market forces. After the oil is imported and

controlled by the public sector, it is then sold back to the private sector.

We are not saying anything radical here. We are not doing anything with private enterprise. If you looked at my proposal on the Public Energy Corp., the design is to keep the greatest possible role for the private enterprise system, but to insure competition through a system of competitive bidding on managerial and extraction contracts, the oil in the ground or under the ocean, and large-scale projects only, would be owned by the public in conjunction with Federal and State Governments. Once that oil is exploited by private enterprise under competitive contract, the public sector would decide, how much do we need, and it could take into account the things that large energy conglomerates, given their very nature, that they must in fact have profits—which is a legitimate concern—it would take in account things that they cannot do, such as the short-run balance of payment positions, the distribution of the energy within the economy, and the multiplying effects of that.

Representative LONG. That would, in effect, be an answer to my question: Break this link that exists at the present time.

Mr. MÜLLER. Without eliminating private enterprise.

Representative LONG. Yes; both from international policy and also from domestic policies that you discussed at the end of your remarks here.

Mr. MÜLLER. Right. May I add one thing, Congressman? The important point is, why propose a split in the domestic depletion allowance? There is one area where we can rely on the public marketplace completely; that is, to induce competition where it is still possible. The reason I wish to give the full depletion allowance to independent producers is because they need it most to remain competitive in this. The large energy conglomerates—and if I have a quote from Frank Zarb in my testimony—are not going to be hurt greatly by that. In fact, we are going to end up socially by increasing private competition where it is still possible.

Representative LONG. I agree with you on that.

Let me relate the same overriding problem to a statement you made on the last page in your prepared statement; that going from the energy field, at least in the conventional energy field as we think about it, to the agricultural field, you state that agricultural stimulation policies are, however, a tender topic, since they can easily lead to further concentration in that sector. I know you did not have time to develop everything in your statement, but you had not really developed that very extensively in the prepared statement. Why do you think that it necessarily leads to further concentrations in that field because of these agricultural stimulation policies?

Mr. MÜLLER. To take a hypothetical example, one of the things we could do to stimulate new supply is, we could have a differential investment tax credit for agriculture, as opposed to other sectors of the economy. I propose that, in fact, for certain kinds of new investments in alternative technologies and transportation. If you adopt the 14 percent investment tax credit economywise for new investments in transportation or agriculture, you may wish to raise that to 16 percent for a 2-year period and experiment with it. If we

did that in the agricultural sector, that means that large agribusiness firms get the same advantage, theoretically, as small and medium size.

Representative LONG. Theoretically only?

Mr. MÜLLER. Theoretically only, and actually it gives us a much larger stimulus, because of their capacity to take advantage of it, than the small and medium firms. As an alternative, I would propose something like this, which I think does need some more study by agricultural experts; is we can begin to underwrite and give to small and medium farm cooperatives, underwrite credit programs to them, because that institution already existed, and is basically existing to serve the small and medium farms. It is a way for stimulating them, and they are highly responsive to small and medium farmers, stimulating their investments to begin to restore some kind of competition at the farm end of the agricultural sector. I would propose that a similar kind of activity is needed in another strategic sector that we have not yet talked about today, because it was not on the agenda. That is housing. The proposal set forth by Representative Reuss takes care of the demand side, but there is a vicious circle in our economy today. If you just take care of the demand side, and stimulate demand for housing without looking at the supply side, there is a tremendous structural bottleneck of the supply side of agriculture and housing; i.e., most of your construction firms are relatively small. When they go to a local bank to get working capital loans of 6 months or 12 months, they cannot get them, because the banker, being a wise businessman, would rather lend to the large local department store, which at least has inventories and asset backing, then the construction firm.

Representative LONG. Also, it is not subject to the variances in the economy.

Mr. MÜLLER. Right. They may in fact stimulate demand, but if you do not overcome the bottleneck in supply, which is working capital right now to differential credit programs, you still have a problem there.

Representative LONG. Thank you, Mr. Chairman.

Chairman HUMPHREY. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman, and I congratulate you for bringing before us a really outstanding panel; Eddie Bernstein, the alumnus of Bretton Woods, who is surely the wisest, and most eminent in this field, and two brilliant younger men. It has been a great morning.

Let me start out by asking you three this question. Would you not, when all is said and done, agree the best single thing that this Committee can do for the international dollar, the subject that you have been discussing this morning, is speedily and steadily to recommend new things that will bring about economic recovery in this country, increase production and more jobs, and which will help to get inflation under control?

Mr. BERGSTEN. I would certainly agree. It is an essential single step, but not the complete answer. Certainly, if you are looking for one primary focus, that must be it.

Representative REUSS. I want to get on to the rest of the answer. I do not find any disagreement, do I, from Mr. Bernstein? Mr. Bernstein said that——

Mr. BERNSTEIN. I agree with that completely.

Representative REUSS. It is important, Mr. Chairman, that we keep that in our mind in our annual report. Now agreeing with Mr. Bergsten that full employment without inflation, or whatever you want to call it, is not the total answer, let me look at your several worries, gentlemen, about an undervalued international dollar. Mr. Bergsten puts it in terms of the overhang that is causing the dollar to decline. Mr. Bernstein's concern is that speculation may be driving the dollar down. Mr. Müller says that, if the Federal Reserve tries to ease domestic credit, and interest rates—which I think everybody at this side of the table feels they should be doing—they may contribute to a further decline in the U.S. terms of trade, and accelerate, the trend for U.S. resources abroad for bargain prices.

I really wonder whether we ought to look to any particular gyrations from the Federal Reserve to get us out of our troubles. Specifically, does it really make sense for the Federal Reserve now to intervene to bolster up the alleged undervaluation of the dollar internationally, under circumstances other than those necessary for the avoidance of disorderly markets, and so on? Might not such zealous and well-intentioned action by the Fed produce some unfortunate side effects? I will name a few. If they take their interventionist activities too seriously, are they not simply going to make it easier for Americans to buy foreign compacts, Volkswagens and Fiats, and thus add to the congestion at the fairgrounds in Detroit, where American compacts are not selling? If they are too zealous, are they not likely to cause deterioration of American exports, particularly in the machinery field? Our prices will go up, and our terms of trade there will deteriorate.

If they are too zealous, are they not simply likely to drive the Arabs to abandon the dollar as the index for their oil sales, a process that seems to be going on already? I can go on, but would it not be really better if the Fed relaxed? The last time that they tried a big intervention in support of fixed rates, in January and February of 1973, it was a disaster.

Mr. BERNSTEIN. Congressman, I do not think you are correct, and I think actually the arguments that you are using are sometimes arguments against intervening for a rise in the dollar, sometimes a fall in the dollar; and the two at least ought to be separated.

First, I would like to give you a comment on the observation about interest rates and the exchange rate. If interest rates of the United States are dropped by 2 or 3 percent, let us say, while they stay the same in Germany and in Switzerland, how much of a fall in the exchange rate for the dollar should that bring? Now, it is strange that some central bankers, who ought to know a good deal about this, seem to think that you can explain nearly every drop in the dollar by the difference in interest rate. That is not correct.

If you have an interest rate differential in two countries, then in order to induce a person not to move funds to the center where the

interest rates are higher, you have to hold out the prospect that the exchange rate will appreciate by as much as the difference in interest rate. Therefore, if we create a 3-percent-per-annum differential in interest rates, the dollar should fall now in order to provide the basis for an appreciation in the exchange rate by the equivalent of 3 percent per annum. The bigger drops do not come from the difference in interest rates. They come from other reasons.

Now, to the question——

Representative REUSS. Before you leave industries, could I ask you one question? Could it be that even the relatively small drop that you had in the international value of the dollar as a result of pursuing recovery-oriented monetary policies in this country would be, to a degree, washed out and compensated for by better economic conditions during the year, which would induce capital inflows to buy equities in Wall Street, let us say?

Mr. BERNSTEIN. Yes.

Representative REUSS. Who is wise enough, really, to figure all of that out? And therefore, why do we not just do, monetary-wise, what is needed for full employment?

Mr. BERNSTEIN. I do not think we have to use the argument you are using about what we do not know. I think we can meet that argument directly. The impact on the exchange rate from a change in interest rates is small, and should be small unless it creates speculative expectations. On the other hand, there are other kinds of capital flows, and Congressman Reuss is completely right that the inflow of funds into this country for investment in securities and other assets would be stimulated by a stronger economy. As a matter of fact, Congressman, one of the big changes in the capital flow last year was in securities. Where we had an inflow of $4 billion from security transactions in 1973, we only had $1 billion last year. It was a very big problem, and certainly is related to the stock market, and certainly related to the state of the economy.

Representative REUSS. If my time is not up, would you now—I know my time is up, and I have not given you, Mr. Bernstein, a full opportunity to answer.

Mr. BERNSTEIN. Another time.

Representative REUSS. When you correct your testimony, I would be very grateful if you perhaps could append an extra paragraph, if you want to.

Mr. BERNSTEIN. In reply to your question?

Representative REUSS. Addressing it, yes; up to that.

[The following was subsequently supplied for the record:]

ADDITIONAL INFORMATION SUBMITTED BY EDWARD M. BERNSTEIN

I agree with Congressman Reuss that we do not have to abandon recovery-oriented monetary policies in order to hold up the exchange rate for the dollar. Lower interest rates were not the cause of the large depreciation of the dollar since early 1974. Comparisons of interest rates in national money markets are difficult to make because the loans and credits to which they apply are not precisely the same. Interest rates in the Eurocurrency markets, however, apply to loans and credits in different currencies under the same conditions. It is worth noting for this reason that interest rates were higher on Euro-dollars than on Euro-D-marks and Euro-Swiss-francs. That indicates that the cause of

the decline in the dollar relative to these currencies in 1974 was the capital outflow resulting from the payment of the oil deficits of this country and of other countries. Further, the decline was greatly exaggerated by exchange speculation based on very short-term expectations.

I am not arguing for official intervention to maintain the dollar at some preconceived exchange rate. I do say that alternating fluctuations of as much as 20 and 25 per cent in one direction and then in another relative to the D-mark, the Swiss franc, and other European currencies cannot possibly reflect changes in economic conditions. For that reason, they prevent rather than help the world economy to make the adjustments necessary for a balanced and appropriate pattern of payments. Of course, the sharp decline in the dollar helps General Motors and hurts Volkswagen. But the sharp rise in the dollar which occurred in the second half of 1973 and again from May to September 1974 hurt General Motors and helped Volkswagen. Actually such large fluctuations which are reversed in a short period have little effect on trade. Instead, they encourage speculative capital flows. More important, the wide swings in exchange rates affect the prices of foodstuffs and basic commodities generally.

Congressman Reuss says that he would have the Federal Reserve intervene only to maintain orderly conditions in the exchange market. I would say that fluctuations of 20 to 25 per cent in one direction and then in another within periods of three to six months indicate disorder in the exchange market. A country cannot escape responsibility for the behavior of its currency in the exchange market any more than it can escape responsibility for the behavior of its domestic monetary system. Actually, official intervention to avoid the sharp fluctuations that we have had since 1973 would help in maintaining a monetary policy appropriate to economic conditions in this country, as the Federal Reserve would not have to give as much attention to the effect of interest rates on the exchange rates.

Senator PROXMIRE [presiding]. Mr. Hamilton.

Representative HAMILTON. We have heard a lot about the foreign investments in the United States from the OPEC countries, and there are proposals that those investments be limited in some way. Are there any economic reasons that will justify the stopping of inflow of capital in the United States?

Mr. BERGSTEN. I do not think there are any economic reasons to justify stopping it. Therefore, I have some doubts about the proposals of Senator Williams and others that would set in place a screening mechanism to review every single incoming investment. It seems to me, in administrative terms, as extremely cumbersome, and could deter a lot of incoming investments that could be a great help to the economy. At the same time, though, I think the administration is being excessively laissez-faire in saying that they do not want any new mechanism.

I think what we need is an escape clause for foreign investment flows, both inward and outward, analagous to the escape clause for trade that we have had for the last 30 years. The basic rule we have had is freedom of trade flows. But there is a mechanism, a safety valve, to which any sector of the economy, including Government agencies, can resort if it feels that a particular flow is adverse to the national interest. It can start a procedure which, if a determination is made at the end of the road that the flow is adverse to the national interest, can either stop that flow completely, or limit it, or take some measure to adjust for it. It seems to me an intermediate proposal of that type would avoid the difficulties of either doing nothing, as the administration seems to propose, or setting in place a comprehensive screening mechanism of the type that Senator Williams and others are calling for.

Mr. MÜLLER. I agree very much with Fred. If you look at the whole problem of foreign investment and learn from it, all over the world, besides the United States, the clear thing that comes out is that what a foreign investor wants, being from Europe or OPEC these days, is clearly to define the rules of the game. This is what I think we all meant before by Fred's term, having a clearly defined escape clause; and my terms, clearly defining which industry we wish to restrict, which industries we do not wish to restrict, and which industries you wish to partially restrict. Once those rules of the game are established, I do not think you are going to impede foreign investment.

Mr. BERNSTEIN. I would like to point out that we already have such rules. For example, total foreign investment in the communications industries are limited by law. At the communications companies, they report regularly to the FCC the proportions of the shareholders that are foreign owned or held by nominees for foreigners.

Representative HAMILTON. Are you satisfied that we have sufficient laws?

Mr. BERNSTEIN. I was not suggesting that. I was using this as an illustration that Fred Bergsten's proposal is not without precedent. Already the United States has reserved industries where we will limit the degree of foreign control. Personally, I rather feel that a minimum control of the inflow of funds from any country is highly desirable. I agree also, though, with the principle that we have established in the past, that there are industries in which the national strategic interest—not so much the economic interest—is so overwhelming that we have to reserve the right to limit the foreign control. That is as far as I would go.

Representative HAMILTON. I would like to ask you to comment, if you would, on the consequences we confront as a result of these high oil prices, assuming those oil prices will stay at a very high level. It seems to me from your testimony that you are suggesting that we are going to be confronted with very large Federal budget deficits for a long time to come, in part because of those oil prices. We are going to have trade deficits for a long time to come, because of those oil prices. We have obligations to the developing nations because of the oil prices, and different mechanisms are being suggested now to deal with their problems. I also get the impression that the oil prices are going to have a major effect on the rate of inflation in this country.

It seems to me that many adverse consequences flow from these high oil prices. Am I right in that?

Mr. BERNSTEIN. Yes, you are right.

Representative HAMILTON. In all of those things?

Mr. BERGSTEN. There are extremely serious consequences. I think we should not lose sight of the fact that there is tremendous downward pressure on oil prices right now.

Representative HAMILTON. Do you think that the oil prices are going to break?

Mr. BERGSTEN. The real oil price has already come down quite a lot. The nominal price has been held, while other prices have been

rising. That alone reduces the real price. The depreciation of the dollar has reduced the oil price to all other countries, certainly to the OPEC exporters, by a great deal, and you are already seeing tremendous signs of downward pressure on the oil market; discounting at the margin by the seller, full storage tanks, tankers at slow speeds.

Representative HAMILTON. Do all of you expect the oil prices to come down?

Mr. BERNSTEIN. I certainly hope that Fred is right, that the real drop in oil prices is more likely to come in the terms of trade. They are going to have to be paying more for our exports, which means that the amount of goods and services that we have to give them to pay for our imports of oil will be going down even if the dollar price comes down very little.

Mr. MÜLLER. One major reason I am against the so-called floor price being proposed by the administration is, in effect, it upsets this downward trend. Second, another key aspect of this inflation deficit that we were referring to—and I cannot emphasize this enough—is part of the reason that those deficits are so high has to do with the fact that we are not taking advantage of correcting tax loopholes, particularly in the foreign sector, to offset the expenditures we are going to have in restructuring transportation and energy.

Mr. BERGSTEN. The only force in the world for higher oil prices right now is the Ford administration, through its proposals for a tariff on oil and a floor price. They are the only forces in the world economy tending to drive up the price of oil. Everything else is downward.

Mr. BERNSTEIN. That means the price of oil on our domestic markets, not the world price.

Representative HAMILTON. Let me just observe that as far as we are concerned in the Congress, we may have to choose between higher prices or import quotas to reduce the importation of petroleum. That may be somewhat of a simplification, but roughly that is the choice that is going to be put to us to vote on, I think. How do you react to that?

Mr. BERNSTEIN. Import quotas would mean higher prices, unless you ration.

Representative HAMILTON. All right. We have to vote on one or the other. Let us assume that. What do we do? Do we go for the higher price route, or do we go for the import quota?

Mr. MÜLLER. The basic thrust of my testimony on this question is that you have a number of steps here that, I think, are sometimes overlooked. You can, in fact, bring about import quotas. You can, in fact, accelerate conservation programs that generate the necessary tax revenues, and they are there. You can, in fact, reduce energy demand significantly if you have added tax revenues that are potentially there, and you can have a standby rationing system, as well as price controls to make sure that your price increases in the energy sector are not being passed on to the consumer, or not only the consumer.

What is equally important here is that if you pass these increases in prices coming off tariffs or some form of taxation onward, then

you are really making an international competitive position of U.S. manufacturing firms bigger. One can talk about single-sector price control in the energy sector as we make this adaption process, so that the trade-off is not necessarily between import quotas and higher prices.

Mr. BERGSTEN. I would certainly support that, and say that I am trying to avoid the choice as you put it. U.S. imports of oil were already down significantly in 1974; about 8 or 9 percent in volume terms relative to trend.

Mr. BERNSTEIN. I just ran the 1974 oil imports through the calculating machine, they were down 3½ percent.

Mr. BERGSTEN. Compared to a trend increase of 5 percent. U.S. oil imports in 1974, in volume terms, were down 8 to 9 percent from where they would have been. Part of that is recession, but a lot of it is price. OPEC has already triggered a major oil conservation program in the United States. We do not need massive further price increases, with tariffs, excise taxes, decontrols of oil and natural gas, in order to get a reduction in demand. The adjustment is taking place already, to a large extent; that is reducing our dependence. The increase of oil output, in a variety of ways, is decreasing our dependence on OPEC. I reject the choice that we have to do an import quota or an oil tariff. I do not think that is the issue.

Mr. BERNSTEIN. If I added a point, I think it would help. I do not think we can just wait for the growth of energy supply throughout the world, and for the longer run, greater elasticity of demand in response to the higher prices, particularly as money incomes will be going up anyway. I do believe, if we want to avoid the continued pressures that the world economy is feeling from the high cost of oil, we have to take positive steps to reduce imports of oil. There are several ways of doing that. I do not think having fixed import quotas that you auction off to oil companies or oil countries at a variable fee is really different from the administration's proposal to set a fixed import fee, and have a variable response to it in the amount of the imports. I think both are undesirable. I would vest rain oil consumption through higher prices, but in uses where the impact of the higher prices will have minimal adverse effects on the economy.

Professor Müller is right. A tariff across-the-board is not only very uneven in its incidence in regions of the United States—a tariff on heating oil, on residual oil, is not the same thing for Florida as it is for New England. That is very unfair. Also, an import fee on crude oil and oil products will do what this gentleman has said. It will raise the cost of production in every industry in the United States, and reduce our competitiveness; which in turn must result in a further drop in the foreign exchange value of the dollar.

On the other hand, if you skip the producer level, and suppose, as an illustration, you concentrate on a tax on gasoline. Now, the consumer price of gasoline is going to rise on that account, but it will not be spread through the rest of the economy, or at least to a very small degree. And gasoline is a very big part of our consumption of oil and petroleum products. You can have tax offsets which retain

the benefit of the impact of the higher price of gasoline in reducing consumption, without reducing the real income of the lower-income groups. There is always a price effect, but it can be minimized, and it can be kept from having pervasive influence on the world economy.

Representative HAMILTON. Thank you, Mr. Chairman.

Senator PROXMIRE. This has been most enlightening and helpful. You are all three most distinguished international economists and we are delighted to have you before us. Mr. Bernstein, you have enlightened me because I have lost touch, I am afraid, with this field to a considerable extent.

Mr. Bergsten, in the course of your remarks and response to Congressman Bolling, you pointed to the enormous difference now in our dependence on world trade, and you gave some interesting statistics. While I was waiting, I looked those statistics up in the President's economic report, the addenda there. I find that great change really has been in the last couple of years, that in 1968 the ratio of exports to GNP was 3.7 percent; in 1970, it was 4.2 percent, an increase but not an explosion. In 1972 it was still 4.2 percent. Then the explosion took place, so that by 1974 it was 7 percent, and of course an even sharper increase in imports than exports, but both fairly large in tandem.

Is this primarily the result of the energy crisis, and if so, is it likely to abate somewhat if we move as we all hope we will move toward a lesser degree of dependence, and therefore a lesser amount of imports of energy.

Mr. BERGSTEN. If you are comparing U.S. exports with GNP, which I think you were——

Senator PROXMIRE. Yes.

Mr. BERGSTEN [continuing]. Then, of course, the higher prices for oil and imported raw materials themselves would not affect the ratio.

Senator PROXMIRE. Except that these things move in tandem.

Mr. BERGSTEN. I was going to say that, for example, from our export side the relative price of food has risen. If it were just an increase in inflation across the board with no industry differentiation, there would not be any effect on this ratio. But since our terms of trade have improved, excluding oil, through the increase in food prices, of which we are a big exporter, then surely the ratio would rise partly for that reason. Whether it is going to continue to rise or fall depends in large part on your projection for food prices. As I look out 5 or 10 years, I agree with the comment Mr. Müller made in his testimony, that food prices are inexorably up. The price of food is going to continue to rise for any 5- or 10-year period, as we now foresee. If that is true, everything else equal, the ratio of U.S. exports to GNP would rise further.

There are obviously a lot of other things involved in the prices of our manufactured goods that are exported, relative to the economy as a whole, so it is hard to predict. But every sign I see, working on it from a number of different angles, is that the U.S. economy is becoming very rapidly more interdependent with the rest of the world. I do not see that turning around.

Senator PROXMIRE. Food is a very important part of our exports. That does not constitute anything like most of it.

Mr. BERGSTEN. One-quarter.

Senator PROXMIRE. One-quarter. Therefore three-quarters of the increase, of course, is in other areas.

We are very dependent for our jobs right now on a healthy world trade and on increasing our exports, are we not?

Mr. BERGSTEN. Definitely.

Senator PROXMIRE. Not only in the farm area, but in the nonfarm area.

Mr. BERGSTEN. Definitely.

Mr. MÜLLER. But if you look at the nonfarm impacts due to decreasing exports, this has been done in 1973, you will find that almost the entire net increase in employment due to exports came from the agricultural sector on jobs.

Mr. BERNSTEIN. I was going to add a point to this.

Senator PROXMIRE. Let me just interrupt, Mr. Bernstein, to say as I understand it, you say it came from the agricultural area. Are you including farm machinery, the agribusiness, or are you just including simply the farmers.

Mr. MÜLLER. I am including farm and farm labor only.

Senator PROXMIRE. That is not a very big increase. We have had a sharp drop in the number of farmers, the number of people working on farms, as you know.

Mr. MÜLLER. Only the relationship between exports and employment tied to exports. Almost all of it came off increases in agricultural production at the farm level.

Mr. BERNSTEIN. Senator, I think you are entirely correct that the big shift in the ratio of imports and exports to the gross national product began around 1964. We had between 1964 and 1969 an increase of about 150 percent in imports of a group of finished manufactured goods. I am not talking about imports of raw materials. I am not talking about imports of foodstuffs. The imports I refer to are machinery, automobiles, and consumer durable and nondurable goods. A part of that increase was due to the development of other areas as producers. Part of it was due to the overevaluation of the dollar. One reason for the increase of our exports in recent years is the greater competitiveness of the United States since the depreciation of the dollar.

Of course, Fred noted, too, if you were taking constant dollars, you would get smaller ratios to constant GNP. That is all over the world. That is for all sorts of groups.

Export prices have risen more than domestic prices. That is true of agricultural products and true of raw materials, and even true of manufactured goods.

Senator PROXMIRE. Maybe we can come back to this later on. Now we would like to ask you about one of the real major impacts on our budget.

The President is proposing a special financing facility for a kind of international energy bank. He asked for $7 billion from Congress this year in obligational authority; $7 billion compared to nothing last year for that. That is by far the biggest increase in obliga-

tional authority except for the completely noncontrollable items like social security or defense. It just dwarfs everything else. It is a colossal increase, eventual size of the facility to be $25 billion.

This is a major new program. I have heard very little about it. You gentlemen are the outstanding experts advising this committee on our international economic policy; you can advise us on how important it is. Suppose we would knock it out of the budget. Suppose we do not do it this year. It is very tempting if you can save $7 billion in obligation authority, a billion dollars in outlay by deleting it.

Mr. BERGSTEN. The rationale for the scheme, as you well know, is as a necessary backstop for the recycling process, to assure that the big change in the balance of payments positions will not lead to a breakdown or severe crisis for any of the individual oil importing countries.

Right from the outset of the oil crisis, so-called, I have been very optimistic that the recycling process would be handled successfully through the private financial markets with the usual backup from central banks and with existing financial institutions like the IMF. So far that prognosis has been good; the international recycling process has worked very effectively.

Senator PROXMIRE. This is an insurance policy in case it breaks down?

Mr. BERGSTEN. It is an insurance policy. As is always the case, how much do you want to pay for insurance? My guess is you would never spend anything like $7 billion. Even if you authorized it, it would be a contingent liability. I doubt that you would ever have to appropriate any significant share, if any, of the money at all.

Senator PROXMIRE. We would actually appropriate the $7 billion this year. A billion dollars would be outlayed, but they would be in a position to contract to obligate us for $7 billion.

Mr. BERGSTEN. Right.

I am just doubting that the money would be spent. Maybe you could buy some insurance cheap. I do not really think it is a necessary element of the whole oil picture.

Mr. BERNSTEIN. Senator, you have to look at it not just from the point of view of the budget but from the point of view of the economy. The recycling has worked reasonably well. Notice, however, that our banks lent $18 billion last year to Japan, Latin America, and other areas, much of it in order to finance their oil deficits. If you do not have this backup, the U.S. economy will be called on again to provide the financing of other countries' oil deficits. It will go through the market.

The main advantage of having this backup in the form of an agreement with other countries is that Germany is involved. Germany would then be brought in with the United States as a supplier of residual funds, if the market does not do a good job. German banks are not doing as much recycling, if you want to use that term, as our banks are doing.

Senator PROXMIRE. Would a German, Swiss, or Japanese, or other parliaments be asked for appropriations of this kind?

Mr. BERNSTEIN. Sure.

Senator PROXMIRE. How large an overall facility would this be?

Mr. BERNSTEIN. $25 billion.

Senator PROXMIRE. $25 billion, of which our total ultimate obligation would be $7 billion?

Mr. MÜLLER. It is quite likely that the total obligation would never amount to $25 billion, therefore——

Senator PROXMIRE. Am I correct that $7 billion is what we are being asked for, and that is it?

Mr. MÜLLER. The upper limit.

Senator PROXMIRE. The upper limit.

Mr. MÜLLER. That those moneys would ever be spent in full, that is quite unlikely. It has—most of the discussion on the issue of the total package being $25 billion. No one envisages the necessity of ever having to use the $25 billion, therefore, not the necessity of ever using the total limit of $7 billion.

Senator PROXMIRE. What happens if, as a matter of fact, we do not pass it?

Mr. MÜLLER. I disagree with Fred on this issue that what is at stake here is basically more than just deficit financing. The recycling question has been solved somewhat successfully for certain countries and not for others. Here I am thinking particularly about Italy. When we talk about a safety net, what we are really talking about, to put this in more concrete terms is a mechanism that allows us to avoid the danger that has a relatively great probability in my opinion, these days, of banking system failures that can get triggered through the Eurocurrency market, particularly other nations, particularly nations like Italy. This is what is at stake, and this is why we need a backup. It is not that the United States has too good a time with recycling, and it can do a better job.

Senator PROXMIRE. Why do we have to appropriate $7 billion for something that may never develop? Why can we not simply add if it is necessary, when it is necessary, that perhaps this is an unlikely contingency, to the extent it is.

Mr. BERGSTEN. The objective is to build confidence. It is a psychological objective. Setting this in place, even if it were never used, would represent a further bulwark against that kind of problem.

Senator PROXMIRE. Balance that against the confidences that some people feel. Perhaps I do not share it completely, but some people feel about the deficit, that deepening the deficit this is also inhibiting or taking action to really, vigorously expand the economy. Most people say the deficit is so big now that this is one of the things that deepens the deficit, therefore would prevent us from taking action in the housing area or other areas, tax cut areas that might be more productive.

Mr. BERGSTEN. If that is the choice, you should clearly spend the $7 billion for productive uses to reinvigorate the economy.

Mr. BERNSTEIN. You are not spending the $7 billion. You are authorizing it.

Senator PROXMIRE. Mr. Bergsten's point and my point is we appropriate it, go through the process, that is part of the budget and it will result in part in increasing the deficit.

Mr. BERNSTEIN. The point I was making, Senator, is this, that there is the seen and the unseen. If we do not provide the safety net,

the American banking system will be pressed to provide the financing of the oil deficits of other countries. If the American banking system does not do it, the International Monetary Fund will do it and it will use our money that we have already given the IMF.

The real economic difference is negligible. The question then is whether it is worth having this authorization in the budget for the confidence it gives in formulating a common oil policy. The impact on the economy is not going to be any greater doing it as a safety net, and without it confidence in the oil policy will be less. The psychological effect on the budget may be great. I do not know. The psychological effect in getting cooperation and holding down oil imports, I think, would be very great.

Senator PROXMIRE. I am sorry. My time is up. You said a psychological effect in holding down oil imports would be great?

Mr. BERNSTEIN. Yes; the purpose of this is to get countries to hold down oil imports—it is a quid pro quo.

Senator PROXMIRE. How would this hold down oil imports?

Mr. BERNSTEIN. Because in order to be eligible for help from the safety fund the countries have to commit themselves to stated reductions in the oil imports. It is a quid pro quo. It is not just an underwriting. They can get that from the IMF. If they just have balance of payment problems——

Senator PROXMIRE. Why is that likely to be very profound when only one or two countries, or any country, or am I wrong about that. Is it not likely that only Italy and possibly Great Britain might borrow?

Mr. BERNSTEIN. From the safety net?

Senator PROXMIRE. Yes.

Mr. BERNSTEIN. I think there is a lot in the proposition that Germany, Belgium, the Netherlands, who would take part in the plan, are not going to need any money, and that Italy, France. England, and perhaps Japan would be the ones who are most likely to draw on it. Even with the safety net, they may find other ways of financing—actually Italy, France, and England financed themselves beautifully and overfinanced themselves. In 1974 they built up their reserves despite enormous deficits. They did not have less dollars and other reserves at the end of the year than at the beginning; they had more.

I do not think that the private markets are going to work anywhere nearly as well this year. I think it will be harder to get credits in the Eurocurrency market and from our banks. I can not conceive of our banks adding $18 billion more to their foreign lending this year. I think that the financing will have to be by official institutions. If you do not provide the safety net, more of it will go through the IMF, if that institution can raise the money.

Senator PROXMIRE. My time is up.

Senator Kennedy.

Senator KENNEDY. Thank you very much, Mr. Chairman. I am sorry I missed the formal presentations. I listened to Mr. Bernstein's final comments about the energy problems and I was in complete accord with him.

Let me ask you, Why have some of the European countries such as Germany been able to handle the energy crisis a good deal better

than the United States? As I understand it, they have been able to hold their inflation at a more reasonable rate, less than ours has been. They have been able to remain highly competitive.

Is there anything we can learn from the way other countries have been able to manage their economies in terms of energy and other problems?

Mr. BERNSTEIN. We can learn a lot from others. We are not very good at this business of conservation and economizing. The Europeans are all more economical in the use of energy than we are. They have been brought up that way. They were brought up that way when their incomes were much lower relative to ours. Now that their incomes match ours, they still are more economical with energy.

Then you must bear in mind that it is typical of the American economy to have 100 million or more automobiles, big in size compared to Europeans, and to have all sorts of household durables. We have, on an average, twice as much household durables as the Europeans and the Japanese. We probably do not have anywhere near such a bigger ratio in cars, but our cars consume on an average 2 to 2½ times as much gasoline. They passed on the higher cost of oil quickly in higher prices, much more than we did.

Senator KENNEDY. How did they pass the prices through? Where did they go?

Mr. BERNSTEIN. Most of the industrial countries added to the increased cost of imported oil by raising the tax on gasoline. We did pass through the higher import price of oil and it was a significant element in the rise of consumer prices. About 1 percent of the 12 percent rise in the Consumer Price Index in 1974 was due directly to the higher prices of oil and energy. If you include the oil and energy used in producing other goods and services, and their higher oil and energy costs, the direct and indirect effect on the Consumer Price Index was about 2 percent. In that sense we passed through the higher cost of imported oil, but not of old domestic oil, to the consumers. In other countries, such as the United Kingdom, they did not simply raise the price of gasoline by the amount of the rise in the price of imported oil. They added an increased tax on top of that.

Mr. MÜLLER. I would like to add something else here on Germany because I think it is important to understand a number of points besides just the relative difference in the Deutsche mark depreciation and the dollar appreciation.

First of all, in 1972 and 1973 one of the big reasons why Germany did not have an inflationary push such as we had is that they had tremendous excess capacity in a number of key industries. They were coming out of a recessionary phase.

Senator KENNEDY. Do we not have that?

Mr. MÜLLER. We, in 1973, were in a boom, as you remember, and were hitting the limits of capacity in this economy. The Germans were just beginning to use up excess capacity.

The second major factor here is——

Senator PROXMIRE. If the Senator would yield. The point, I think Senator Kennedy's point, is that do we not have it now and have we not had it for the last 6 months at a far greater degree of vacant capacity, unused capacity, in proportion to what Germany had?

Mr. MÜLLER. Right.
Senator PROXMIRE. Particularly in respect to manpower but also in respect to facilities.
Mr. MÜLLER. We are talking about an inflationary buildup. What we are experiencing today is due to the last 2 or 3 years. It is not a phenomenon that is taking place now. It is the boom of 1973, a shortage of the capacity that existed at that time that led to this further and put us in inflation. Also the fact that we have crucial kinds of bottlenecks in our economy. Petrochemicals is one, not just oil itself, where we do not have excess capacity and they happen to be in those bottleneck areas, very high inflationary multiplier areas. The Germans do not have that.

The second point about Germany that we should remember besides this historic 1972–73 period is that the Germans recognized roughly 3 months before we did the need for employment stimulation programs. The other point is their unemployment is much less a pressure in terms of the kind of credit policies that they formulate and tax policies because of the large number of foreign workers in those countries. Unemployment first eats away at the so-called Gastarbeiter before it gets to German residents themselves.

Senator KENNEDY. Mr. Müller, or the steps that they took in the Federal Republic, what other kinds of things did they do? Did they do the same things we are talking about here?
Mr. MÜLLER. They took a number of definite taxes as steps way back in the early fall.
Senator KENNEDY. Personal reductions or industry?
Mr. MÜLLER. We are talking about taxes on industry, basically in business.
Mr. BERGSTEN. Both.
Mr. BERNSTEIN. A big increase in expenditures at the Federal level and the State level.
Mr. BERGSTEN. And monetary policy.
Mr. BERNSTEIN. And monetary policy very much easier than it had been.
Mr. BERGSTEN. For the first time in German history, the Bundesbank announced its growth target for the succeeding year. The growth target is in the 6–8 percent range. That compares to a minus rate of money supply growth in the first half of 1974.
Senator KENNEDY. In terms of control of inflation, what can you do to control it, while you are carrying out programs of stimulation to deal with the simultaneous recession?
Mr. BERNSTEIN. I tried to explain why in 1974 our prices rose by 12 percent, and Germany's by 6 percent. I attributed the difference to two points:

First: The deutsche-mark appreciated by 25 percent from January of 1974 to February of 1975. That makes an enormous difference because our import prices in dollars rose 40 percent. Theirs, including oil, probably rose by only 20 percent.

Second: We had a drop in output per manhour productivity by 3½ percent from the last quarter of 1973 to the last quarter of 1974. Now in Germany there was no such drop in productivity. Actually their wages rose more than ours. They rose by about 12 percent. Our wages rose in round numbers by about 10 percent.

Our decline in productivity and the depreciation of the dollar relative to the deutsche-mark account for practically the whole of the difference in the rate of inflation. We had a tight monetary policy. As tight as theirs. We had a fiscal policy which, not by design but by the effect of inflation, brought our deficit in the third quarter of 1974 on a national income accounts basis down to a rate of only $2 billion a year—a rapid change. So we did not really have an easier budget or monetary policy than Germany. We were quite tight. Our greater inflation was due to the two elements I mentioned. The Germans did start by midyear to recognize the change in their economic situation and they did all the things that Fred mentioned.

Mr. BERGSTEN. Germany has carried out a real social contract. Here in the United States and Britain there has been a lot of talk about it: the Germans have done it. The massive wage negotiations just finished in Germany led to very small wage increases; 6.1 percent for the 2.4 million metal workers and 6.8 percent for the public service workers. That was their part of the social contract. The other part has been the very clear, decisive Government measures to stimulate the economy. They have done it while we have talked about it, and it is working.

Mr. MÜLLER. Let me insert here a 6.8 percent wage increase in Germany, that was running 6 percent relative inflation, has to be now looked at in the United States, running a 12 percent inflation. Do not use those percentage ranges across the board.

Mr. BERGSTEN. Except our inflation is now down to much less than 12 percent.

Mr. BERNSTEIN. I am not quite sure what your point is.

Senator PROXMIRE. I would like to follow up for a couple of minutes on some of the things that Senator Kennedy asked about. You were talking about a social contract, Mr. Bernstein, and you talked about wages. You did not talk about prices. The fact is this inflation in 1974 was administered price inflation to a considerable extent. Wage increases were very small. In fact, in real terms they were negative. Price increases are out of this world. The price of steel went up 45 percent. The price of nonferrous metals 40 percent. The price of chemicals, 60 percent. The price of food went up very sharply for the consumer and the farm prices went down. So there were administered prices here. But somehow they are able to escape from any kind of social contract or anything else. I do not know why they did it in Germany. It seems to me that this may well be part of the explanation.

Mr. BERNSTEIN. I was suggesting that considering that, since Germany imports most of the same things we do, plus food, which we do not import nearly as much of, the appreciation of the deutschemark helped hold down the rise of their prices. On top of that, Germany had a better experience with productivity.

Senator PROXMIRE. I am not talking about these macroeffects. I am talking about specific microdevelopments here where you had steel, for example. They testified before us. We had the head of U.S. Steel, Inland Steel, Bethlehem Steel, testify. They admit their cost increases were about 20 percent; 21 percent I think is the precise figure. Their price increased 45 percent. They just used their muscle, their pricing power, to increase their prices very sharply.

Mr. BERNSTEIN. This is undoubtedly true in steel and maybe in automobiles and in other industries.

Senator PROXMIRE. We figure about two-thirds of the wholesale price index could be accounted for because of this kind of price increase.

Mr. BERNSTEIN. Let me consider these figures. You are quite right that wholesale prices of farm products were down. They had nothing to do with the rise in consumer prices last year. As to other goods and services, the 13 percent rise in the implicit price deflator of the private nonfarm output was caused by a bigger rise in unit labor cost. Unit nonlabor costs, including profits and interest, rose less than unit labor costs from the last quarter of 1973 to the last quarter of 1974.

What made this big rise in unit labor cost? The big rise was due primarily to the drop of 3½ percent in output per man-hour. Now when you have a drop of 3½ percent in output per man-hour, there is no way by which real wages can fail to fall. Real wages in the United States, real earnings, fell by a little over 5 percent for the standard workweek. If you take out the change in the hours worked, the Bureau of Labor Statistics gives us the following answer. Eight-tenths of 1 percent of that fall is due to the tax and social security system. The rest is due to the drop in productivity and, I would add, to the higher cost of import goods.

Senator PROXMIRE. The drop in productivity, as you indicated earlier, is just an automatic development whenever you have a slow-down in the economy.

What we had last year for the first time—in all American history it never happened before—an average workweek of less than 37 hours. Even in the depths of the depression we did not have that. In January we went down to 35.7 hours per week.

When you have a situation where employers cannot keep their work force busy, no work for them to do, they are sitting around with nothing to do, under those circumstances productivity drops. The production per hour of paid time obviously is going to decline.

As we pull out of this, as I think you indicated, or one of you gentlemen indicated, as we pull out of the recession and we recover economically, we are going to have some very sharp improvements in productivity. It should be helpful in preventing inflation from asserting itself for some years.

Mr. BERNSTEIN. It is going to have a marked effect. It could be the biggest element in slowing inflation.

Senator PROXMIRE. I agree.

Mr. MÜLLER. I would like to add that the aggregate figures can be somewhat deceptive for other reasons in terms of inflation. No. 1 is the largest profit increases were experienced and those that contributed most to inflation were experienced in the most concentrated industries, and it is relatively unfair to take aggregate figures where we are taking from industries and from sectors that have very, very low inflationary impacts, largely because some of them are very competitive and not to look at the facts separately. Our most important industries are most concentrated, have had the highest impact on inflation. Those are the ones that experience the greatest increase in profits relative to wages; point 1.

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Point 2 is the whole question of productivity, where I agree very much with Mr. Bernstein. And I do not know if you were in the room when we talked about this earlier, but one has to ask the question: Why has there been a deterioration, a secular deterioration in U.S. productivity starting way back in the sixties? And I think one of the fundamental reasons here as compared to Germany, that we got into the game of foreign investment on a wholesale level much sooner than the Germans did. When you start investing and creating capital stock abroad and relatively decreasing new capital stock here, you directly affect productivity of American workers in a negative sense.

The Germans just began their outward expansion in the mid-sixties and accelerated only in the early seventies.

Senator PROXMIRE. Very good.

Gentlemen, I thank you very, very much. This was most helpful testimony. We are very grateful to you.

The committee will stand adjourned.

[Whereupon, at 12:50 p.m., the committee adjourned, subject to the call of the Chair.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, MARCH 12, 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, Proxmire, Kennedy, and Javits; and Representative Brown of Michigan.

Also Present: John R. Stark, executive director; Loughlin F. McHugh and Courtenay M. Slater, senior economists; Richard F. Kaufman, general counsel; William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Jerry J. Jasinowski, L. Douglas Lee, and Carl V. Sears, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. We will continue our hearings on the President's economic program, and the state of the economy.

Our first witness this morning is the distinguished former Chairman of the Council of Economic Advisers, Mr. Walter Heller.

I want you to know, Mr. Heller, we appreciate very much the effort you have made to get here. We know that has not been as easy assignment for you. But we are just now completing the hearings that relate to the Joint Economic Committee's responsibility in analyzing the President's report on the economy. That will be completed this month. We wanted very much to have your testimony before that document was finalized.

So this morning we welcome you to the committee and seek your counsel. I will not keep you waiting any longer. You have other things to do. We look forward to your testimony.

STATEMENT OF WALTER W. HELLER, REGENTS' PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. HELLER. Mr. Chairman, thank you very much.

As your committee exercises its customary leadership—with renewed vigor, I might add—on behalf of decisive action to reverse the slump and sustain recovery, it faces several roadblocks thrown up in the name of prudence and responsibility. They take the form of the following assertions:

First, that the economy will soon bottom out and that self-corrective forces will generate a satisfactory recovery without massive stimulus.

Second, that bold attempts to speed the turnaround and accelerate recovery will sow the seeds of a new round of inflation.

Third, that the deficit of $70 billion or so for fiscal 1976 under the kind of program the committee proposed last Friday will be unmanageable.

Fourth, that budget spending is headed for alarming heights in fiscal 1976.

It is on these grounds that the battle for an adequate—and that means aggressive—program of tax, budget, and monetary stimulus has to be fought. So I shall concentrate my remarks on these issues rather than boring the committee by spelling out yet one more program. Fortunately, I can handle the latter issue by reference to the committee's own statement to the Senate and House Budget Committees last Friday, a statement whose basic tenets and broad program outlines I can heartily endorse.

Just for the record, I might note that for over a year I have favored a tax and budget relief program for the low-income victims of inflation and recession; that I repeatedly expressed alarm in 1974 over the developing recession and urged early preventive action, notably, before this committee last August; and that since December, I have been urging swift enactment of a $20 to $25 billion continuing income tax cut.

HOW DEEP THE SLUMP?

Now let me turn to the first and most basic of the issues listed above; namely, the further course of our sickening slump, the slack it will leave in its wake, and the prospects for recovery. No one any longer denies that we are in a severe slump calling for remedial action. But the same forces of "prudence and responsibility" that glibly dismissed the slide into recession as a shortages blip or sideways waffling now profess to see an early bottoming out and upturn just around the bend. Therefore, they add, let's not overdo stimulus.

Even if the upturn occurs in the next 6 to 9 months, it will be the economic nonevent of 1975—much as the end of the oil embargo was the nonevent of 1974 when compared to the impact of quintupled oil prices. Rather, the critical issue is how strong and how sustained the recovery will be and how much economic slack it will have to absorb.

At the moment, the forces that will turn us around are not clearly in sight. Unwanted inventories have still been piling up in many segments of the economy rather than being worked off swiftly as a prelude to recovery. The housing industry, which so often leads a recovery, is bedeviled by a large backlog of unsold homes, high construction costs, and a shriveling of the real incomes of consumers.

Consumption? The intangible, "consumer confidence," we hear so much about follows the lead of the tangible, "consumer real income." Unless and until that income is bulwarked by tax cuts and carefully targeted budget programs— backed by aggressive rather than grudg-

ing monetary ease—consumer income won't lead and consumer confidence won't follow.

So far, then, there is little to arrest and reverse the economy's sickening slide. I see no sign of the bottoming out that President Ford thought he detected during his recent trip to Florida. The figures I look at suggest that real GNP is still sliding at about a 10-percent annual rate this quarter and will continue to slide at a declining rate into the spring and summer. Whether and how strongly the economy then turns up depends on (*a*) how soon and how clearly the Federal Reserve gets the message that war on recession can now be waged without losing the war on inflation and (*b*) how quickly the Congress enacts tax cuts and budget relief.

It is quite true that the Congress and especially your committee, long before the White House bestirred itself, were alert to the problems of our now 16-month-old recession and the plight of the lower income groups. And it is fair to say that, by traditional standards, Congress has been moving with commendable speed, contrary to a lot of charges that have been made. But traditional standards won't do in the face of the current economic emergency. The Joint Economic Committee is to be applauded for its continuous monitoring of the current economic crisis and for pressing its colleagues in Congress for swift action. The appearances of Chairman Humphrey before the Senate Budget Committee on Friday and the Senate Finance Committee on Monday are significant steps in helping maintain that sense of urgency.

Specifically, the Senate ought not go home for Easter until, as a bare minimum, a hefty tax rebate for individuals—preferably on the House pattern, though somewhat larger in total amount—has been passed. If a continuing tax cut can be passed at the same time, so much the better. Indeed, it should be. But if not, splitting off the one-shot tax cut and then coming back to the continuing tax cut—and percentage depletion—after Easter would make both economic and political sense. I would repeat, it would seem to me, an act of irresponsibility not to have part of that tax cut in place before the Easter recess.

The depths to which the economy is now plunging underscore this judgment. While I do not view this plunge as a depression—indeed, scare talk about depression, like scare talk about deficits, makes for good copy but not necessarily for good policy—neither is it an ordinary recession. From peak to through—that is, from the end of 1973, when unemployment averaged 4.8 percent, to sometime in the second half of 1975, when it will roughly be twice as high—real GNP will have dropped by some 7 to 8 percent—at annual rates—nearly twice the drop in any previous postwar recession—though hardly in the same league with the one-third drop in the Great Depression.

With the economy's potential growing about 6 to 7 percent during those 6 or 7 quarters, a huge GNP gap is opening up. U.S. output is falling 13 percent below potential, even if we define "potential" conservatively—and I am sure the chairman knows that I always take the conservative point of view—in terms of 5-percent unemployment. By a substantial margin, this is the economy's worst performance since World War II. The shortfall, or GNP gap, will reach an unbelievable $200 billion or more at annual rates during 1975.

The counterpart in unemployment will be a peak rate of 9½ to 10 percent. It is true that the February rate held steady at the January rate of 8.2 percent—but only at the grievous cost of 580,000 discouraged workers dropping out of the labor force. This is clearly an instance where the steadiness of the unemployment rate is cause, not for complacency or optimism, but rather for dismay and alarm.

One hopes that the grim numbers will jar into action even those implacable inflation foes who have regarded the unemployed more or less as statistical cannon fodder in the war on inflation. We are hearing all too much about "unemployment will hit only 10 percent of the labor force, but inflation hits everyone." Not only is that statement wrong: When unemployment reaches 10 percent, it hits about 30 percent of the labor force sometime during the year. It is also misleading: We are already far beyond the point where a cutback in unemployment comes at the expense of a boost in inflation. At this stage of the game, economic recovery will bring (*a*) short-term relief in the battle against inflation by triggering a new surge in productivity and thereby cutting costs, and (*b*) help in the long-term battle against a resurgence of inflation by boosting the flow of savings and restoring the will to invest in plant and equipment that is vital to breaking the bottlenecks in our primary processing industries, and those are the ones that plagued us in the 1973 inflationary outbreak. Another way of putting this point: We have already pushed recession and unemployment far beyond the point of diminishing returns—probably even beyond the point of no return—in the war against inflation.

In the light of the huge human losses, production losses, and capital losses that this worst of recessions is now inflicting on us, what's holding us back? Why isn't a huge antirecession program roaring through Congress? The question brings us to the inflation, deficit, and budget fears that are, if not intimidating, at least inhibiting Congress in its fiscal actions to reverse the recession and restore prosperity.

INFLATION FEARS

Two questions confront us on the inflation front: First, how rapidly is the current wave of inflation subsiding? Second, how likely is it that a major offensive against recession will touch off a new upsurge of inflation?

By and large, the portents are highly encouraging. All three forces that fastened this monstrous inflation on us in 1973–74 are abating in 1975:

Excess demand has long since disappeared and will be years in reappearing.

External-shock or commodity price pressures, the villains that caused two-thirds of the 1973–74 inflation. One can attribute only about one-third to the traditional causes, excess demand or cost push. Exploding commodity prices, especially of oil and food, together with devaluation accounted for two-thirds of the 1973–74 inflation. These pressures are easing rapidly.

Cost-push pressures are weakening under the hammer blows of massive unemployment, declining interest rates, and business belt-tightening.

First, before the Congress allows fears of renewed demand-pull inflation to stay its hand on large tax cuts, it should recall that the 1964

tax cut of $12 billion, which translates into a $26 billion tax cut in terms of 1975 GNP, was enacted at a time when the economy was running only 7 percent below its potential calculated at 4 percent unemployment. In 1975, the projected shortfall is 13 percent, calculating potential at that more conservative level of 5 percent unemployment. Yet, in 1964–65, as recovery accelerated and unemployment dropped steadily, inflation crept up to less than a 2 percent annual rate by August of 1965, when war in Vietnam was escalated. Today, with inflation ebbing rapidly, with the economy still sinking, and with nearly twice as much slack in the economy as in 1964, it would be both fallacious and foolish to deny ourselves the tax cuts, budget relief, and monetary stimulus that can lift us out of the deepening morass in which we are mired.

It seems hard to believe that anyone could look at the distressing numbers that pinpoint the vast underutilization of the economy's human and material resources and still fear demand-pull inflation:

Let's start with the optimistic assumption that the GNP gap is only 12 percent of GNP at the beginning of 1976. I say "only" because some calculate it at 13, 14, and 15 percent.

Next, factor in a 4 percent annual growth in GNP potential—a conservative number in light of the new Morgan Guaranty survey analysis that pegs the rate at 4.4 percent, consisting of a 2.0 percent annual growth in the effective labor force and a 2.4 percent annual increase in output per worker.

Next, assume that stimulative policy measures boost the actual growth of the economy to an 8 percent rate starting in 1976. It would be the end of 1978 before the GNP gap was closed and the economy returned to 5 percent unemployment. If we manage only a 7 percent average rate of expansion, it would take 4 years—that is, until 1980—to return to 5 percent unemployment. That is under a considerably more stimulative program than the Ford administration is proposing. So they appear to be willing to settle for a long period of unemployment and underutilization of our great capacity.

Thinking small about fiscal-monetary policy in the face of such enormous economic slack would unnecessarily condemn millions of workers to prolonged unemployment and boost the GNP loss incurred in the fight against inflation during the seventies to well over $1 trillion. I believe the chairman of the committee estimated it could even run as high as $1.4 trillion.

Chairman HUMPHREY. Under the projections in the budget message. Under the projections made by the OMB.

Mr. HELLER. Right.

Turning, second, to the external-shock inflation arising in 1973–74 out of skyrocketing commodity prices and devaluation, one finds the skies rapidly clearing:

Most of the food and fuel price explosions—subject only to new petroleum taxes—will have worked their way through the economy by midyear.

Further erosion of the dollar on international exchanges may give inflation a small push, and I mean really small, but it will certainly be minor compared to the $10 to $12 billion boost in prices of imports attributable to devaluation in the past 2 years or so.

Sensitive commodity prices have come down between 25 and 30 percent in the past 3 months. When I say sensitive, I should add I spoke to an agricultural group in Kansas City yesterday, and they are mighty sensitive to the income side of that, however encouraging it may be to the consumer on the price side.

Food prices are destined to drop a bit in the second half of 1975 if crops are normal.

The consumer price index has already eased from a record rise—at annual rates—of 14 percent last summer to about 7 percent in January. I think people are overlooking the fact we have already cut the inflation rate in terms of the cost-of-living by half in the past 6 months or so.

All of this is not to suggest that commodity prices are about to fall below their pre-1973 levels. The worldwide commitment to full employment and a better life, the pressures of rising population and aspirations, and the dwindling of our low-cost resource inheritance will all put upward pressure on the prices of primary materials over the longer run. Thus, however strongly the ebbtide of prices is now running, we may find the ocean level gradually rising. But this calls for longer term structural measures and a greater emphasis on advance planning rather than a curb on short-run expansionary monetary and fiscal measures.

Third, won't the feared wage explosion upset the applecart? Let me offer two quick and hopeful observations on this front: In spite of such spectacular settlements as those in coal and oil, the rate of increase in average hourly compensation in the economy as a whole has not risen into the double-digit range; with woefully weak labor markets inhibiting wage rate increases—especially for that part of the labor force that falls outside of the 25 percent or so that is strongly organized—a dropoff in the rate of increase to 7 or 8 percent in average hourly compensation by the third or fourth quarter of 1975 is a reasonable expectation.

These favorable developments led me and my associate, George Perry of Brookings, early in January to project a 5 percent or lower inflation rate during the second half of 1975. Since then, we have had to yield our position at the end of the limb to economists of the First National City Bank, who assert that: "It is not unrealistic to expect inflation to fall back into the 3–4-percent range by the second half of this year."

DEFICIT FEARS

With the evidence mounting almost daily that the hot blasts of inflation are rapidly cooling off, the advocates of a go-slow and think-small posture on economic stimulus are turning to fears of the disruptive and distortive effects of huge budget deficits as the basis for their counsel of caution. The likely $70 to $75 billion deficit for fiscal 1976, it is said, will shoulder aside private borrowing, boost interest rates, and generate new fuel for inflation.

Since I have explicitly considered these points in a recent article entitled "Deficit: Where Is Thy Sting?", from the Wall Street Journal, March 7, 1975, I respectfully submit that article for inclusion in the hearing record as an attachment to this statement.

Chairman HUMPHREY. It will be so printed.

Mr. HELLER. Thank you.

Let me quote here just two excerpts that are particularly relevant to my testimony today:

For clear thinking, the Congress and the country should divide the budget deficits into two parts: Type A, the passive deficits generated by the negative effects of recession and slack on the budget. Type B, the active deficits generated by positive fiscal actions—tax cuts and budget boosts—to combat recession and take up economic slack.

The President's budget is referring to Type A deficits when it says, "If the economy were to be as fully employed in 1976 as it was in 1974, we would have $40 billion in additional tax receipts, assuming no change in tax rates, and $12.7 billion less in aid to the unemployed. "This $53 billion is the mirror image of the deficit in output and jobs.

The quickest way to shrink and eventually end such Type A deficits is to incur Type B deficits via swift and bold tax cuts and budget hikes that will get the economy expanding again. Indeed, while such fiscal stimulus will temporarily enlarge the deficit—to perhaps $70 billion in fiscal 1976—it will also pay such large dividends in rapidly rising revenues that it will produce a smaller aggregate deficit for the 1970's than would a more timid program.

In short, the Congress can prudently proceed with a strong program to reverse the recession and revive the economy. No fears of unmanageable deficits or imminent inflation need stay its hand. This is not to say that financing the deficit will be simple nor that it will be accomplished without a pinch here and a bind there. But sources ranging from impeccable to unimpeachable seem to agree that, with a responsive Federal Reserve, the huge deficit can be managed at low interest rates, with little displacement of private investment, and without rekindling inflation.

Mr. Chairman, it struck me as extremely interesting that while Secretary Simon has been sounding alarms about the deficit, one of his staff members, Sally Ronk, spoke to the National Association of Business Economists a couple of weeks ago and went through an analysis, suggesting that the prospective deficit—and I do not believe I am overinterpreting her—was quite manageable, given the prospective flows of credit, both the supply side and the demand for credit in the next couple of years.

Chairman HUMPHREY. What is the date of that statement?

Mr. HELLER. February 26. She is a financial economist with the Office of Debt Analysis, and this was a talk before the National Economists Club on that date.

Chairman HUMPHREY. We will get that and place that in the record at this point in your testimony, so that we have continuity of this discussion.

Mr. HELLER. I think you will find it of substantial interest.

[The statement referred to follows:]

FLOWS OF FUNDS IN RECESSION AND RECOVERY

(Remarks by Sally S. Ronk, Financial Economist, U.S. Treasury Department, Before the National Association of Business Economists, Washington Chapter, and the National Economists Club, Washington, D.C., Feb. 26, 1975)

The big question on many minds, ever since the Budget and the Economic Report were unveiled three weeks ago, is how the prospective deficits are going to be financed without either (1) driving up interest rates or (2) reviving inflation. I have addressed myself to that question by preparing a flow of funds forecast based on the economic outlook projected in the Economic Report and on the Treasury and Federal agency financing contained in the Budget. The attached tables showing my flow of funds projections are on a fiscal year basis. This serves to pinpoint the magnitude of the problem over the coming period when the brunt of the recession-induced deficits will be felt. Presumably, by the second half of the calendar year 1976, the economy will have revived and Treasury receipts will be beginning to pick up strongly.

The first observation one may make concerning the projections in the tables is that in the current fiscal year—fiscal 1975—private demands for funds are falling off sharply. Thus, even though Treasury demands are skyrocketing, total demands for funds are declining by an estimated 15 percent. The biggest reduction is, of course, in business loans from the commercial banks; business loan demands slackened noticeably last fall and have sloughed off week by week so far this year. If the inventory liquidation in sight materializes, it may be anticipated that business loan demands will be dampened even further in the period ahead. Other types of business borrowings, except those from the U.S. Government, are also dropping back noticeably. At the same time, consumer credit is still being liquidated. According to my projections, total short-term credit demands will decline from $94.4 billion in fiscal 1974 to $35.2 billion in fiscal 1975.

Total government demands for credit are projected as rising from $40.2 billion in fiscal 1974 to $77.4 billion in fiscal 1975. This rise would be even greater if it were not for the fact that Federal agency borrowings, which include GNMA pass-throughs as well as Budget and sponsored agency isues, will probably be substantially smaller in fiscal 1975 than in fiscal 1974, as the Federal Home Loan banks retire debt during the current half year period. In all, during fiscal 1975 the increase in demands by government will fall short of the reduction in short-term demands by some $22 billion.

On top of that, long-term credit demands, in total are estimated at some $12 billion less in fiscal 1975 than in fiscal 1974. True, corporate bond borrowings are surging, but mortgages—which still make up the larger part of demand in the long-term credit markets—have been registering smaller and smaller increases for the past two years. The mortgage market is now probably bottoming out at an annual rate of increase in mortgages outstanding of about $42½ billion, compared to the peak rate of increase of over $80 billion in the second quarter of 1973. However, any revival in the mortgage market is likely to proceed slowly, since the savings institutions are expected to utilize a large portion of their renewed savings inflows to pay off debt and rebuild liquidity.

Similarly, the disarray in the stock market has brought the net new issuance of stocks virtually to a halt; over the past half year, July–December 1974, net new issues amounted to only $1.2 billion, compared with peak annual rates of $13–$14 billion three years ago. A much longer period of gain in the stock market than we have witnessed recently will probably be required before there is much strength in the new equity issues market.

This slackening in demands from the private sector during the 1975 fiscal year is currently being accompanied by improving savings inflows and a more expansive credit policy. The rate of expansion of bank credit was exceptionally low during the July–December 1974 period, and, even after the substantial step-up anticipated for the rate during the current half year, the rate for the entire fiscal year 1975 is estimated at a relatively low 7.5 percent compared with the 17 percent and 14 percent rates of the two previous fiscal years.

In sum, on the supply side of the equation, the major suppliers, i.e., savings institutions and commercial banks, have the funds available to absorb the amount of credit instruments demanded. Over the current half year, with demands for funds—except from the Treasury—still on the low side, the funds are available to finance the huge demands from the Treasury.

One indication that the problem in financing the Treasury's demands in the current half year will be mainly temporary and technical, and connected with the timing of issues rather than with saturation of the market, is the size of the residual on the supply side. During fiscal 1974, when funds were tightening up and the markets were under the pressures of heavy demands and restricted supplies, residual buyers of credit instruments—the household and non-profit sectors—were called upon to step up their purchases to the unusually high level of $23.4 billion. It is necessary for interest rates to rise sharply above customary levels in order for residual holders to be induced to make heavy direct purchases in the credit markets, and, as we all know well, the outcome was spectacular. The current period, according to my projections, is one during which residual holders will not, on balance, be net buyers of credit instruments; even though they will probably show net purchases of Treasury securities, their takings of other securities and credit instruments will probably be curtailed drastically.

But one may ask, is not the current period one representing the depths of a recession? What about the situation in fiscal 1976 when private credit demands revive and Treasury borrowings are still mounting? The economic assumptions in the Budget and Economic Report do not suggest a strong rebound in real growth, while at the same time, the rate of price increases is expected to be slackening (after the boost given prices by the oil import levy in calendar 1975). However, because of the depressed level of activity in calendar 1975, the growth of current dollar GNP in calendar 1976 is estimated at 12.6 percent. This represents the dimensions of the extra activity that will need to be financed in the credit markets.

For fiscal 1976, Treasury borrowings, which include borrowings to finance the lending activities of the Federal Financing Bank, are estimated at $63.7 billion in the Budget, while Federal agency financing will subside further to $14.7 billion. Even under the asumption that state and local government borrowings will virtually level off from fiscal 1974 to fiscal 1976, borrowings by government at all levels in fiscal 1976 will reach a whopping total of $95.4 billion, up $18 billion from fiscal 1975's unprecedented total of $77.4 billion.

At the same time, mortgage and short-term credit demands—the laggards currently—will undoubtedly pick up. The question is how strongly? For the mortgage market, I am in the camp that believes that the large overhang of housing inventory will inhibit the spurt in housing starts that usually follows the resumption of savings inflows to, and shoring up of liquidity positions of, the thrift institutions. Consequently, my projection for starts calls for only about a 1.3–1.4 million annual rate late in calendar 1975 and an average of 1.6–1.7 million during the first half of calendar 1976. This would bring the net new volume of mortgages issued only part way back to the fiscal 1974 total, which itself was considerably below the fiscal 1973 total.

Concurrently, in fiscal 1976, corporate bond offerings will probably begin to diminish, although the level will probably remain historically high. Even though their external requirements for funds for plant and equipment and inventories still remain relatively low, corporations will probably maintain a relatively high level of long-term borrowings in order to continue to increase their net working capital and liquidity positions. However, net new stock issues, which are currently almost nonexistent should begin to pick up. In all, long-term borrowings are projected as rising by nearly $12 billion, or 15 percent, in fiscal 1976.

The volume of short-term credit issued in fiscal 1976 should show an even stronger revival than long-term funds, if only because the fiscal 1975 level is so weakened. While business borrowings from the banks will probably strengthen from their current slack, a fairly substantial reversal will be required to bring the 1976 fiscal year's total above the level of fiscal 1975; this is because the current half year's flattening in bank loans to business was preceded by a period of moderate growth during the first part of fiscal 1975. With other types of business borrowings—open market paper, finance company loans and government and agency loans—still soft, total business borrowings will probably show a levelling off rather than an increase during fiscal 1976. Nevertheless, with consumer credit demands beginning to revive and security credit turning around, a strong—25 percent—increase in total short-term funds is projected for fiscal 1976. Thus, at the very time when Treasury demands are peaking, virtually all sectors of the credit markets will be under greater pressures from demands.

The crucial question is, will this confluence of stronger demands place the credit markets under undue strain so that rising interest rates will again be necessary in order for the demands to be financed?

The projections which I have made for the supply side foresee continued growth in savings flows in fiscal 1976, but not the very strong revival that we have witnessed in past post-disintermediation periods. Bank credit, on the other hand, should increase smartly as the Federal Reserve's easing process continues and takes hold. The projected expansion of $51 billion for commercial bank credit in fiscal 1975 will come only if there is a large increase during the current—January–June 1975—period since there was a virtual halt in the growth of bank credit during the latter half of calendar 1974. For fiscal 1976, I have projected an increase in bank credit of $75 billion, which is considerably below the $88 and $82 billion increases, respectively, in fiscal 1973 and 1974. Such an increase would represent a 10.2 percent rate of growth, which compares with 7.5 percent in fiscal 1975.

My assumptions also include fairly strong foreign investment in the United States—$16.8 billion in fiscal 1975 and $17.4 billion in fiscal 1976—but these would still be below the record levels of fiscal 1971 and 1972.

These projections suggest that the enhanced volume of funds to be raised in fiscal 1976 may be financed without much call on residual investors. In other words, the credit markets may be in position to absorb the financing without undue upward pressure on interest rates. Thus, there is reason to expect that interest rates will continue to decline through late this year and that thereafter there may be only moderate rises, unless the Federal deficit situation should worsen.

TOTAL FUNDS RAISED IN U.S. CREDIT MARKETS, FISCAL YEARS

[In billions of dollars]

Funds raised	1972 (actual)	1973 (actual)	1974 (actual)	1975 (estimated)	1976 (projected)
Long-term funds:					
Mortgages:					
Home	34.6	44.9	37.0	26.7	34.2
Multifamily	9.2	10.8	7.3	6.6	7.5
Commercial	12.7	16.7	16.6	7.3	8.0
Farm	2.5	3.4	4.4	5.1	5.2
Total	59.0	75.7	65.2	45.7	54.9
Corporate securities:[1]					
Bonds	21.7	15.4	17.4	28.6	26.9
Stocks	14.3	12.2	7.1	3.3	7.5
Total	36.0	27.6	24.5	31.9	34.4
Total long-term funds	95.0	103.3	89.7	77.6	89.3
Government securities:					
U.S. Government	19.6	18.5	2.1	43.9	63.7
Federal agencies	8.7	14.4	21.3	17.6	14.7
State and local governments	15.6	12.6	16.8	15.9	17.0
Total government securities	43.9	45.5	40.2	77.4	95.4
Short-term funds:[2]					
Business credit:					
Open market paper	2.9	1.6	15.0	10.0	4.0
Bank loans	11.2	40.9	40.5	10.6	14.0
U.S. Government loans	.3	.9	1.1	6.2	3.6
Federal agency loans	−.7	6.3	8.1	3.8	−.7
Other[3]	5.1	3.6	4.9	−5.6	2.7
Total	18.8	53.3	69.6	25.0	23.6
Consumer credit	14.5	23.3	16.3	1.7	7.0
Security credit	9.0	−3.2	−3.3	−4.0	1.0
Foreign loans:					
Banks	4.5	7.5	8.4	7.5	5.0
U.S. Government	1.1	2.1	1.5	1.6	2.9
Total	5.6	9.6	9.9	9.1	7.9
Other loans:					
Banks	2.3	1.7	−1.4	−1.8	.4
U.S. Government	.6	.6	.6	2.7	3.0
Policy loans	1.0	1.2	2.7	2.5	1.4
Total	3.9	3.5	1.9	3.4	4.8
Total short-term funds	51.8	86.5	94.4	35.2	44.3
Total funds raised	190.7	235.3	224.3	190.2	229.0

[1] Including foreign securities.
[2] Including bank term loans and long-term Federal credits.
[3] Finance Company loans to business and security RPs.

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, Feb. 21, 1975.

TOTAL FUNDS SUPPLIED IN U.S. CREDIT MARKETS, FISCAL YEARS

[In billions of dollars]

Funds supplies	1972 (actual)	1973 (actual)	1974 (actual)	1975 (estimated)	1976 (projected)
Savings institutions:					
Contractual-type:					
Life insurance companies	13.1	14.3	16.4	15.7	17.2
Private pension funds	6.4	6.9	7.0	9.4	10.0
State and local retirement funds	6.5	8.8	9.3	12.1	12.0
Fire and casualty insurance companies	6.5	6.2	4.7	4.4	5.0
Total	32.5	36.2	37.4	41.6	44.2
Deposit-type:					
Savings and loan associations	31.0	38.4	22.1	18.0	30.0
Mutual savings banks	10.3	8.6	3.7	3.0	7.0
Credit unions	3.0	3.0	2.4	2.7	2.5
Total	44.3	50.0	28.2	23.7	39.5
Other:					
Investment companies	-.2	-2.8	-1.3	1.9	2.0
Real estate investment trusts	3.9	4.8	3.0	-.2	
Total	3.7	2.0	1.7	1.7	2.0
Total savings institutions	80.5	88.2	67.3	67.0	85.7
Banking:					
Federal reserve banks	7.0	4.0	7.4	7.8	9.0
Commercial banks	57.8	88.0	82.0	51.0	75.0
Total banking	64.8	92.0	89.4	58.8	84.0
Business:					
Nonfinancial corporations	7.2	6.6	.85	2.2	4.0
Finance companies	5.8	12.2	6.8	1.1	2.0
Security brokers and dealers	3.7	-1.7	-1.3	-.7	2.0
Nonfarm noncorporation business	.6	1.2	1.0	1.4	1.1
Total business	17.3	18.3	15.0	4.0	9.1
Government:					
Federal Government	1.9	2.3	3.7	15.6	12.3
Federal agencies	7.5	12.1	21.2	19.1	15.8
State and local governments	1.7	.3	1.8	6.1	1.5
Total government	11.1	14.7	26.7	40.8	29.6
Foreign	18.1	13.3	2.5	16.8	17.4
Households (residual)	-1.1	8.8	23.4	2.8	3.2
Total funds supplied	190.7	235.3	224.3	190.2	229.0

Source: Office of the Secretary of the Treasury, Office of Debt Analysis, Feb. 21, 1975.

BUDGET FEARS

Mr. HELLER. Finally, as to budget fears, another misconception abroad in the land is that the President's fiscal 1976 budget represents a quantum jump over 1975 and that any substantial addons would "bust the budget." Without dwelling at any length on this charge, I want to underscore what the committee already knows: Far from being a quantum jump, Mr. Ford's budget would increase spending just 8½ percent if one adjusts it by taking out (*a*) the $7 billion of energy tax paybacks that, given the demise of the misguided White House energy program, won't be needed, and (*b*) the increase in unemployment insurance payments—which will rise another $4 billion in fiscal 1976 after having jumped $8 billion in fiscal 1975.

This 8½ percent increase just barely keeps up with the year-over-year increase in prices applicable to fiscal years 1975 and 1976.

Comparing the Ford proposals for fiscal 1976 with the estimated 1975 outlays—after taking out the energy paybacks and the rise in unemployment payments—the increases come to 11.3 percent for defense, 9.3 percent for income security, 6 percent for health, 3 percent for revenue sharing, and zero for education, manpower, and social services. Those are not buffered against inflation at all, whereas the military budget is not only buffered against inflation, but provides for a real increase.

Fourth, as a proportion of GNP, Federal outlays in 1975–76 are programed at about the same percentage as they were in 1968 and 1953, right around 21½ percent.

If the economy can be restored to reasonably full employment, the President's budget shows that Federal receipts under current law would increase from $284 billion in 1975 to $517 billion in 1980 and that even with steep expenditure increases and some downward adjustment in taxes, there would be a potential surplus, or budget margin, of $25 billion in 1980. That is under his unemployment assumptions, which I think are too pessimistic.

Against this budget background, the sizable increases demanded by the combination of humanitarian and antirecession needs can safely be undertaken. Such actions as rejection of the 5 percent cap on the social security benefit payments, expansion of the emergency public service jobs program, and major antirecession grants distributed to State and local governments in direct ratio to the incidence of unemployment can readily and responsively be undertaken by the Congress. Indeed it would be economically and socially imprudent not to undertake them.

CONCLUSION

I have not undertaken to deal with the energy program in this already lengthy statement. Suffice it to say that the kind of compromise that seems to be shaping up—combining a gradualist approach that won't accelerate both recession and inflation—as the President's program would have—yet will be tough enough to cut back the use of oil, especially in the form of gasoline, has much to commend it. Assuming that a stairstep increase in the gasoline tax, say, to 30 cents a gallon is put into effect in the next few years, Congress should be sure (*a*) to buffer the impact on low-income groups and (*b*) to match the income and outgo in such a way as not to retard recovery.

SPEED PAYS

For the antirecessionary program as such, three points arising out of the foregoing statement should be underscored in closing: The sooner the tax cuts and budget reliefs are put on the books, the faster recovery will take hold and the faster it will pay off not only in more jobs and higher GNP, but rising revenues and falling deficits. If any convincing on this score is needed, one should recall that under the stimulus of the big 1964 tax cut, tax revenues exceeded their former levels within a year, by 1965, and resulted in a significant budget surplus just before Vietnam escalation struck. Professor Burress will cite this in his testimony.

SIZE PAYS

To reverse the recession, reduce unconscionably high unemployment, and narrow and eventually close the staggering gap between actual and potential GNP, the Congress and the White House not only have to act fast but think big.

I am convinced that rapid action will result in lower deficits because the faster we get going the more rapidly revenues will be flowing into the Treasury.

In an economy with a $1.6 trillion potential, and with inflation waning, this is no time for Members of Congress, or the Federal Reserve System, or the White House to be "men of little faith" or "women of little faith" in the U.S. economy.

HUMANENESS PAYS

In the debate on tax cuts and easier money, it is high time to stop the scaremongering about the inflationary tinder and focus on the human tinder we have already thrown into the streets. With inflation ebbing rapidly, the danger of a renewed price upsurge lies years away. But with unemployment mounting by leaps and bounds, the danger of renewed human despair and social unrest lies dead ahead.

Thank you.

Chairman HUMPHREY. Thank you very much, Mr. Heller, for a statement that is both provocative and encouraging to us.

[The attachment referred to in Mr. Heller's statement for the record follows:]

[From the Wall Street Journal, Mar. 7, 1975]

DEFICIT: WHERE IS THY STING?

(By Walter W. Heller)

As the Senate tackles tax cuts to fight recession and the Congress outsiders budget relief to succor the victims of inflation and unemployment, the legislators are being bombarded with dire warnings that the resulting deficits will crowd out private borrowing, push up interest rates and rekindle inflation. Lest they be unduly inhibited or even intimidated by this barrage of scare-talk about unmanageable and inflationary deficits, let them bear in mind four central facts.

First, the very forces of rampant recession that make tax and budgetary stimulus so imperative are the forces that open up a yawning financial gap for the deficit to fill. The deeper the plunge of the economy, the greater the shrinkage of private outlets for savings in the form of corporate borrowing, mortgages and consumer installment debts. In an economy running $175 billion below its potential, the deficit will help fill the void, not elbow out private borrowing.

Second, for clear thinking, the Congress and the country should divide budget deficits into two parts:

—Type A, the passive deficits generated by the negative effects of recession and slack on the budget.

—Type B, the active deficits generated by positive fiscal actions—tax cuts and budget boosts—to combat recession and take up economic slack.

The President's budget is referring to Type A deficits when it says, "If the economy were to be as fully employed in 1976 as it was in 1974, we would have $40 billion in additional tax receipts, assuming no change in tax rates, and $12.7 billion less in aid to the unemployed." This $53 billion is the mirror image of the deficit in output and jobs.

The quickest way to shrink and eventually end such Type A deficits is to incur Type B deficits via swift and bold tax cuts and budget hikes that will get

the economy expanding again. Indeed, while such fiscal stimulus will temporarily enlarge the deficit—to perhaps $70 billion in fiscal 1976—it will also pay such large dividends in rapidly rising revenues that it will produce a smaller aggregate deficit for the '70s than would a more timid program.

Third, Congress can and should look to the Federal Reserve to accommodate the large deficit just as it has in past economic slumps. The White House clearly does so, as this passage from the President's Economic Report makes clear:

"One way of preventing significant displacement of private investment in a substantially underemployed economy would be to increase the rate of money supply growth to reduce federal financing pressures. Under such conditions, an increase in monetary growth need not be inflationary in the short run, especially if there is a large unsatisfied demand for liquidity."

In other words, in an economy that has fallen so far from the grace of full employment, the Fed can safely generate the bank reserves and expanding money supply required to ward off rising interest rates and crowding out of private borrowers. And having provided liquidity for today's dehydrated economy, it will have plenty of time to sop up any excess funds before the economy again nears the inflationary danger zone of full employment.

A REMOTE THREAT

Fourth, just as the swift slide into deep recession makes the return to high-pressure prosperity a distant prospect, so the rapidly dwindling price pressures make a resurgence of inflation a remote threat. In the face of a $175 billion shortfall of aggregate demand, falling commodity prices and the massive unemployment that is defusing a feared wage explosion, the hot blasts of inflation are turning into a warm breeze. Early in the year, under the prodding of my colleague George Perry of Brookings, I ventured the far-out forecast that inflation would ebb to a 5% rate before the end of 1975. But now our position at the end of the limb has been preempted by the economists of the First National City Bank who assert that "it is not unrealistic to expect inflation to fall back into the 3% to 4% range by the second half of this year."

Since the burden of proof that the fiscal problem is manageable has strongly been shifted by the creators of the problem to their critics, let me elaborate on each of the foregoing points.

On the first, namely that the recession is drying up credit demands in the private sector and thus freeing funds to finance the Treasury deficit, one quickly finds supporting evidence in both the global and sectoral flow-of-funds figures. For example, the most recent Salomon Brothers' analysis shows total net demand for credit shrinking from $185 billion in 1973 to $163 billion in 1975, even with a jump of $31 billion in federal (including agency) borrowing. Total business and household credit demands are estimated to shrink from $150 billion in 1973 to $95 billion in 1975. Bearing in mind that a fully functioning economy in 1975 could have produced a $200 billion supply of credit, one may conclude that a federal deficit considerably larger than $50 billion could be accommodated without unbearable strains in 1975.

The Morgan Guaranty Survey for February, after carefully matching shrunken private credit demand and expanded Treasury needs (even if these run to $60 billion in calendar 1975) concludes that "the interplay of steep declines in economic activity and easing monetary policy affords latitude for an orderly matching of the supply and demand for credit during 1975. As this process unfolds, the near-hysterical whoops in some quarters of an impending financial crunch should subside." Amen!

Turning, second, to the salubrious effect of economic expansion on the federal deficit, one should bear in mind the following numbers:

—Under present tax rates and transfer programs the federal revenues at full employment would run about $20 billion to $25 billion ahead of expenditures in 1975.

—For every $10 billion narrowing of the $175 billion GNP gap, federal revenues rise by about $3 billion and transfer payments shrink by about $1 billion—a handsome return on the investment in expansionary fiscal policy.

—The $12 billion tax cut in 1964 (which translates into a $25 billion tax cut today) more than paid for itself by 1965, and, indeed, had produced enough economic expansion to generate a surplus in the federal budget by mid-1965 prior to the Vietnam escalation.

On the third point relating not just to the Federal Reserve's unquestioned ability but to its willingness to accommodate a vigorous attack on recession,

one can truly say that the Fed has hardly begun to fight. True, the plummeting demand for credit has pulled short-term rates down dramatically. But its efforts to inject funds into the economy and help stem the tide of recession have been too feeble to register on the M-1 seismograph in recent months. The most optimistic reading of this failure is to assume that the Fed will practice "percentage averaging" and allow itself at least a spell of the 8% to 10% growth rate in money supply that ought to be standard procedure in an economy cursed by the deepest and longest recession since the Great Depression and blessed by waning inflation.

Just a word to those who feel that all our policy instruments are tilted in an inflationary direction: Rest assured that the Federal Reserve, with its chronic allergy to inflation reinforced by searing memories of its untimely expansiveness in 1968 and 1972, will be a trigger-happy guardian at the gates of inflationary hell as economic recovery takes hold. One is reminded of Justice Holmes' dictum that "the power to tax is the power to destroy" and Justice Brandeis' rejoinder, "Yes, but not while this court sits." As the Federal Reserve gingerly shifts from the brake to the accelerator, apprehensive of the inflationary legacy it might leave, it would do well to bear in mind that "the power to expand the money supply may be the power to destroy price stability—but not (necessarily) while the Federal Reserve Board sits."

AN HISTORICAL NOTE

On the fourth point, the evidence that the inflationary tide is going out is mounting month by month. As an historical note, one should mention that the Ford energy program would have reversed that tide by tacking three percentage points onto the inflation rate. But the Congress will not let that happen.

In a rather curious switch, White House spokesmen are more pessimistic on inflation forecasts than most private forecasters. Yet with sensitive commodity prices off nearly 30% in the past three months, with food prices destined to drop if crops are normal with woefully weak labor markets holding average earnings increases below double-digit levels, and with the Consumer Price Index already easing from a record rise (at annual rates) of 14% last summer to about 7% in January, it it hard to see what will keep inflation from dropping to 5% or below in the second half of 1975.

As an added starter, let me bring in a fifth point in the form of a question: Wherein lies monetary prudence and fiscal responsibility? Was it prudent and responsible (a) to press monetary tightness and fiscal toughness to the point of plunging the economy into a near-depression, and (b) brush aside those of us who sounded recessionary alarms with soothing reassurances that the economic slide was a mere "energy spasm" or "phantom recession," or "sideways waffling"?

The same disciples of "prudence" and "responsibility" who overstayed tightness and overdid toughness are now counseling caution and urging the Congress to think small on tax and budget policy lest it plunge us into financial perdition and inflationary ruin. But the country would pay a heavy price in prolonged stagnation and stubborn deficits if Congress made the mistake of identifying prudence with timidity and fiscal discipline with niggardly tax cuts and budget parsimony.

In short, the Congress can prudently proceed with a strong program to reverse the recession and revive the economy. No fears of unmanageable deficits or imminent inflation need stay its hand. This is not to say that financing the deficit will be simple nor that it will be accomplished without a pinch here and a bind there. But sources ranging from impeccable to unimpeachable seem to agree that, with a responsive Federal Reserve, the huge deficit can be managed at low interest rates, with little displacement of private investment and without rekindling inflation.

Dr. Heller is Regents' Professor of Economics at the University of Minnesota and former chairman of the Council of Economic Advisers under Presidents Kennedy and Johnson. He is also a member of the Journal's Board of Contributors, five distinguished professors who contribute periodic articles reflecting a broad range of views.

Chairman HUMPHREY. Mr. Heller, I want to mention in reference to the statement of Sally Ronk, she has testified before this committee

in the past, when she was in private employment, and her analyses of the market conditions have been most helpful to the committee and we have considered her to be a very able and competent witness and expert in these areas. So we are very grateful for your bringing her statement to our attention.

I just have a few questions to start this round of questioning with you. I wanted to come back to the tax question because this is right on the front burner now.

As you know, this morning the Senate Finance Committee hearings are still underway. As you indicate, I did testify before that committee this week. You say that you have been urging swift enactment of $20 to $25 billion of continuing income tax cut. I gather that is over and beyond any rebate?

Mr. HELLER. That is correct. I would say that the $8 billion rebate proposed by the House is certainly on the right pattern. I would even feel that given the severity of the slump and the fact that it is getting worse every day and the farther we slide down that slope the more rope we have to throw out, that immediate tax cut ought to be larger. I think it would be entirely responsible for the Senate to enlarge that to $10 or $12 billion and on a continuing basis to bring in a $20 to $25 billion cut. That is entirely within the range of capability for our economy to respond to with no more than an inflationary ripple. I think we have so much unused capacity in the economy and with commodity prices coming down, as I say, I do not believe we have any fears there.

I think it is worth noting that inflation, itself, has sort of usurped the congressional legislative function, because inflation has "legislated" a very sizable increase in tax rates in the past 2½ years of inflation. Probably there are different calculations, and this committee, I am sure, has heard some, but I would say, when you take this whole inflationary episode, it has pumped income into higher brackets in the tune of a $20 billion unintended tax increase—a tax cut of $20 billion would do no more than correct that unintended increase in income taxes.

Chairman HUMPHREY. I think that is a point that is very important to emphasize. The study that the staff made, which I released here some time ago, indicated, of course, that for the middle and higher income families, tax bite due to inflation as actually reduced the total income, the real spendable income of the individual taxpayer appreciably. You could justify a tax reduction simply on the basis of tax equity, simply trying to give some relief from the inflationary impact, and therefore Congress has the responsibility to legislate a tax reduction to give it some balances.

You have indicated a figure of $20 to $25 billion as a continuing income tax cut, and I assume you mean a permanent tax cut or at least one that continues for several years until a vigorous economic recovery has been established and reduced substantially. Do I properly interpret your definition of permanent?

Mr. HELLER. You do, indeed. I use the word "continuing" because there are some people who are afraid of making it permanent because they think in a few years we will be back on the road to prosperity and inflation, and, therefore, need fiscal restraint instead of fiscal stimulus, and, therefore, they feel it should be made temporary.

But let me say to that, two or three things. First, a temporary tax does not have as big a stimulus as a permanent tax. If people will feel this is a permanent addition to their take-home pay, they are likely to spend more of it now—and that is what we need now to get the economy revved up again.

Second, I do not think it is dangerous or irresponsible in any way to make a sizable part of it permanent, given the fact that the automatic growth in revenues of our tax system is so large. With the combination of real growth plus the inflation factor, the Federal revenues automatically grow $30 to $35 billion a year.

Third, the point is often made that you should preserve the revenue-raising capacity of the tax system for important things like health systems and so on. I certainly agree with that general sentiment. I would make two observations on that. First, that a carefully structured tax cut can have the same effect as a social transfer payment program in helping the lower income groups and helping the disadvantaged, and so forth. In other words, this sharp distinction between greater outflow and reduced tax income in terms of what it does to the taxpayer is somewhat overdone.

I think, with the new sense of responsibility that I detect in the Congress, if we were to need a tax increase, difficult as that is politically, later on, I do not see any reason it could not be enacted at that time and this tax cut would meanwhile be more effective if people thought it was a continuing increase in their take-home pay.

Chairman HUMPHREY. The majority members of the Joint Economic Committee last week recommended total tax cuts in the range of $32 to $35 billion. That includes, of course, the rebate. We were talking in the range, in other words, of $24 to $27 billion, if you want to take the House figures on rebates, of continuing tax cuts, of which about $4 billion would be an investment tax credit and the balance would be for tax cuts to individuals.

Now, those tax cuts that we spoke of would extend through 1976, but not all of them would necessarily continue in further years. The ones that related to the low-income allowance and the standard deductions; they would continue on. But some of the others could be removed.

Am I correct in concluding that our overall tax cut recommendation, without going into all of its details, would be in the same order of magnitude as what you have been talking about here this morning?

Mr. HELLER. Very much so. You have the $10 billion, let us say an immediate rebate of $8 to $10 billion and about $5 billion for business—there is about a billion or something there for small business, too, is there not?

Chairman HUMPHREY. Yes, in the House bill.

Mr. HELLER. And then add $15 to $20 billion.

I would go to a total of $30 to $35 billion, coupling the rebate and the continuing tax cut. I recognize the argument that underlies putting some of these on sort of an annual reenactment basis. But I would prefer to go all out and make them permanent.

Chairman HUMPHREY. Your point is, in order to sustain a recovery, assuming you would get a lift out of the initial tax cut, it is

necessary to maintain the stimulus over a sufficient period of time to really have it get a hold of the economy?

Mr. HELLER. Yes, I think we have to break out of the mold of thinking of these postwar recession that we have had earlier. The other five postwar recessions, four of the five we got out of rather readily, and a long continuing tax cut would not have been appropriate.

But in the 1960's, when we were again mired in a long period of slack and semistagnation, coming out of the policies of the Eisenhower administration, we needed to take some of the overburden of the tax system off to assure a sustained recovery.

That was why President Kennedy's tax cut, which was finally enacted in March of 1964, provided for a permanent reduction of taxes by $12 billion, and remember that, in today's terms, would be $26 billion.

As I emphasized in my testimony, we were only running 7 percent below our potential at that time, calculated at 4 percent unemployment, and the economy was already rising when that tax cut went into effect. It did not cause a ripple of inflation. It did pour revenues into the Treasury that more than made up for the tax cut, and in other words, paid for itself in spades.

In the current situation, when we are 13 percent below potential and calculated more conservatively at 5 percent unemployment as the target, if I took the 4 percent target I would have to say we are running 16 percent below in the same terms as I calculated the 7 percent for 1964. Well, we are years away from attaining a satisfactory level of prosperity and full utilization of our resources. Under those circumstances, there is virtually no risk involved in a bold program of tax cuts.

Chairman HUMPHREY. You believe that speedy action on a tax cut is the first priority of the Congress, am I correct?

Mr. HELLER. Absolutely No. 1 priority.

Chairman HUMPHREY. The thing that I sense here, Mr. Heller, in the Congress is a timidity, the kind of thing that you expressed in the latter part of your statement. The Congress has been so inundated with the words of "caution and fear" about the size of the deficit, possibilities that the money markets could not finance both the deficit and private borrowing, that somehow or another Congress is hesitantly approaching the seriousness of the problem.

I might also add that the seriousness of the problem is oftentimes glossed over as Secretary Simon's statements indicated. He pointed out the other day that he saw some blue sky in the wintry atmosphere. I must say the only blue sky that I have been able to see in the temporary upturn in the stock market with its downturn yesterday, as they said, for profit taking purposes.

Do you see any real patches of blue sky out there right now that tell us that we ought to proceed slowly now and kind of cut back and not move too rapidly?

Mr. HELLER. No, I certainly do not. I see a break later on in the year in the sense that after we have worked off some of these inventories, we will have to go back to production to satisfy demand rather than draw on inventories. We can have a turnaround in a few months

in the sense of moving from this sharp slide, deep recession, bottoming out and moving up. But that does not constitute blue skies as far as I am concerned, because without a sharp stimulus we are not going to move up from that $200 billion deficit in GNP at a rate that is sufficient to meet either our human needs or our investment needs.

So to talk about patches of blue skies as a means of inhibiting actions in Congress does a disservice to the cause of good economic policy.

Chairman HUMPHREY. I yield now to Senator Kennedy.

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

I, too, want to welcome Professor Heller. A little over a year ago, you urged action by Congress to stimulate the economy through a tax reduction. A number of us in Congress proposed a $6 billion stimulus, and the amendment I offered to that effect on the Senate floor was passed but later defeated. It does seem to me if we had moved in that direction at that time, we might have halted the recession and avoided the problems of the economy at the present time.

Let me ask you, what is your reaction to providing a larger rebate, to obtain a greater immediate impact in terms of the front-end load of the stimulus? Should we be moving from an $8 billion rebate up to $10 or $12 billion, and reduce the permanent tax cut somewhat?

What I am getting at is, should we be provided a bigger bang in the front end?

Mr. HELLER. I would suggest the bigger bang for a buck that you are going to get is at the front end. The faster that gets into place the more payoff you will get. So that I am in favor of boosting that $8 to $10 or $12 billion. I do not see any loss in that whatsoever. If you pump $10 to $12 billion into an economy that is so far below par, it is reasonable to expect that it will express itself in more consumption, more output, more jobs, more income and more profits but not higher prices.

At the same time, I feel that the continuing stimulus in the form of the week-in week-out additions to the pay envelope is awfully important in sustaining that recovery. You cannot just prime the pump and have it keep going automatically. You have to keep pumping. Under these circumstances—and I know you are in favor of a sizable continuing tax increase—but under these circumstances, rather than say "let's have a fairly moderate continuing cut and then come back and take another bite if we need it," it would be more effective to put a continuing tax cut on the booms now. If you really have doubts about the longer term necessity of it, then do something along the line that Senator Humphrey was talking about; namely, provide a 2-year phaseout—but if you find later that the economy still needs that stimulus after 2 years, continue it. But I would rather put it in place with provisions for having it terminated if you feel that the economy is really moving well enough.

I just do not think people realize how far down that slippery slope we have slid. When you are running $200 million a year below your potential, you have just an awful lot of room for restoring income and confidence and production.

Senator KENNEDY. How do you suggest that we bring the Federal Reserve along? How can we be sure the Fed will be a partner in terms of overall economic recovery?

Mr. HELLER. Well, I sometimes despair. I sometimes wonder whether the Fed recognizes even with by far the worst recession since the Great Depression, that recession is indeed public enemy No. 1. Now, I do not suggest that the Congress take over the day-to-day management of the Federal Reserve and I do not imagine the Congress does either, but I think it should let its intense interest in the Fed accommodating this expansionary movement be known in no uncertain terms. It seems to me also that there ought to be closer coordination, close consultation between the Fed and the responsible committee in Congress to make sure that the expansionary tax policy is not thwarted by a stingy monetary policy.

Senator KENNEDY. Can we really afford an independent Fed?

Mr. HELLER. Well, the Fed has to be, to use the old cliche, independent in but not of the administration. For example, President Kennedy used the quadriad as the method of coordinating fiscal and monetary and other policy, and that worked rather well.

Just looking at the executive side of it, a great deal depends upon the way the President manages policy. It is possible within the present set of laws, if you will, to work a pretty well coordinated policy. But "independent" should not mean that the Federal Reserve System in effect thumbs its nose at the Congress, and if they maintain their present stance that is exactly what they will be doing. I hope and believe that when the time comes they will accommodate the tax cut and facilitate financing of the deficit in spite of the rhetoric and in spite of the very poor record they have in the past few months.

On this score, let me refer to this morning's column by Nicholas von Hoffman, who seems to be playing a new role as an ill-tempered economist. But he made a good point in quoting Beryl W. Sprinkel, a member of the so-called shadow open market committee group. He sits on the investment committee of his bank in Chicago——

Chairman HUMPHREY. Harris Bank in Chicago?

Mr. HELLER. It is the Harris Bank, and he said in effect, "We don't let excess reserves sit around. We put them to work, and if the excess reserves are not put to work in business loans we buy Government bonds or do something else with them." That suggests that if the Federal Reserve were really diligent about pushing money out into the system that the banks would put it to work. They are not going to let excess reserves burn a hole in their profits.

So I am not terribly persuaded by all the arguments I hear explaining why the Federal Reserve is not able to increase the money supply. It can if it tries hard enough. I think if you are not rabbit hunting and you shoot at a rabbit 100 times and you miss every time, you are not trying very hard. That does not, in a sense, answer your tough question; namely, how do you make them hit the rabbit? But I would say keep at it.

Senator KENNEDY. Should the Congress be doing more in terms of accountability of the Fed, or is it primarily an executive function? What should we be doing?

Mr. HELLER. Let me put it this way. The executive, it seems to me, in its day-to-day contacts between the White House, the Treasury, the Council of Economic Advisers, and the Fed, probably, if they fail to play their role in pressing the Fed to do the right thing for a

stabilization policy, it is very tough for the Congress. I suppose there are some devices you could use.

It is not that Mr. Burns is not up here on the Hill testifying often enough. I think he is. But most of the time he is testifying about the past and present. There is something to be said for trying a system of having given an accounting of what the future is to bring, just as the executive branch—the Council of Economic Advisers, the Treasury, and others—has to do. They have to come up here and tell you, on behalf of the President, what their projections are as for the future, and what their future policy is—and it is, of course, embodied in the budget and economic documents.

Perhaps it would be helpful to have the Chairman of the Federal Reserve be required to come up once or twice a year, maybe more often, maybe quarterly, to say what the projected policy is.

Senator KENNEDY. The problem is that the advice being received by the administration from Mr. Greenspan and Mr. Simon is in accord with that of Mr. Burns, and it is quite contrary to what you and many others feel is an appropriate policy. How does Congress exercise its responsibility? I think you have outlined at least one possibility, and that is to ask them to testify and to give some projections.

I wonder whether there is a legislative solution for a greater degree of accountability?

Mr. HELLER. I find it an extremely difficult question to answer. I do not find any easy solution to strike a balance between not trying to run the day-to-day policy of the Fed and yet getting a more effective input by Congress. The Fed has to be nimble. They are our front line of defense against recession and inflation, because they can move fast, and are not bound by some of the institutional constraints whereby you in Congress necessarily move more slowly on budget and tax matters.

So they do have to have day-to-day, week-to-week, month-to-month flexibility, and yet you want some sort of method by which Congress can weigh in and say look, you are not following the policy that is best for the country. I find it very difficult to suggest a legislative or institutional formula that reconciles those two considerations.

Senator KENNEDY. Let me ask you, in the economic recovery program that you have outlined, would you take special steps with regard to the housing industry or the automobile industry or other depressed sectors of the economy? Or would you rely principally on the kind of general stimulation of the economy that you have outlined here?

Mr. HELLER. No. 1, strong stimulus to the economy overall is the best way to take the pressure off of industries that have been hit hard. If you want to transfer resources into other industries you have to have a prosperous economy.

No. 2, housing—I am really worried about housing. because while the savings inflows are coming into the thrift institutions again, people's incomes simply are not high enough to take on the longer run commitments. So we need two things, the strong stimulus through taxes and budget programs and we need, above all, a Federal Reserve policy even more towards ease, because the housing market has never recovered when we have had a tight money policy.

No. 3, I would say we ought to have more sharply targeted grants to State and local governments, depending on where economic reces-

sion or even depression is—there are some areas that look like depressions, those areas where unemployment and recession hit hardest.

Now, on housing itself, I happen to be in favor of programs for subsidizing low-income rent and so forth. Yet, over the years, as we look at those programs—and while we can strongly support them on grounds of humanitarian and distributional considerations—they have never been a very dramatic boost to the housing industry. If you do not have the basic economic conditions and basic economic policy, the housing industry just does not go.

On automobiles that is a tough one. We will have to transfer resources out of that industry over the long run to meet our national objectives.

The main case of the pain, apart from targeted areas, is a strongly functioning economy.

Chairman HUMPHREY. Congressman Brown of Michigan.

Representative BROWN of Michigan. Professor Heller, I have enjoyed your presentation and your response to questions very much.

I would like to be reeducated a little bit, if I may. As I recall, you were not Chairman of the Council of Economic Advisers during the administration of President Johnson, at the time the surtax was passed by the Congress. I think you had left at that time.

Mr. HELLER. Right, I left at the end of 1964.

Representative BROWN of Michigan. I forgot what your position was on that.

Mr. HELLER. On the surtax?

Representative BROWN of Michigan. Yes.

Mr. HELLER. I can tell you quite explicitly.

As you may know, I continued to serve as an outside adviser and consultant to President Johnson, and by December of 1965—as a matter of fact during a visit to the ranch—I strongly urged that he ask Congress for an immediate surtax to help finance the war in Vietnam, and to help ward off inflation.

As you may recall, President Johnson's view at that time was that Congress would simply not go along with it, that he would not be able to get the tax increase through Congress and that there was no use asking for it.

I do not happen to agree with that, never have. I felt the country, the economy would have been better off if we had bitten the bullet, taken our medicine and had that tax increase early in 1966, rather than assuming we could have both guns and better without the tax increase.

Representative BROWN of Michigan. Concurrent with the adoption of the tax, the Federal Reserve Board, thinking there would be—at least, this is what was alleged—in effect overkill on the economy by the surtax and proceeded to expand the money supply and relax monetary policy significantly. What was your posture at that time?

Mr. HELLER. Frankly, I was in favor of the Federal Reserve's expansionary policy, because I thought the Congress, by that time, with both a cutback in the budget and the 10 percent surtax, was in danger of thwarting reasonable expansion. You know, one just has to stand up and be counted. I was just dead wrong.

Representative BROWN of Michigan. Mr. Heller, why is it not entirely possible that you might be dead wrong now, with respect to

your advocacy of a greatly expanded monetary supply, greater relaxation by the Federal Reserve Board along with the fiscal measures that are being taken?

Mr. HELLER. Because we have such an incredible amount of slack in the economy, and because the economy is still sliding very fast toward a recession, as I say, not a depression, but beyond any recession we have had since the war. There is so much slack in the economy that it is very much, Congressman Brown, like the situation in the early 1960's when we were talking about the big tax cut that was finally passed in 1964. There was no way that that tax cut could overstrain the capacity of the economy, because we had so much slack in a stagnating economy. That is the situation we are in now—only we're even deeper in the economic hole.

We cannot underscore enough the fact we have a tremendous margin for error. Even if one were not precisely correct about the degree of slack, there is so much margin for error—suppose it were $150 billion instead of $200 billion—the projected tax cut and budget increase could not possibly outstrik the potential of the economy. So we have a lot of margin for error.

Representative BROWN of Michigan. To what extent would you suggest that the Federal Reserve expand the money supply?

Mr. HELLER. As Paul McCracken and a number of others have suggested, we need an 8 to 10 percent sustained growth rate in the money supply. But the first thing we need to change is the attitude, and that attitude has to be a more accommodating one.

Representative BROWN of Michigan. Pardon me.

Mr. HELLER. That attitude has to be a more accommodating one. That is, to accommodate the fact that expansion is needed and the only way it will be gotten is by an appropriated expansion of the monetary medium in this economy. Thus, if we need 8 to 10 percent, or if we need 15 percent for a while, OK. But I am also convinced that when the economy is really functioning well, the Federal Reserve will quickly pull in its horns and be our first line of defense against inflation. There will be plenty of time to do that. That is their basic bias. That is their basic approach to life, an anti-inflationary one. That is fine where inflation is endemic. But when you are running $200 billion below your potential that is certainly——

Representative BROWN of Michigan. I was pleased with your colloquy with Senator Kennedy with respect to rebate vis-a-vis permanent taxation relief, because it seems to me the most permanent, if you are looking for something with confidence, the most permanent thing you can do is give them money in hand, which is rebate.

I presume that it would be your position that chronologically placing the action of the Federal Reserve Board, fiscal action of the Congress and all, that you would say as the improvement commences, then the Federal Reserve should tighten up before there is a tightening up of the fiscal policy by, in effect, rescinding or appealing of the tax relief that you are advocating?

Mr. HELLER. Let me start out by saying yes, and quickly go on to say that I hope they don't start tightening long before we have gotten back to some reasonable semblance of high employment, prosperity, and full employment. They have to do it several months in

advance, because we know from studies by Milton and others, it takes 6 to 9 months for the full impact in that shift in monetary policy to be felt. That doesn't mean there is not some immediate impact, because there is. We are talking about the full impact. They have to be on the frontiers, the guardians of the gate in fighting inflation. The trouble is that the past year, they were fighting inflation long after it was doing us much good. They were putting the economy through the wringer and squeezing out the economic life blood rather than the inflationary water.

In saying that the Federal Reserve should and will be ready to cope with inflationary pressures when they reappear, one has to hope they won't play "Horatio at the Bridge," as in the present case, long after the enemy had left the scene of the battle.

So, yes, the Federal Reserve has to be the front line of defense against inflation, but must be backed by fiscal policy.

Representative BROWN of Michigan. Mr. Heller, the most significant reason for tax rebate or tax relief is what?

Mr. HELLER. The most significant reason is to put the economy back to work, and that means putting human beings back to work.

Representative BROWN of Michigan. But how does a tax cut do that, by creating greater purchasing power for the consumer?

Mr. HELLER. All the evidence we have, Congressman Brown, over the years is that when you put additional purchasing power into the hands of individuals by tax rebate or by continuing tax cuts, they put it to work. In other words, they spend some where between 90 and 94 percent of it in buying goods and services on the market.

Representative BROWN of Michigan. Now, then, how do you reconcile that, Professor Heller, with the fact today we have probably the lowest consumer debt that we have had in years?

Mr. HELLER. The lowest consumer debt—consumers have been working off their installment debts—

Representative BROWN of Michigan. In other words, the potential for purchasing it seems to me is there today. You don't need tax rebates where tax rebates will just add to that potential, that purchasing capacity that is there in the consumer. It will add to it.

Now, isn't there something more serious here than merely having in the hands of people more money to be able to buy things with?

Mr. HELLER. Well, the truth of the matter is that the consumer income has taken a fierce battering. Consumers have had $30 billion leached away from them by the ransom we are paying to the oil cartel, $30 billion net is gone. Devaluation has leached away another $10 billion in prices of imports. Increased farm prices, from the standpoint of the city worker, have taken another $10 to $20 billion.

Inflation combined with poor employment opportunities has also undercut buying power. Workers' real income is down 5 to 6 percent from a year ago and about 10 percent from 2 years ago if I have my numbers right for the second year.

With all of those erosions of the consumer income, you can readily explain why he has been pulling in his horns and not encurring new installment debt. He simply does not have the income to undertake either a mortgage or installment debt for payment over a sustained period of time. You can say all you want about his capacity to under-

take installment debt, but he can't undertake that debt either to buy a refrigerator or car or stove or to pay on a mortgage for 20 or 30 years unless he has assurance he is going to have income.

One way to help the consumer get that assurance is the direct effect of tax cuts plus the indirect effect of stimulating the economy and creating steady jobs.

May I go on to say, I agree with the analysis in part that Glenn Burress is going to present to you later showing that once the consumer gets that income and begins to gain restored confidence, he will also begin to utilize that installment debt capacity. Then, for a while in the recovery you will find, contrary to what a lot of people are saying—namely, that if he gets a tax cut, he will just squirrel it away and save it—contrary to that, every recovery has had a period where the consumer has spent more than 100 percent of his additions to income. He supplemented these with installment debt.

Representative BROWN of Michigan. My time has expired, but just one final question.

What level of budget deficits do you feel can be tolerated without having a serious impact on the credit market?

Mr. HELLER. You know, it is terribly hard——

Representative BROWN of Michigan. Also, the Treasury Department was talking in the $30 to $40 to $70 billion range, whereas now the chairman of the Appropriations Committee on the House side says $170 billion in deficits. What is your figure?

Mr. HELLER. I have said, and very specifically in the Wall Street Journal, that $70 to $75 billion, it seems to me, which is 15 percent above what the President had proposed for fiscal 1976. is a manageable number. Now, I do not know where it becomes unmanageable. So as an economist, I can be expected to say," it all depends—" If the U.S. economy should slide to a point where unemployment rises to 11 percent, then we could tolerate more deficit than if it turns around rapidly. But the indications are that we have enough economic slack to go ahead with $70 or $75 billion dollars.

Chairman HUMPHREY. Senator Javits.

Senator JAVITS. Mr. Heller, I am terribly sorry that I was not here to hear your original presentation, but we were reporting out the bill for the Agency for Consumer Advocacy. I am senior member of that committee. I apologize.

I had one basic question that I would like to lay before you. I like what you have said and answers to the questions of Congressman Brown of Michigan and what we could tolerate, rather than permit or accommodate, "tolerate".

But I would like to have your affirmative prescription looking down the road. I think most Americans are pretty confident that we will get out of this recession, the vitality of the country is still very strong, and that somehow or other I see a revival of faith in the fact that, as we have before, we will get out again.

But I think so many of us are worried about, on the conservative side, a reoccurrance of inflation. In other words, just getting out of this, because the reduction of inventories, the increase in productivity, because people will put their shoulder to the wheel a little more. If they are worried about unemployment, you will encourage more ma-

chinery and equipment. So you will bet out of it and right back to a higher inflationary syndrome in 2 or 3 years. That is the conservative word.

On the other hand, liberals have an equal worry, but it is on the other side. Are we really changing anything in the economy which brought about these fundamental conditions. We have continuing, let us say, a $30 billion extra tax take on the American people in the excess price of oil. That continues. Productivity is very soft, I think disastrously so. The American worker is still not reconciled to his job in the traditional sense. We still are very shaky on advanced planning against the vicissitudes of life and the economy.

Now, you can think of probably four or five other things. Yet, as one of our most distinguished economists, what is your observation on both these sides, both the worry of the conservatives and the worry of the liberals, and how can we do something about them here in the Congress?

Mr. HELLER. Senator Javits, you are raising, of course, a real tough question about reconciling the shortrun and longrun objectives in the economy.

I have said ever since the 1960's that no modern industrial nation with a free economy has learned how to reconcile persistent full employment with persistent price stability. The Germans have come close to it, but even they have had a very substantial amount of inflation. That is a dilemma for which no economist has an easy solution.

By the way, we have talked about this not just for the past 10 years, but the past 30 years, ever since the 1940's. We have talked about the unstable triad: In an era of strongly organized producer groups—unions as well as big businesses—it is very difficult simultaneously to have full employment, price stability, and economic freedom.

Now, let me come back to the short run.

I said before you came in that we have enormous slack in the economy—absolutely unprecedented since the great depression and since World War II—running to something like $200 billion. That is the GNP gap between where we are in mid-1975 and where we could readily be at 5 percent unemployment. There is $200 billion of slack to take up.

So as I was saying to Congressman, Brown, it is almost inconceivable that we could exceed either the speed limits or the capacity of the economy with the kind of tax cut program now being considered by Congress.

So in the short run—and the short run to me in this case means at least 2 years—I do not see that we will take up that slack fast enough to get back into the inflationary position we were in for years.

Now, the longrun problem is far more difficult. I think it takes careful social engineering and advance planning and concentration on shortages in primary processing capacity. And we need a persistent watchdog of the Council on Wage and Price Stability type with some teeth, with the ability to move in, I mean whether President Ford wants it or not, or whether Al Rees wants it or not.

They do want subpena power. But it seems to me you want a watchdog with teeth to keep an eye on powerful labor unions and

big business to restrain and retard their discretionary pushing up of prices and wages means powers of prenotification and powers of suspension of outsized wage and price boosts and eventual rollback in flagrant cases. It won't be neat and easy, but we can muddle through better that way than we have in the past.

A final observation. The Congress and the administration of this country are constantly being castigated for contributing to inflation. I find the Congress, as an outsider, far more responsive to and concerned about inflation than ever before, not just because we have experienced double-digit inflation, but because the Congress learns by experience. So I am saying that I am more encouraged about the likelihood of getting at least a tolerable solution—and the word "tolerable" seems to be a favortie one here—a tolerable solution of our unemployment-inflation problem in the long run, in spite of the fact we have just gone through a very special kind of double-digit inflation.

Senator JAVITS. One other point.

Senator Humphrey and I are working on some kind of planning mechanism, very much of the type that A.T.&T. has, which we can show you a chart of what they are planning for, what they consider to be the hypothesis other decades spent, 10 years. Is that also a contributory mechanism to the mechanisms you speak about?

Mr. HELLER. As a matter of fact, I very much had in mind the bill you were talking about.

Chairman HUMPHREY. National Growth and Development Act?

Mr. HELLER. Yes, I think we do need that kind of measure. I might add, Senator Javits, I have been in favor of experimenting with something like the French approach to indicative planning for many, many years. But I will never forget that experience in the early 1960's when President Kennedy "ordered" me to go over to Paris and not come back until I found out how the French were so successful in guiding their economy without having a smothering blanket of controls. Of course, they have different institutions and different powers and so forth. But in that day and age the word "planning" was a dirty word. When we once proposed to the Business Council that they think through with us this kind of approach to life; that is, project what, if there were full employment, the different industries would be doing, they shied away because of their fear that if you spelled out what full employment could mean to jobs and output. The government would force you to do it. So we had to back off.

But today, I believe we have more maturity and understanding, and I think the business community would work with you on something like this, and we have to move in that direction.

Senator JAVITS. Thank you very much.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Senator Proxmire.

Senator PROXMIRE. Mr. Heller, it is a real pleasure to have a chance to read your statement. Unfortunately, I could not be here earlier because we had a meeting of the Banking Committee this morning to mark up our Federal Reserve resolution, the Proxmire, Humphrey, and Buckley resolution. It accommodates something that you raise in your statement where you say, "Whether and how strongly the econ-

omy then turns up depends on (*a*) how soon and how clearly the Federal Reserve gets the message that war on recession can now be waged without losing the war on inflation and (*b*) how quickly the Congress enacts tax cuts and budget relief."

No. 1, what we do is call on them to stimulate the economy more vigorously than in the past. No. 2, we provide for a long-range increase in the money supply commencerate with the growth of the economy. No 3, and this is the real cutting edge, we provide that the Federal Reserve Board shall make estimates as to the increase in the monetary aggregates in figures, in terms, so that 5 percent, 7 percent, 8 percent, whatever it is, and tell us so that we know what our monetary policy is, not in language but in some kind of number.

We have modified this to some extent, but the committee reported, I am happy to tell Senator Humphrey, by voice vote, it was a bipartisan agreement, so I think we are in good shape to get that through the Congress. I think we are really beginning to move on that front.

Mr. HELLER. I wish you had been here when I had a colloquy with Senator Kennedy on this very subject, because it is a tough one to know where exactly to draw the line between pressing the Federal Reserve and yet not interfering with their day-to-day monetary policies.

Senator PROXMIRE. In the resolutions they considered we did not specify a number that they should meet. We simply asked them to arrive at what they thought would be the policy and announce it so we could debate it and discuss it so we could have some influence on it.

You have talked at some length and very persuasively in your statement about our capacity to finance the debt without inflation. Supposing we have a vigorously expansive housing policy, an emerging housing program that would result in subsidising mortgage interest down to 6 percent, because the Federal Government can borrow money at 7 percent and start moving in that area. We get a million additional mortgages, average mortgage $30,000, $30 billion of additional debt to finance. In your view, does that raise any question either from the standpoint of our capacity to finance that without exacerbating interest rates elsewhere or the inflationary effect of that kind of a program?

Mr. HELLER. It seems to me, Senator, that in judging a policy like this one, one has to take all the different facets into account.

Now, if more is done and is effectively done on the housing side, and therefore the Federal Government directly stimulates the economy and indirectly stimulates deficit financing by the private economy, it obviously has to take that into account in determining how much it should do by way of tax cuts and how much by way of other stimulative programs.

So that fundamentally, I agree with what I think is the implication of your question, that you have to look at this question of deficit financing comprehensively, and if there were successful stimulative programs that promoted a tremendous amount of private deficit financing, then you would want less Federal deficit financing, simply in terms of stimulating the economy, and in terms of using the available credit capacity.

I am somewhat skeptical, and I expressed this before you came in, of housing programs that do not rely fundamentally on easier money and on an economic policy that generate the levels of income that people can——

Senator PROXMIRE. That is exactly what this would be. The money would be 6 percent instead of 9 percent. You say you would prefer a program that would rely on easier money without singling out housing for special treatment. Is that it?

Mr. HELLER. Well, I guess it is one of these cases where I have not thought it through enough to know whether you can get enough done by this kind of a method relative to the other credit needs of the economy.

Senator PROXMIRE. The problem is that housing has been really clobbered by the tight money; that is, persistently. In every credit crunch, housing has been the prime victim.

We now have such tremendous unemployment in housing, such unused resources in housing, such an inviting opportunity to put people back to work. One estimate is, if we can have another million housing starts, we will provide 2 million additional jobs and get the unemployment down below 6 percent from our activities in that field alone, with 95 or 98 percent of the money coming from the private sector, and therefore a very constructive budget impact.

Mr. HELLER. I would hope John Dunlop would see to it that the construction unions would not use the higher job opportunities to boost those construction wages the way they have in the past few years. In other words, I think one has to take into account not just the total demands for housing but the construction costs. We have to think more about social contracts in this economy and this society. Whereas, I am not opposing the program you suggested, I would hope there would be some kind of agreement with the unions and the contractors, that if there were such a surge of stimulated housing demand, that is by positive government programs, they would not use it as an opportunity to gouge the homebuilder and the homeowner.

Senator PROXMIRE. Can I ask you to give us an estimate of how high unemployment is likely to go under the following assumptions. No. 1, if the Ford program is the kind of economic policy program we follow; that is, with a $16 or $18 billion tax cut and without other expenditures except with the increase, of course, in the defense budget and so forth.

Mr. HELLER. Accepting his rescissions?

Senator PROXMIRE. That is correct.

Mr. HELLER. And also the energy program, or should I leave that aside?

Senator PROXMIRE. That is correct.

No. 2, if the Joint Economic Committee's program, which you studied and are aware of, if that program is put into effect. Can you give us a rough estimate of what unemployment might be, say a year from now?

Mr. HELLER. I do not have a computer at hand or even the back of a envelope. You are asking me for a heroic kind of undertaking.

But I think one can make a kind of what we say boxcar estimate. If the Ford program were put into effect and we have this one shot stimulus, that is all, no continuing stimulus, if we had all his rescis-

sions the budget would really only rise about 8½ percent from last year overall—that is taking out unemployment compensation increases and the energy program, that would have taken $10 or $15 billion out of consumer spending power net—because it would raise prices of energy certainly more than the $30 billion of tax increases, perhaps $40 billion, while only $25 or $27 billion would be put back in. Having specified that, I would say unemployment would rise to 10 percent or more, over 10 percent under that program if we did no more than that. You might have a temporary stimulus and a double-bottom recession.

Senator PROXMIRE. How about the Joint Economic Committee's program?

Mr. HELLER. That, as I understand it, would have a total tax cut somewhere between $30 and $35 billion. There is an additional stimulus of about—well, it is just about double this, another $16 million. It would not have the rescissions and it would put in—let's see, you have public service jobs, you have special antirecession revenue sharing targeted to the State and local governments which have the biggest unemployment. One has to get the numbers straightened out. So you would be adding $16 million there on tax cuts and be adding a total of about $20 or $25 billion of expenditures, Senator, all-told, compared with the President's program.

The energy program would not be put in, so there would be another saving of $13 billion, let's say, or $14 billion, I want to get a round number, $14 billion of negative effect on the economy. Overall that is $50 billion, not $50 billion additional to the deficit, but $50 billion improvement as I see it over the Ford program. It seems to me that that by a year from now—first of all, if this program were quickly put into effect I think we could hold the worst unemployment rate to about 9, 9½ percent as against 10 percent. Second, a year from now under the President's program unemployment would still be between 9 and 10 percent. But under the program of this committee it could be moving down nicely to 8 percent or even less.

So I think it could make a difference within the next year or two of a couple million in the unemployment level.

Senator PROXMIRE. One other question I would like to pursue. You do, I think, a very, very constructive job here of analyzing and considering what it takes to restore real inflationary pressures in the economy. You disabuse us of the notion if we stimulate the economy we will set off excessive inflation. You indicate there is so much opportunity to expand, that the factors that go into a demand-type inflation are likely to be missing for a long time.

What degree of stimulus whould it take in your view over the next 2 or 3 years before we got a situation in which prices would be likely to be pushed up by the demand element in the economy?

Mr. HELLER. Well, I would say——

Senator PROXMIRE. We would have to get below 5 percent unemployment, would we not, based on past experience?

Mr. HELLER. On past experience I have had to give some ground on my own objective on unemployment. I have to agree we have as much inflationary pressure, in the long run at 5 percent unemployment as we used to at 4 percent. For the time being we probably have

to settle for a 5-percent target. I do that very reluctantly, but I think that is economically realistic.

As you approach 5 percent unemployment you begin to find the inflationary pressures mounting again.

But, as I point out in my testimony, suppose you have conservatively calculated just a 12-percent gap between GNP potential and GNP actual, say on January 1, 1976, and suppose you have mounted a program that got the recovery going at 8 percent a year in real terms, it would take 3 full years before you would be approaching 5 percent unemployment by all the relationships we know in the past——

Senator PROXMIRE. You say 3 and 4 years to approach unemployment?

Mr. HELLER. Yes.

Senator PROXMIRE. If you did what?

Mr. HELLER. If you started with a 12-percent gap beginning in 1976 and plugging in 4 percent a year growth in GNP potential——

Senator PROXMIRE. So how much growth per year?

Mr. HELLER. That means you would have to have 8 percent growth for 3 years to do two things, absorb the 12-percent gap and accommodate the 12-percent growth in potential.

Senator PROXMIRE. That has been a long, long time since we had 3 back-to-back years of 8 percent growth.

Mr. HELLER. That is right. So that is why I come back to the proposition we are very unlikely to exceed the speed limits of this economy.

Senator PROXMIRE. I would just like to point out before I yield that I think we ought to put the deficit, which appalls all of us, in perspective. I have just done some hurried calculations. If we have a $50 billion deficit, $55 billion, that is about 3½ percent of our GNP. If we have a $100 billion deficit, it is 7 percent. In 1943 the Federal deficit was 12 percent of our GNP; in 1943, 28 percent; in 1944, it was 23 percent, and in 1945 it was 22 percent. So there we have four back-to-back deficits that were infinitely greater that the biggest deficit that anyone has suggested at this time. We were able—sure, it was wartime and there were many forces working under those cirmumstances, but we were able to do that and at the same time have an ability to control our inflation and improve very greatly the real income, the standard of living of our people. So I think if we put the deficit into perspective we should not be overwhelmed by the fact that that deficit is appallingly large.

Mr. HELLER. What you say is music to my ears, and if you had that information I would have included it in the Wall Street Journal article.

Representative BROWN of Michigan. Would the gentleman yield?

Senator PROXMIRE. Yes.

Representative BROWN of Michigan. The wartime deficits stem from a totally different kind of Federal expenditure.

Senator PROXMIRE. The wartime deficits were really wasteful. There was no economic production at all in producing the guns and tanks and the ammunition that we blew to blazes. It did not increase anybody's standard of living. So it was much more difficult under

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those circumstances, far more inflationary. Am I right, Mr. Heller, or wrong?

Mr. HELLER. It was more inflationary spending than presumably what we have in mind here, which would be more productive in terms of investing in human beings and in plant and equipment.

Chairman HUMPHREY. All right. I will take time for just a few observations, Mr. Heller.

I was just noticing one of your appearances before this committee was in August 1974. That is about 7 months ago. Just to show you what has happened in our economy, you testified at our midyear hearings and you really shocked this committee when you said, and I quote, that "unemployment could go close to 7 percent before the Minnesota winter is over.' That was in the days when, if you talked about 7 percent unemployment no one could believe you. Now we are up to 8.2 percent.

Mr. HELLER. And the Minnesota winter is not over.

Chairman HUMPHREY. That is right, and, of course, the 8.2 does not take into consideration those who have disappeared, so to speak, from the labor market. It does not take into consideration those who want full-time employment; and are having to satisfy themselves with part-time employment; and when you factor all those in, you come closer to 10½ percent unemployment.

Now, the question is, if we had a real antirecession program, is there still time to shave that peak that we now have of 8.2 percent—and you have indicated that you though it could go substantially higher—is there time to shave that peak by moving quickly to adopt an adequate antirecession program?

Mr. HELLER. Well, I think that a rise to over 9 percent is already in the works, and there is very little that can be done to stop that rise. But it is never too late to prevent any worse rise.

I would say that if action is slow and inadequate the unemployment rate will rise above 10 percent.

When I project a high, let's say of 9½ percent unemployment, I am assuming on the part of the Congress quick action. So I am in effect building into my forecast an answer to your question.

Chairman HUMPHREY. You are assuming, in other words, that we even now act rather promptly on these matters before us?

Mr. HELLER. Indeed.

Chairman HUMPHREY. And still the unemployment would be up 9 and 9½ percent?

Mr. HELLER. Right. And also one has to constantly bear in mind it will take more than 4 percent real growth to start dissolving that unemployment rate, because otherwise you are just absorbing the new labor resources that are coming on the market.

By the way, I cannot resist, if you will permit, Mr. Chairman, expressing my appreciation of your mentioning of the August 1 testimony. You know, we are hearing a great deal about how economists did not foresee this recession. We have heard a great deal in the past about our goofs in forecasting, and indeed we have a lot of sins to answer for, especially in our forecast of inflation for 1973 and 1974. Of course, I do not know how we were to forecast that anchovies would disappear from the coast of Peru.

But there were quite a number of us since last summer and as long ago as January of last year who were saying we were headed toward a recession. For a while we thought there would be an upturn because we could not believe that the Federal Reserve would put the economy on such a starvation diet when it was already in a recession.

Chairman HUMPHREY. You have pointed out this recession has been in effect 16 months and the impact of the recession in causing high unemployment, high prices has only been fully apparent in the last 2 or 3 months.

Mr. HELLER. I figure when the economy is receding that is a recession—and it has been receding for 16 months. As you know, some of us appearing before this committee, the Senate Budget Committee, the Senate Appropriations Committee and other committees urged as long as a year ago or more than a year ago that we at least moderate this recession by giving some tax relief to lower income groups.

Chairman HUMPHREY. We introduced such legislation here in the Congress. My colleagues, Senator Mondale, Kennedy, myself and others recommended then a little over $10 billion. At the time it looked like that might be adequate.

Mr. HELLER. Then some of us last June, when we saw the Federal Reserve's unrelenting tight money policy, began to sound the alarms on the recession. By August 1, in this room, I projected a 7 percent rate of unemployment—which at that time seemed terribly high—for this winter. By September 18 I am on the record that we were sliding into the worst recession since the great depression. That was the precise term I used, Mr. Chairman. I underscore this because we are hearing from the administration, so to speak, that "nobody warned us." Well, perhaps nobody listed. But there were a number of us who were absolutely alarmed about the recession prospects by last summer and last fall.

Chairman HUMPHREY. Now, I am not going to spend much time any longer on the Federal Reserve matter.

I think I should note that one of your former associates, Charles Schlutze, said one of the ways Congress could be helpful is to keep peppering away at the Federal Reserve Board, so to speak. He said they were not immune from the political realities and economic realities if we keep bringing it to their attention.

I might say to you, Mr. Heller, that I intend to introduce legislation that will reduce the term of the Federal Reserve members from 14 years down to 7. It promotes accountability. It does not put them in the political spectrum. Senators run every 6 years, Congressmen every 2 years.

Mr. HELLER. I am sure you will recall that an outstanding business committee, the Commission on Money and Credit in the 1960's recommended precisely that.

Chairman HUMPHREY. I recall that, and I think it is long overdue.

In 1958, you may recall, we were beginning to get out of that recession, and just about the time the economy was beginning to move the Fed choked it off again.

What I am doing here is merely to emphasize once again, just as you have said, that there needs to be some continuity in tax policy to get a recovery underway. There also has to be some continuity in Fed-

eral Reserve monetary policy, recognizing, as Senator Proxmire has indicated on behalf of both of us here, that we do not want to set in Congress a rate of money supply growth. We think this has to be a matter that is under the control of the Federal Reserve, but hopefully we can put up the warning signs that when the patient begins to show signs of life again and get the color back in his or her cheeks, it is no time to start bleeding the patient again and give them another case of pernicious anemia. I think that is about the best way I can put it.

It appears every time there seems to be a recovery or restoration of confidence in the business community, then bingo, the Federal Reserve says well, this is going too good. They are so concerned about the rise in inflation that they slam on the brakes before the recovery has really gotten hold of the economy.

Mr. HELLER. May I just add there that it is fine to have a watchdog against inflation, but you hate to see them rush out and bite the intruder before he has even gotten inside the gate. That has happened time and again, and one does not want to live in the past, but I remember so vividly in 1961 when Bill Martin—with all the best motivation in the world I might add—wanted to fight inflation after one quarter of recovery in 1961. This is the basic bias, the basic stance of the Federal Reserve, and I think we can rely on it for inflation protection later in the game, but it certainly should not be exerting that restrictive pressure for sometime until we are well along the road towards full employment.

Chairman HUMPHREY. While you have indicated properly that the Federal Reserve can take prompt action because of it's unique status, I think it also should be noted for the record that the action it takes sometimes requires a period of time to have effect. Therefore, it is important for the Federal Reserve to have some vision down the line. In other words, as you were indicating here some months ago, a recession was just underway. There was the economy receding, and it would appear that that was the time that the Federal Reserve should have taken at least some modest action to loosen up on the money supply rather than waiting now until doomsday, so to speak, and then rushing on in as some economists have said in a massive expansion of money supply in 1 year. This business of starts and stops, of spurts and jamming on the brakes I think is what causes unbelievable maladjustments in our economy. I just toss in my own observation on it.

I have been looking at what the Federal Reserve has been doing over the years, and they always seem to wait and wait and wait until even a blind man can see the disaster that is befalling us.

Mr. HELLER. You know, if you keep your powder dry when you're being shot to pieces it seems to me you are holding your fire much too long. But that is what has happened this time, in spite of the fact that many of us are on the record starting last May and June saying that (*a*) The Federal Reserve was over doing it and; (*b*) the kind of inflation we had was relatively unresponsive, as I said earlier, to a fiscal-monetary squeeze.

So I do not think that the record will treat very kindly the actions of the Federal Reserve since about last June.

Chairman HUMPHREY. I just have to say in summarizing my comments on the Federal Reserve that when any of us seem to have any criticism of the Fed it appears as if we are attacking fundamental tenets of philosophy. It is almost blasphemy and heresy. The Fed has so insulated itself from the public and from the developments that take place in our national life that when a Senator or Congressman expresses an opinion, all at once there is a kind of outrage, how did you dare do this.

I do not want to run the Federal Reserve. I do not know enough to do that. I do not think that the Congress ought to on a daily basis handle the Federal Reserve and try to indicate every weekly or daily movement that the Federal Reserve makes. But as Senator Proxmire said, we have a right to set out goals. We do have a right to outline guidelines, and we do have a right to ask accountability. Everybody else has to have accountability these days.

I do not believe the Federal Reserve System is without fault. I think it is subject to scrutiny, and it ought to preserve its independence within the system.

May I add, we are going to have some hearings on planning in this committee. Senator Javits, Senator Bentsen, and others here have taken an active role. We happen to think we need to look at the structure of our economy, and as you know, by an exchange of letters between yourself and myself and Congressman Reuss, whom I believe was here earlier, we will go into that and hopefully develop a body of evidence. It is my judgment, without some kind of forecasting and planning within our Government, we are going to go pellmell down the road, forcing us to make sudden changes and adaptations.

Might I suggest that the staff write you a note giving you the questions and observations that we are concerned about. Maybe in due time, either in one of our articles in the Wall Street Journal or some testimony you might want to respond to it. I say this very sincerely, because we watch to see what you write and say, and we would like for you to know our concern about capital formation. I have a concern about that. I think it takes much more money today to provide for a job, much more money in terms of capital investment. I think the business community has legitimate concern in this area. I believe there is a question about whether the investment tax credit ought to be temporary or have some permanency, whether it could be related even more specifically to certain depressed industries, giving them a better investment tax credit than others.

Mr. HELLER. May I say in that connection, just so that one does not create the wrong impression about the longer run, that one of my reasons for being so concerned about stimulating the economy in reference to these structural questions that you have been raising, and especially in reference to the enormous demands for capital investment, not only for energy, but to break the bottlenecks in our primary processing industries—there will be bottlenecks again in a big expansion—we will have to run a surplus in the Federal budget. I am not for deficits year in and year out. We need a surplus of $10 or $15 billion a year to take money out of the hands of consumers in a prosperous economy and feed it into the capital markets by retiring debt. I think that to keep our eye on that kind of target for

the longer pull within the context of the shortrun actions you do need some kind of a planning agency, and planning, as we have said before, is not a dirty word in this day and age. It is absolutely essential for meeting our longer run objectives.

Chairman HUMPHREY. What you have just commented on are some of the observations I have in mind.

But time runs out.

Mr. Heller, we thank you. You have really been most helpful to us today, trying to make this committee a real effective instrument of economic policy and your counsel is greatly appreciated.

Mr. HELLER. Thank you.

Chairman HUMPHREY. Now, we have as our concluding witness, Mr. Glenn E. Burress. He has a remarkable background, Journal of Commerce, New York; economist in Clairmont, Calif., and University of Texas.

Congressman George Mahon was here and he had to go back to the House to take care of a bill that was on the floor, appropriations for the jobs program.

I want to thank you very much for coming. We have read your prepared statement but we want you to proceed with it, and I will have some questions and other members will be here as well.

STATEMENT OF GLENN E. BURRESS, ECONOMIST, JOURNAL OF COMMERCE, NEW YORK, N.Y.; PITZER COLLEGE, CLAREMONT, CALIF.; AND THE UNIVERSITY OF TEXAS OF THE PERMIAN BASIN, ODESSA, TEX.

Mr. BURRESS. I have accepted your invitation to prepare a prepared statement and this opening statement is, of course, a summary of that statement for the record.

Chairman HUMPHREY. We have your full prepared statement for the record, do we not?

Mr. BURRESS. Yes.

Chairman HUMPHREY. Thank you. It will be incorporated in the hearing record at the end of your oral statement.

We lost a man who has to go vote. That is the problem around here.

Mr. BURRESS. Mr. Chairman, I have long enjoyed and found useful your analogy between the practice of medicine and the practice of economic policy. You have properly emphasized that the patient, the U.S. economy, is critically ill. You have also properly emphasized that recovery of the patient depends on proper diagnosis. But proper diagnosis is not enough.

Even with proper diagnosis, this Congress will never write a prescription for recovery with reduced inflation so long as the good doctors you consult continue to use theories and models which were developed to explain consumer spending and saving in the 1930's, but which fail systematically to explain consumer behavior in recessions and recoveries over the last 20 years.

For example, consider the two leading private models—those of Chase Econometrics, Inc., and Data Resources, Inc. These are the two models used by the CEA recently to compare the effects of the

administration's program with the alternative offered by this committee. Both of these models tell us that as a result of the tax cut, personal saving will rise sharply. They see the personal saving rate climbing to 11.3 or 11.8 percent—nearly a third higher than the alltime high, 9.5 percent. Both tell us that the tax cut will affect spending significantly only after long delay.

In the 1930's that is indeed how consumers did react to increased income in recoveries. But in not one case in the last 20 years has the consumer reacted to increased income in recovery by increasing the proportion of income saved. Indeed in 1955, 1959, 1968, and 1972 recoveries when income rose, spending increased even more than income. As a result even the absolute level of saving fell.

In every recovery period for 20 years the consumer has proved the economists' forecast wrong. Only time will tell how consumers will react to the tax cut during the recovery that will get underway later this year. But if consumers follow the path of the last 20 years, they will again prove the economists wrong. In short, if consumers follow the path of the last 20 years, it will mean that most economists are underestimating the impact of the tax cut on consumer spending.

In my own work one finds an approach to consumers spending and saving that carries a highly successful forecasting record. These forecasts were sometimes published in advance by Business Week and the Wall Street Journal and have often appeared in my column in the Journal of Commerce. Many of my forecasts have been most successful in recent years precisely when forecasts based on the depression model of the consumer most seriously led this government astray in the formulation of economic policy.

But today I want to do more than emphasize the high probability that others are underestimating the impact of the tax cut on consumer spending. I want to emphasize here today that other economists, and therefore this committee and others in government, are neglecting an otherwise unnoticed $15.2 billion stimulant that will flow into the hands of consumers during the year beginning July 1. This neglected stimulant, which I will describe shortly, will flow to consumers in high spending middle-upper income groups. What I am reporting to you, then, is that other economists are not only probably underestimating the impact of the $16.2 billion tax cut on spending, but that they are also generally unaware that the total stimulant for the consumer sector during the year beginning July 1 is more like twice the fiscal stimulant that is now making its way through Congress.

Before elaborating and spelling out the implications for the economic outlook and sound policy, let me interject a couple points. Widespread dissatisfaction with recent work of economists, especially their forecasts, is no secret. That does not mean this committee should quit consulting economists, any more than you quit consulting physicians after they fail to cure a serious illness. But I would like to see this committee play a major role opening the windows to new thinking. The economics profession is now more in need of major innovation in thinking than at any time since the 1930's.

In my own experience, I find it easy to find outlets in scholarly journals for minor innovations that do not rock the boat too much. But that same experience suggests it is next to impossible to win a hearing for a major innovation. This is why I attach very special significance to this opportunity to appear here today. You could play a crucial role. I might say, I heard Walter Heller mention a few minutes ago that in recent recoveries consumers increased spending more than 100 percent of the increase in income. This, of course, is my thesis and it is the first time I have heard a major economist make this statement. This is the kind of impact on thinking I am talking about.

In my own judgment economists will continue making serious errors, leading this Congress far astray in the formulation of economic policy, until economists at least adjust their models of the consumer to account for changes in how consumers spend and save since the 1930's. One very important change since then in how consumers spend and save is represented in the growth of consumer installment debt. This is the focal point of my research. And it is in the behavior of installment debt that I find the $15.2 billion stimulant I am reporting to you. Before explaining this in more detail, let me also report that although this work is not well-known, several able economists, including persons who have testified here, have examined how I make this computation and totally agree with my logic. The research was also well received at a staff seminar of the National Bureau of Economic Research in late 1973.

To relate this $15.2 billion stimulant to something with which you are familiar, we all know consumers cannot spend all they earn. There are two major legal claims against the income consumers can earn. One is talked about a lot. It is taxes. The other receives little attention. It is the legal requirement that consumers repay what they have borrowed in the past. Consumers are free to spend only that income left after paying their taxes and meeting required repayments on past borrowing. My research has focussed for 16 years on the effects of past borrowing on current spending and saving.

One way I approach this problem is to note that for any period, such as the year beginning July 1, 1975, part of the repayments on debt within that year is totally predetermined by borrowing before the year starts. Because of this particular pattern of borrowing between mid-1971 and mid-1975—assuming my forecast for borrowing for the 4 remaining months of these 4 years—my model shows there will be a deceleration of repayments on past borrowing the year beginning July 1.

Chairman HUMPHREY. Is that because consumer installment indebtedness has fallen?

Mr. BURRESS. That is part of it. It is not just the deceleration of borrowing since July 1, 1974. It is also because consumers borrow on a 3-year repayment pattern. As a result, we are dropping repayments on the sharp increase in borrowing between mid-1971 and mid-1972. But we are adding to this repayment pattern a period—between mid-1974 and mid-1975—when borrowing is dropping rapidly. Hence repayments will be down sharply.

The fact is if borrowing had fallen from mid-1971 to mid-1972 by the same amount that borrowing is falling between mid-1974 and

mid-1975, there would be no stimulant for the year beginning in mid-1975. Hence the stimulant is not just a result of the recent deceleration of borrowing. It is a result of the pattern of borrowing extending back to mid-1971.

Chairman HUMPHREY. In other words, the borrowing rate was higher in the 1972 period?

Mr. BURRESS. Yes, if we drop a period of much higher borrowing and add a period of much lower borrowing, you tilt the repayment pattern down.

Chairman HUMPHREY. I get your picture.

Mr. BURRESS. This will put $15.2 billion into the hands of consumers next year that was used the previous year for debt repayments. This will be income freed to spend—like a tax cut—that had been committed in the past.

In the prepared statement I submit for the record, I document several successful forecasts I have made in the past that would have been of special interest to you. But I want to direct your attention to one. It is the attempt of the profession to forecast the effect of an expected $22 billion tax refund in early 1973 enlarged due to the overwithholding of Federal income taxes in 1972.

Relying on theories of consumer spending and saving developed in the thirties, the November 1972 printout of the econometric model of the University of Michigan said saving would rise sharply at first. The depression model is also evident in the 1973 Economic Report of the President. In early April 1973, Business Week interviewed several economists, including myself, on the pattern of the saving rate throughout 1973. Other economists, according to Business Week, said the saving rate would indeed be high in the first half.

I told Business Week—and they reported in part—that the saving rate would fall in the first quarter and that the absolute level of saving might even fall. Before first quarter 1973 data were adjusted, primarily to reflect the business profits of the unincorporated farmer, the data showed that personal saving fell $4.4 billion.

Business Week reported that other economists, like those at the CEA and the University of Michigan believed that as income slowed in late 1973, consumers would dip into their saving and cushion any tendency towards recession. Under the heading "Which Way for Saving," Business Week reported my view that this forecast was based on the theory born of depression and dead wrong. I forecast that the probability of a 1974 recession was higher than others thought. And rather than cushion any tendency towards recession, I forecast consumers would play a major role in producing that recession.

In the final half of 1973 income slowed as was widely forecast. The saving rate shot up—as I had forecast—to 9.5 percent, a postwar high by a wide margin. There are few who would argue that the consumer did not play a major role in producing the current recession.

What does all of this mean for the economic outlook? Consumer confidence is much lower now than in earlier recessions. The immediate response of consumers spending may not be as great as in the past. But the saving rate will not go to 11.8 percent. Nor will it be

even close to 9.5 percent—its alltime previous high—throughout 1976 as suggested by both Chase Econometrics and Data Resources, Inc. This means the recovery will be stronger than most expect, especially in early 1976. I expect the sharp increase in output to bring an equally sharp increase in productivity and reduction in unit labor cost. This will push the rate of inflation down to 5 percent by mid-1976, maybe lower.

Perhaps the most important remaining question is whether this strong recovery in 1976 will set the stage for a return to double-digit rates of inflation and double-digit interest rates in 1977.

One ray of hope is found in current estimates of potential GNP. If these are right, this economy at midyear will be producing nearly $180 billion below what it would be producing if unemployment were 5 percent. In 1974 dollars, the figure should increase $15 billion per quarter.

But as Mr. Evans said before this committee, there is evidence that with so much capital spending going to pollution abatement plus the influence of controls and the like, we may not have increased our stock of plant and equipment since 1973. I noticed in the testimony, Mr. Chairman, that you interrupted Mr. Evans at that point and asked if his statement was factual. You raised a very important question to which we must address ourselves.

The inflationary bottlenecks hit recently when unemployment was above 5 percent supports Mr. Evans' thesis. This raises a very important question; namely, whether equations for potential GNP may be overstating our potential output as much as $50 billion. This, in turn, raises the possibility that a strong 1976 recovery may soon again slam against inflationary bottlenecks in 1977—unless more is done now to expand the capacity of this economy to produce.

But there is another ray of hope that is brighter. The installment debt forces I have cited as providing stimulant the year beginning July 1 will reverse themselves and provide modest restraint—acting like a tax increase—beginning in mid-1976. The restraint will become even stronger the year beginning in mid-1977. This pattern is suggested by the equations in my model and the pattern has been followed after every postwar recession.

Chairman Humphrey. Very interesting, very good.

Mr. Burress. We have had this restraint problem. Half of the $16.2 billion stimulant passed the House in a rebate on 1974 taxes will not be a source of further stimulant in 1976. This will leave only the $8.1 billion permanent reduction in taxes in 1976 and part of this will be offset by restraint from installment debt variables. I am sure that in this setting this Congress will be looking to ways to stimulate the economy even more.

I can only hope you will take the position of the statesman and design fiscal stimulus that will increase the productivity of workers and expand our capacity to produce.

What I am suggesting is that resumption of strong growth with substantially less inflation is a possibility. But these rays of hope, I am afraid, are dimmed, if not totally darkened, by two other considerations.

First, the faster than expected recovery in 1976 will push short-term interest rates up much faster than even the Federal Reserve

expects on the basis of their textbook depression models. I expect short-term rates to start rising rapidly even while the unemployment rate is still rising. If this were fully anticipated with a more realistic model, we might be able to cope with this development. But because it will be, in part, unexpected, there will be pressure both from within the Fed and outside the Fed to moderate the increase in short-term rates, such as the prime rate. The only way the Fed can moderate the increase in short-term rates is through an excessive expansion in the money supply. This, in turn, would almost assure close to double-digit inflation in 1977. And I would expect long-term interest rates, important for housing, which did not fully adjust to recent inflation, to increase even more.

The second and most fundamental reason all rays of hope are almost entirely dimmed is that it will be years before the economics profession reformulates it's thinking and methods. The problem is not just a matter of use of a theory which explains the 1930's, but fails to explain the last 20 years. But econometric models—we have seen here by citing Chase and DRI—still tell the economists that, just as in the 1930's, saving still falls in recessions and rises in recoveries. You yourselves can check the official data and see that the pattern is just the opposite. I suggest this committee start asking some tough questions of economists using these theories and econometric models.

I am convinced that we do have an opportunity to resume a strong increase in output with lower rates of inflation. The total $31.4 billion stimulus from the tax cut and the deceleration of debt repayments is not, by itself, too much because it is cut back by three-fourths starting in 1976. But there is little reason for optimism.

We will need statesmen at the Federal Reserve to get the money supply moving much faster now, then provide necessary restraint in 1976 and later. We will need statesmen in the economics profession who will no longer stimulate consumer spending on goods which pushes us beyond our capacity to produce and create more inflation. We will need a Congress that will do all in it's power to increase the productivity of workers and the capacity of industry so that all may enjoy a higher standard of living with less inflation.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Mr. Burress, I want to express the thanks of the committee for what I consider to be really innovative and far-reaching testimony. I think you have challenged us here and I want you to know we are going to accept that challenge, particularly as to these econometric models.

I have to go down and cast a vote. I know this is impolite, but I hope you will forgive me. We will put all of your testimony in the record.

I may take the liberty, if you do not mind, of posing some questions to you in writing, and if you will be kind enough to respond we will include that along with the body of your testimony.

Mr. BURRESS. Very good.

Chairman HUMPHREY. Because I want to explore with you in more detail, which I cannot do now——

Mr. BURRESS. I fully understand and appreciate it.

Chairman HUMPHREY [continuing]. The question you are putting to the economic profession. I sense what you are saying is so true, and I want to explore it further.

Mr. BURRESS. I hope you will get a chance to look at the more detailed study.

The economics profession will not change from within. We have got to have pressure from outside the profession from people like yourselves to get the kind of reformulation we need.

[The prepared statement of Mr. Burress follows:]

PREPARED STATEMENT OF GLENN E. BURRESS

A NEW APPROACH TO FORECASTING THE IMPACT OF FISCAL POLICY ON THE CONSUMER WITH SPECIAL REFERENCE TO THE PROPOSED 1975 TAX CUT

There is no longer debate over whether the federal government should provide fiscal stimulus to halt recession. The only remaining question is over the nature and size of the stimulus required to end recession without rekindling the fires of inflation.

There are some important similarities between the problem faced by government now and the problems faced by government in the early sixties. As in the early sixties, unemployment is too high and output too low. There are also important differences. Perhaps the most obvious difference is that we are more sensitive to the problem of inflation. But another important difference is that we now have the results of both the 1964 tax cut and the 1968 surtax to search for clues on how a tax cut now may affect the U.S. economy in 1975 and beyond. To suggest that the evidence from these two experiences is conflicting, even contradictory, is to put it mildly. What can be said is that both the economists and the layman now see the U.S. economy as far more complex than was assumed in the early sixties.

As in any other profession, how the economist sees his or her world is shaped by the tools used. One tool used by the economist is economic theory. Economic theory is no more than statements which economists believe explain how the economy works. Another important tool of the economist is econometrics. Econometrics draws on statistics, mathematics and economic theory to describe the past and project the future. For example, when the Council of Economic Advisers recently compared the effects of the President's program for recovery with the alternate program offered by the Joint Economic Committee, the CEA used two well-known econometric models. Because such models are assumed to describe most accurately economic relationships in the past, it is assumed that they are the best available tool to project the future. One of the theses developed in this paper is that these models do not describe accurately the past and therefore are unlikely to project accurately the impact of the proposed 1975 tax cut.

Thus stated, it may seem that the issues raised in this paper are both controversial and highly technical. They are controversial. But they are not technical.

To most laymen, the economist's world of economic theory is a world of the mystic. What few laymen recognize is that the econometrician's world of equations and models is often, even to his fellow economist, also a world of the mystic. In these worlds of mystics, few care to venture forward on the basis of commonsense or intuition. Laymen therefore place their faith in the economist. And most economists therefore place their faith in the econometricians. But the record of the last decade suggests clear reason to question these faiths.

It is not suggested, not by any means, that economic analysis should return to casual application of common sense and intuition. But experts on the methodology of economics will agree that laymen, on the basis of common sense, are often as qualified as anyone to judge the appropriateness of the fundamental postulates or axioms from which sophisticated work of the economist follows.

It is the thesis of this paper that one reason the evidence on the effects of economic policy of the last decade seems so confusing and so contradictory is that economists are focusing on inconsistencies in the conclusions of their sophisticated analyses when they should be focusing on inconsistencies between (1) their fundamental postulates and (2) the way the economy has worked

since World War II. If the problem lies at this level, some of the issues can be addressed for evaluation, not merely to the professional economists, but also to the layman, especially those who use the economist. This paper is addressed to both audiences.

But the reason the paper is addressed to both audiences is not just to expand readership. Rather this audience is selected with the conviction that influential users of the output of economists—such as members of the Joint Economic Committee for whom this is written—have a very special role in improving the track record of economists. If these influential users do not bring pressure from outside the profession to reformulate basic models, there is little hope for improving on the track record of the last decade. This paper is an attempt to bring pressure on the profession from without. The reasons why this is necessary will become clear. Hence, in a sense, these persons outside the profession are the more important audience of the paper. Therefore I have tried to avoid technical jargon and address the paper to essentially the same audience I reach in my column in the Journal of Commerce.

In Part I there is a summary of what I view as erroneous use of the 1964 tax cut and 1968 surtax experiences as guides for approaching a program of fiscal stimulus in 1975, 1976 and beyond. In Part II there is an explanation of a $15.2 billion stimulant that will flow into the hands of consumers during the year beginning July 1, 1975. It is argued that this has been overlooked by the profession because the profession fails to question its fundamental postulates of both theory and method. Problems with some of the methods of economists are treated in non-technical fashion in Part III and problems with some of the theory of economists are treated in similar non-technical language in Part IV. In Part V both the 1964 tax cut and the 1968 surtax are examined through the lenses provided by the new approach and it is found that this approach has specific and important implications, not just for 1975 and 1976, but for 1977 and 1978 too. Finally, in Part VI, there is a summary followed by implications of the new approach for the economic outlook and for policy. Those short on time can skip to Part VI. But an understanding of these issues by busy users of the output of economists is precisely what is required to induce necessary reformulation within the profession. I hope they will find time to read the entire paper. Economists will want more detailed proof of some of the assertions here. They are referred to a paper prepared for a Staff Seminar at the National Bureau of Economic Research in New York City November 16, 1973. Its title: "One Response to Frustrated Economic Policy: A More General Theory of the Consumption Function."[1]

1. A CRITIQUE OF THE PROFESSION'S APPROACH TO THE 1975 TAX CUT

To develop support for the tax cut passed by the House and now before the Senate, many are citing the success of the 1964 tax cut. In March, 1964 taxes were cut, increasing the deficit substantially. Most of the tax cut went to consumers. The response of personal saving and consumer spending was almost exactly as forecast by proponents of the tax cut. The rate of saving rose at first and consumer spending appeared affected only after some delay.

Indeed it is well known that economists at the Council of Economic Advisors in the summer of 1964 feared that the response of consumer spending was too long delayed. But spending, output and employment did rise in time. Even with the lower tax rates, the rise in taxable income associated with expansion of the economy generated so much Treasury revenue that a year later there was no longer a budget deficit, but a surplus. As for the rate of inflation, prices were up only 1.7 percent in 1965, hardly changed from 1964 as measured by the Consumer Price Index.

Of course inflation did accelerate later. But many economists attribute that to the build-up of Viet Nam spending, not the 1964 tax cut. Although economists will long debate whether it was the tax cut or the simultaneous increase in the money supply that stimulated the economy, they will agree that

[1] This paper is not available at the NBER. It appears as a working paper in the monograph series of the College of Management, University of Texas of the Permian Basin, Odessa, Texas, 79762.

the behavior of the consumer after the 1964 was a classic example of textbook theory. After that experience, one finds whole sections in later Economic Reports labelled, "The Dependable Consumer."[2] Confidence in the fiscal policy as a tool for stabilization rose to new highs.

It is suggested that this apparent glowing success of fiscal policy was fortuitous. To be sure, it is well known that since 1967 consumer spending and saving have deviated far from the script provided by theory. What is not well known is that this pattern of consumer behavior, contradicting textbook theory, predated the 1964 tax cut a decade. Textbook theory—a restatement of Keynes's "fundamental psychological law"—tells students that when income falls in recessions, saving also falls and when income rises in recoveries, saving also rises. In contrast to this theory, in the ten years before 1964, the absolute level of saving moved opposite direction of the change in income six times. In 7 of these ten years, the direction of changes in the percentage of income saved also contradicted textbook theory. These data are annual and adjusted for price and population changes.

In light of this history, it is suggested that the confirmation of textbook theory found in the 1964 data was fortuitous. Yet the data for that year—when combined with econometric interpretations of these earlier years, a problem discussed in non-technical language below—were interpreted by the CEA to justify reference to The Dependable Consumer.

Of course it was on the basis of the assumption that one could rely on The Dependable Consumer that the Johnson Administration proposed and the Congress passed the 1968 surtax to contain inflation. That proposal was formulated on the assumption that as income rose rapidly in 1968, consumers would increase their saving, supplementing the surtax as a drain on purchasing power to reduce inflationary pressures. But as income rose in 1968, spending rose even more than income and the absolute level of saving fell. (The data are inconsistent with the textbook theory even if one allows for the fact that income, without the surtax, would have been higher.) It was after this experience that many economists, the business press, academic journals and others questioned whether the consumer is so dependable, and many switched to the opposite extreme, the position of the monetarists.

The reason the "apparent" success of the 1964 tax cut was unfortunate was, not merely that it led to unjustified confidence in what the 1968 surtax would do. On the contrary, it is suggested that a far more unfortunate effect, one that continues to impede progress in the economics profession, was the polarization of the profession between the monetarists and the fiscalists.

Monetarists are economists who, in explaining fluctuations in economic activity, assign a primary causal role to fluctuations in the rate of growth of the money supply controlled by the Federal Reserve System. This group is led by Dr. Milton Friedman of the University of Chicago. Fiscalists assign a primary causal role to fiscal policy—changes in tax rates and government spending. This group is led by Dr. Walter Heller of the University of Minnesota with Dr. Paul Samuelson of MIT and Dr. Arthur Okun of the Brookings Institute. Due to the initial polarization of the profession after the 1964 tax cut, the issue between fiscalists and monetarists was drawn sharper. And when the 1968 surtax appeared to have had little effect on the economy, as forecast by the monetarists, the polarization grew even sharper.

But since 1968, it has become clear that neither group has a monopoly on a model that satisfactorily explains the process of economic change. But continued polarization of the profession between these two schools makes difficult the objective interpretation of new evidence. Most economists seem more interested in showing how any new evidence can be related to their continuing debate as either monetarists or fiscalists rather than using new evidence for a reformulation of models for better explanation of the data.

It is suggested that one reason we have seen more heat than light in the debate between the monetarists and the fiscalists—and why both are underestimating the impact of the proposed tax cut on consumer spending—is that both use models of how consumers spend and save that are essentially unchanged since the 1930's. It is a thesis of this paper that neither this Congress,

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[2] 1965 Economic Report of the President, p. 41.

nor the Administration, nor even the Federal Reserve, has a significant chance of success in the formulation of economic policy so long as the economists to whom they turn continue to use the textbook depression model of the consumer.

There is abundant evidence that in analyzing the impact of the proposed 1975 tax cut, economists both in and out of government, continue to use these depression, textbook models. For example, consider the two leading private models—those of Chase Econometrics, Inc. and Data Resources, Inc. These are the models used by the CEA recently to compare the effects of the Administration's program with the alternative offered by this Committee. Both of these models tell us that as a result of the tax cut, personal saving will rise sharply. They see the saving rate climbing to 11.3 or 11.8 percent later this year soon after taxes are cut—nearly a third higher than the all-time high, 9.5 percent. Both tell us that the tax cut will affect spending significantly only after long delay. Both tell us this will be a replication of 1964. That year, 1964, was not a year of recovery. But the next few quarters will be. We shall see that this makes a difference. Other economists have not yet recognized that the rate of change of real disposable (or discretionary) income is a powerful determinant of even the direction of change of personal saving.

In the 1930's it was indeed true that consumers reacted to increased income in recoveries by increasing saving faster than income. The percentage of income saved rose. But in not one single period of recovery in the last 20 years has the consumer reacted to increased income by increasing the proportion of income saved. Indeed, in 1955, 1959, 1968 and 1972 recoveries when income rose, spending increased even more than income. Because real income rose so fast, even the absolute level of saving fell.

In every recovery period for 20 years the consumer has proved most economists' forecasts wrong. Only time will tell how the consumers will react to the tax cut during the recovery that will get under way later this year. But if consumers follow the path of the last 20 years, they will again prove most economists wrong. In short, if consumers follow the path of the last 20 years, it will mean that economists are underestimating the impact of the tax cut on consumer spending.

The alternative approach to consumers spending and saving described here carries with it a highly successful forecasting record. These forecasts were sometimes published in advance by Business Week and the Wall Street Journal and have often appeared in my column in the Journal of Commerce. Many of the forecasts with this new approach have been most successful in recent years precisely when forecasts based on the depression model of the consumer most seriously led this government astray in the formulation of economic policy.

But the objective of this paper is to do more than emphasize the high probability that others are underestimating the impact of the tax cut on consumer spending. It must be emphasized that other economists, and therefore this Committee and others in government, are neglecting an otherwise unnoticed $15.2-billion stimulant estimated to flow into the hands of consumers during the year beginning July 1. What I am reporting, then, is that other economists are not only probably underestimating the impact of the $16.1-billion tax cut on spending, but that they are also generally unaware that the total stimulant for the consumer sector during the year beginning July 1 is more like twice the fiscal stimulant that is now making its way through Congress. The total stimulant is estimated at $31.4 billion.

II. THE NATURE OF THE NEGLECTED $15.2-BILLION STIMULANT

The most important change since the 1930's in how consumers spend and save is represented in the phenomenal growth of consumer installment credit. A study of data in Table 1 will show that most of the inconsistencies between textbook theory and the script actually followed by consumers in recessions and recoveries over the last 20 years can be explained by data on consumer installment debt. That is, if one removes from the official reported data the effects of installment debt on the changes in personal saving, (column 2), the adjusted data are far more consistent with textbook theory.

TABLE 1.—SELECTED DATA ON ORIGINS OF ANNUAL CHANGES IN PERSONAL SAVING AND THEIR CONSISTENCY WITH THEORY, 1953-72.

Year	Millions of current dollars					Years of significant short-run change [1]		
	(1)=(2)+(3) change in personal saving	(2) change in personal saving without installment debt change	(3) change in personal saving due to installment debt	(4) annual real per capita MPC	(5) saving-income ratio	Identified	Are data consistent with traditional theory?	Are data consistent if installment debt change removed?
1953	$+153	$−354	$+507	0.95	0.072			
1954	−1,904	−4,943	+3,039	[2] −0.22	.064	Recession	Possibly [3]	
1955	−579	+4,196	+4,775	1,04	.057	Recovery	No	Yes
1956	+4,749	+2,225	+2,524	.30	.070			
1957	+171	−495	+666	1.91	.067			
1958	+1,536	−838	+2,374	1.22	.070	Recession	No	Yes.
1959	−3,219	+2,612	−5,831	1.38	.057	Recovery	No	Yes.
1960	−2,040	−3,924	+1,884	2.23	.049			
1961	+4,135	+1,337	+2,798	.27	.058	Recession	No [4]	No.
1962	+439	+4,345	−3,906	.97	.056	Recovery	No [5]	Yes.
1963	−1,648	+289	−1,937	1.16	.049			
1964	+6,246	+6,686	−440	.72	.060			
1965	+2,244	+3,199	−955	.89	.060			
1966	+4,095	+1,246	+2,849	.82	.063			
1967	+7,839	+5,670	+2,169	.55	.074	Mini-recession	No [4]	No.
1968	−608	+4,531	−5,135	1.10	.067	Recovery	No	Yes.
1969	−1,551	−508	−1,043	1.27	.060			
1970	+16,644	+12,243	+4,401	1.12	0.079	Recession	No [4]	No.
1971	+6,080	+11,072	−4,292	.80	.082	Recovery	Yes	n.a.
1972(P)	−10,415	+3,609	−6,806	1.44	.062	Recovery	No	No.

[1] Defined as periods when the rate of change of disposable income deviates significantly from its trend. The pattern is more evident in quarterly data. For report on fit of model to quarterly data, see Burress, "The Initial Effect of the 1964 tax cut on Consumer Spending," National Tax Journal, 17, (September, 1964), pp. 265-73.

[2] Sign explained by reduction in spending as income rose gradually.

[3] Unpublished Federal Reserve sources suggest 1954 consumer saving data are inconsistent with theory if separated from data on unincorporated fifms.

[4] Short-run or cyclical MPC concealed in annual data.

[5] Saving-income ration fell in recovery; annual MPC exceeded apparent LR-MPC.

Sources: Business Statistics, 1971; Survey of Current Business, July 1972 and July 1973; Federal Reserve Bulletin, December 1968, October 1972 and March 1973.

It was for this reason that efforts to reformulate textbook theory to explain official data (column 1) have focused on the behavior of installment debt. And it was a by-product of this task that led to the variable that will produce a $15.2-billion stimulant in high spending, middle-upper income groups during the year beginning July 1, 1975.

A logical question to ask is why this $15.2-billion stimulant is not recognized by other economists? Why should members of this Committee place confidence in this report? First, it can be reported that several able economists, some well-known to you through testimony before this Committee, have checked through the work and not one disagrees with the logic of this calculation. Second, the work was well received at a Staff Seminar at the National Bureau of Economic Research by individual economists, although that in no way implies NBER endorsement. Another question to then be asked is why the profession as a whole has not embraced the new approach? The answer to this question is important, both for this Committee and the profession. The question therefore receives considerable attention in Parts III and IV below. In general, it can be said that when one quarrels with the theories and methods that define what is professional activity and what is not, change is slow to come. This is true in any discipline and not just economics.

Turning to a non-technical explanation of the logic of the new approach, because consumers can readily borrow and repay from future income, current spending is not limited to current income as was generally the case in the 1930's. But to the extent that consumers must repay from current income the amounts due on what they have borrowed in the past, consumers often are less free than they were in the 1930's to spend their current income. In working through the effects of these new patterns on spending and saving, it is found that part of the repayments in any period—such as the year beginning next July 1—is predetermined and this amount is readily calculated. This is that part of repayments in the current period on borrowing before the current period started—as distinguished from repayments in the current period on borrowing within the new or current period.

When the rate predetermined repayments accelerates, the past pattern of installment borrowing—stretching back over the four previous years under current practice—acts like an increase in the tax rate. That is, in that case this predetermined portion of current repayments tends to reduce spending, increase saving, increase unemployment and cool inflationary pressure. But when the pattern of borrowing the preceding four years brings on a deceleration of the rate of repayments in the current year, this predetermined portion of current debt repayments acts like a tax decrease, tending to increase spending, reduce saving, reduce unemployment and increase inflationary pressures.

The particular pattern of borrowing from mid-1971 to mid-1975—assuming my own forecast for borrowing for the remaining five months of this four year period [3]—will combine to produce a deceleration of predetermined debt repayments between the years beginning last July 1, 1974 and next July 1, 1975. In the year beginning July 1, 1975, this prior pattern is expected to put $15.2-billion into the hands of consumers that had been absorbed or required for debt repayments predetermined for the year beginning last July 1, 1974.

In essence what this new approach suggests, at least implicitly, is an extention of the concept underlying the definition of personal disposable income. The measure known as personal disposable income was developed in the 1930's because it was recognized that not all income earned by consumers was available for spending and saving. That is, government has a legal claim against income earned in the form of taxes. Therefore the disposable personal income was developed as an approximate measure of after tax income available to the consumer on spending or saving as the consumer wishes.

But since the 1930's the legal requirement that consumers repay amounts due on past borrowing has developed as another major legal claim on the disposable income of consumers. In the 1930's personal taxes and non-tax payments—the amount by which personal income is reduced to measure personal income—ran four to five times installment debt repayments. But now the

[3] The $15.2 billion stimulant assumes borrowing through March falls at the mean of the absolute rate of reduction for the months August through November of 1973 and then stabilizes through June. An assumption that the rate of reduction in borrowing continues through June produces a $16 billion stimulant and the assumption of moderate to strong recovery starting in April produces a $14 billion stimulant. The total reduction in borrowing reported for December and January is well below the assumed rate.

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relative magnitudes are reversed. In 1974, claims on income from installment debt repayments were 1.27 times claims from personal tax and nontax payments.

But it should be emphasized that the $15.2-billion stimulant reported here is not the result of a predicted deceleration of total repayments on installment debt used here to compare the 1930's and 1974. On the contrary, as mentioned above, the $15.2-billion figure relates only to that portion of the repayments in the year beginning July 1, 1975 that represent repayments on borrowing before July 1, 1975. The reason this is important and repeated is that the accuracy of any calculation of deceleration of total repayments for the year beginning July 1 would depend, in part, on the accuracy of a forecast of consumer spending that year—to the extent that installment debt borrowing is due for repayment that year. What I am underscoring is, then, that the $15.2-billion deceleration of repayments or stimulant for the year beginning July 1 is an outgrowth of the pattern of consumer borrowing before that date. This means that as of July 1, 1975, the $15.2-billion stimulant is totally predetermined. It is independent of actual events during that year—just like a predetermined scheduled increase in social security or other taxes. Put differently, while it is predetermined and independent of events during the year in question, it surely can affect events during the year in question.

It should be emphasized that acceptance or rejection of the $15.2-billion stimulant is independent of whether one accepts or rejects textbook theory of consumer behavior. Indeed there are experts in traditional theory found in the textbook who have written in letters reporting that, although they are not ready to put aside their own views, the calculation which provides the stimulant is a "fundamental" contribution and "should see the light of day" in professional journals. On the other hand, this particular variable explains much of the inconsistency of postwar data with traditional theory. That is, it has already been reported that if one removed from the official data the influence of consumer installment debt, the "adjusted" data are far more consistent with textbook theory. It will be recalled that this is why the new approach to explaining the data seeks to modify traditional theory to account for the role of such debt. What is suggested now is that in some major cases it is this predetermined repayments component of consumer installment debt that explains the inconsistencies. It therefore seems clear that acceptance of this variable and recognition of its role in rendering accepted theory inconsistent with the data logically calls for at least an effort to reformulate accepted theory. In the next two parts impediments to reformulation of theory and methods are explained. Those less interested in the theory and methods of economists can skip this non-technical material and go on to Part V.

III. A NON-TECHNICAL ILLUSTRATION OF MISUSE OF ECONOMETRIC MODELS AS AN IMPEDIMENT TO REFORMULATION OF THEORY

To illustrate how misuse of econometric models serves as an impediment to the reformulation of theory, suppose an economist wants to know what has happened to the percentage of disposable income saved during recoveries over the last 20 years. That is, suppose the economist seeks to develop a theory or explanation of the saving ratio in recoveries in the past and forcast in the future. Common sense might suggest that he should look to the data for the years 1955, 1959, 1962, 1968 and 1972. To be sure, the economist will not look only at annual data. But common sense would suggest that these annual data should be examined. Yet, that is not what the economist is trained to do. His training tells him, not to look to data for a series of separate periods, but to look to computations known as regression coefficients. These coefficients, according to econometric theory, are supposed to provide an objective summary measure of what happened to the saving ratio during these recoveries.

Now it so happens, as has been emphasized earlier, that the saving ratio fell in each of these years—in every recovery spanning the last 20 years. But a regression coefficient, computed from data for these same 20 years and only these 20 years, tell the economist he should assume the saving ratio rises in recoveries! This, then, explains why the two models used by the CEA to evaluate the program offered by President Ford and the alternative offered by this Committee has the saving ratio rising to 11.3 percent or 11.8 percent later this year when taxes are cut. This is why these same models tell us that the saving ratio will remain near or above 9.5 percent, it's all-time high, through projected strong recovery in 1976. History tells us saving will not be that high.

History tells us that spending will not be that low and that recovery will therefore be stronger than predicted by these models used by the CEA.

This point is so important that further elaboration is in order. Not only are economists trained to look at regression coefficients rather than a collection of data for individual years, it is also true that they are trained to develop theories to explain, not a series of observations for individual years, but to explain regression coefficients. But if these regression coefficients misrepresent even the direction of change in the raw data, it should come as no surprise that theories developed to explain the regression coefficients can be used to neither explain nor predict even the direction of change in the raw data.

One of the best examples of this was illustrated in a conversation in late 1972 between myself and a staff economist at the CEA. It seemed to me to be such an important conversation that it was confirmed by letter and I secured permission to paraphrase our conversation and report it without attribution as follows:

Burress: Why did the CEA forecast that the saving ratio would not come down in 1972?

CEA economist: We were expecting a fairly sharp increase in income and it was a matter of the simple texbook case. That is, when income rose rapidly, you expect saving to rise even more rapidly, pushing the saving ratio higher. It was so high in 1971 it might not go higher. But we had no reason to think it would come down in 1972.

Burress: What is your evidence that, in fact, the textbook case describes the real world? What would be the case for planning policy on the basis of the textbook model?

CEA economist: You look to the regression coefficient in econometric models of the consumption function. These show that when income rises rapidly, saving rises even faster and when income falls in a recession savings falls even faster. You can see this in any well-known econometric model.

Burress: I am aware that this is found in all the well-known econometric models. But have you looked at specific earlier recovery periods when income rose as rapidly as was expected for 1972? That is, are you aware of what happened to saving as income rose rapidly in 1955, 1959, and 1968?

CEA economist: No, I am not. The regression coefficients in econometric models provide the best description of the past that is available to economists. I know they show saving rose in recoveries in recent years. But I have not looked at what happened to saving in these specific years and I doubt if any other economist in the CEA has either.

Burress: Well, my approach is to look at the specific years. The fact is, the absolute level of saving fell as income rose in 1955, 1959, and 1968. And it looks like that's going to happen again this year. How can you reconcile these data for individual years with the econometric estimates of the past?

CEA economist: You are always going to have some years that depart from your model.

Burress: You also mentioned that the econometric models tell you that saving falls in recessions. Are you aware that saving rose, rather than fell as you suggested, in 1958, 1961, and 1970 recessions as well as in the 1967 mini-recession? As I read history you have a pattern here. The econometric model systematically misses even the direction of change of saving in recessions and recoveries since the mid-1950's.

CEA economist: If there were such a pattern, it would be picked up in the error term of the econometric model. The econometric models tell us what happened, fundamentally, despite all these "wiggles" in the data.

Years of efforts to see the theory of consumer behavior reformulated leaves me convinced that the problem illustrated in this report is the most serious of all impediments to change. Some may conclude that these comments represented the approach, not of the economics profession, but of this particular CEA economist. But most economists, like the former CEA chairman with whom the discussion was discussed, will recognize this as a predictable dialogue. Yet, because of the importance of the issue and because some may remain convinced that the problem is not so widespread, another example is cited.

This example comes from a memorandum to a private client dated December 7, 1973. The client in question subscribes to forecasts generated by one of the well-known econometric models. The model is not identified because the criticism offered is not a criticism of the firm in question, but the approach

of the profession. Hence, the name of the firm in this passage has been changed to "X".

The assignment was to evaluate the November, 1973 forecast produced by the model for the consumer sector in 1974–75 with particular reference to the automobile industry. An excerpt from the memo follows:

"Some, of course, would argue that econometric models such as X's are non-ideological, merely depicting past relationships, independent of debates on consumption function theory. Be that as it may, a close examination of the quarter-to-quarter pattern of changes in spending and income justifies serious questions as to whether respected and well-known econometric models do indeed depict accurately past relationships. That is, projections of the cyclical pattern of consumer spending through an expected recession and recovery should, it would appear, bear some relationship to the cyclical pattern in previous recessions and recoveries. To determine if this is the case, it is instructive to compare (1) the cyclical pattern of changes in spending and income projected by X during the recession and recovery they forecast for 1973.4–1976.1, to (2) the actual data for the last recession and recovery period, 1969.4–1973.1. Presumably these data were used as a basis for the X projections for 1974 and 1975."

"In the peak quarter, 1973.4, X projects a fairly large increase in personal disposable income, $7.3 billion. But the increase in spending lags at $1.4 billion. (All figures here are in 1958 dollars.) Then as the economy slows down in 1974, X predicts consumers will continue to increase their spending, even as real per capita disposable income falls. The X model forecasts that during sluggish 1974 the mean quarterly increase in disposable income will be only $3.2 billion, but the mean quarterly increase in spending will be even more, $4.9 billion. The increase in spending exceeds the increase in income every quarter of 1974 as consumer spending fails to respond immediately to the slowdown."

"The X forecast for the recovery suggests the consumer is likewise sluggish in his adjustment to rising income, just as suggested by the textbooks. According to X, for the five quarters 1975.1–1976.1, the mean increase in income in recovery is $9.9 billion. But the mean increase in spending is only $6.5 billion. In each of the five quarters of recovery, the increase in spending is less than the increase in income. In short, the consistency of the X forecast with traditional theory holds up in every quarter of recession and recovery."

"But this pattern is a striking contrast to the 1969–71 experience. In the peak quarter, 1969.4, the data are similar to those suggested by X for the 1973.4 peak. But during the 1970 recession, when the mean increase in disposable income was $4.1 billion, the mean increase in spending was only $1.3 billion. Except for 1970.4 during the auto strike. the increase in spending was less than the increase in income every quarter. In that fourth quarter, income fell $4.7 billion and spending fell $3.4 billion."

"The contrast between the data for the 1971–72 recovery and the projected recovery is even more striking. Recall the X model has spending increasing less than income in every quarter of recovery. But in the 11 quarters, 1971.1–1973.1, the data show that the increase in spending exceeded the increase in income 9 times. For all 11 quarters the mean increase in income was $7.4 billion and the mean increase in spending was $8.4 billion. Quite obviously, there is more at issue here than whether the habit hypothesis is an appropriate theory. There is the closely related econometric question: If this is the pattern of the data, why do standard econometric models fail to pick up the pattern, at least in the error terms. Both questions are of course, focal points of the NBER paper."

It is very clear that these examples illustrate an unwitting conspiracy between problems in economic theory and problems in the use and interpretation of econometric models. That is, we have a theory—developed in the 1930's—which says that we should expect the saving ratio to fall in recessions and rise in recoveries. When you look at the data for individual years of recessions and recoveries since 1955, these data clearly show the opposite pattern. But when you fit equations to data for these years to summarize or distill lessons of the past, the econometric model tells the economists that saving still falls in recessions and rises in recoveries, just as it did in the 1930's. That is, the econometric model tells the economist his theory still explains the data and no revision in theory is necessary. This simply is not true.

This clearly illustrates the econometric problem. I have suggested however, that there is an unwitting conspiracy between this problem in econometrics and a problem in theory—quite independent of the econometrics.

The next part focusses on the problem in economic theory, i.e., the economist's explanation of why saving is supposed to fall in recessions and rise in recoveries.

IV. A NON-TECHNICAL EXPLANATION OF THE THEORETICAL PROBLEM

What is the theory of consumer behavior—i.e., what is the explanation of consumer behavior—offered by economists which leads them to predict that saving falls in recessions and rises in recoveries? Actually, the entire explanation follows from an assumption that spending is habit forming. In a scholarly journal I have shown that this explanation was first set forth explicitly by Keynes in 1936, but it is usually attributed in error to Duesenberry and Modigliani in the late 1940's.[4] This is why current theory can be called a depression model. It dates from Keynes in 1936.

To see why the assumption that spending is habit forming leads economists to predict that the percentage of income saved falls in recessions and rises in recoveries, assume first there is a recession. Income falls. If spending is habit forming, spending cannot fall as fast as income. If spending cannot, due to habits, fall as fast as income, saving must fall faster than income and therefore the percentage of income saved in recessions falls—so it is reasoned.

Now assume a recovery, like the one expected later this year. It is the assumption that spending is habit forming that explains why models employed by the CEA forecast that the saving rate will jump as high as 11.8 percent later this year and remain at or above 9.5 percent, its all-time high, as income rises rapidly throughout 1976. To see why all this is true, one need only reason that if spending is habit forming, spending cannot be increased in recovery as fast as income. Hence, if spending, due to habits, cannot increase as fast as income, saving must rise faster than income and therefore the percentage of income saved in recoveries rises—so it is reasoned.

What's wrong with this line of reasoning? What's wrong with this theory? It is my position that consumers develop habits of using such things as durables, but that consumers purchase such large ticket items so infrequently that they cannot and do not develop habits of spending.

If spending on such goods is not habit forming and can be postponed during recessions and accelerated in recoveries, it is easy to see why one would then expect and would also then predict that saving rises in recessions and falls in recoveries. For example, if there is a recession and spending is not habit forming, outlays on such things as durables can be postponed. If the recession is mild and the reduction in income is moderate, it is not hard to see that spending could fall more than income. In that case saving rises as income falls.

Then during the recovery, outlays that were postponed during the recession are now accelerated and spending can rise more than income. As a result, saving would fall as income rises.

The notion that a reduction in income can cause saving to rise and that an increase in income can cause saving to fall contradicts textbook theory built into the models used by the CEA and others. But this approach, which contradicts accepted theory, is consistent with data on every recession and recovery for 20 years.

That, of course, is not enough for economists. Econometricians in recent years have, in fact, developed tests of whether spending is or is not habit forming. The most recent and sophisticated work along these lines is the 1966 and 1970 volumes by Hendrick S. Houthakker and Lester D. Taylor of Harvard University and the University of Michigan.[5] They develop what appear to be powerful tests of whether spending is or is not habit forming. They conclude that these tests show that spending is habit forming and that data, when fit to their new model, justifies the long-standing notion that saving falls in recessions and rises in recoveries. Indeed this major study, financed by the Bureau of Labor Statistics and the National Science Foundation, doubtless explains, at least in part, why major models continue to forecast that saving falls in recessions and rises in recoveries. Paradoxically, using this same test developed by Houthakker and Taylor, one can reach just the opposite conclusion from a more extensive analysis of post-war data.

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[4] Glenn E. Burgess, "Who First Proposed the Habit Persistence Hypothesis: Keynes or Duesenberry and Modigliani," South African Journal of Economics, Dec., 1972.

[5] Consumer Demand in the United States, Harvard University Press, Cambridge, Mass., 1966, 1970.

They conducted their post-war test for the 1947-64 period with both annual and quarterly data. I used their model to make the same test for 187 other post-war periods using annual data. The results are illustrated in Figure 1. A study of Figure 1 shows the Houthakker-Taylor conclusion for 1947–64 provides support to the conclusion that spending is habit forming. But these results for 1947-64 are contradicted by most other post-war periods if one restricts himself to annual data for periods 17 years or longer.

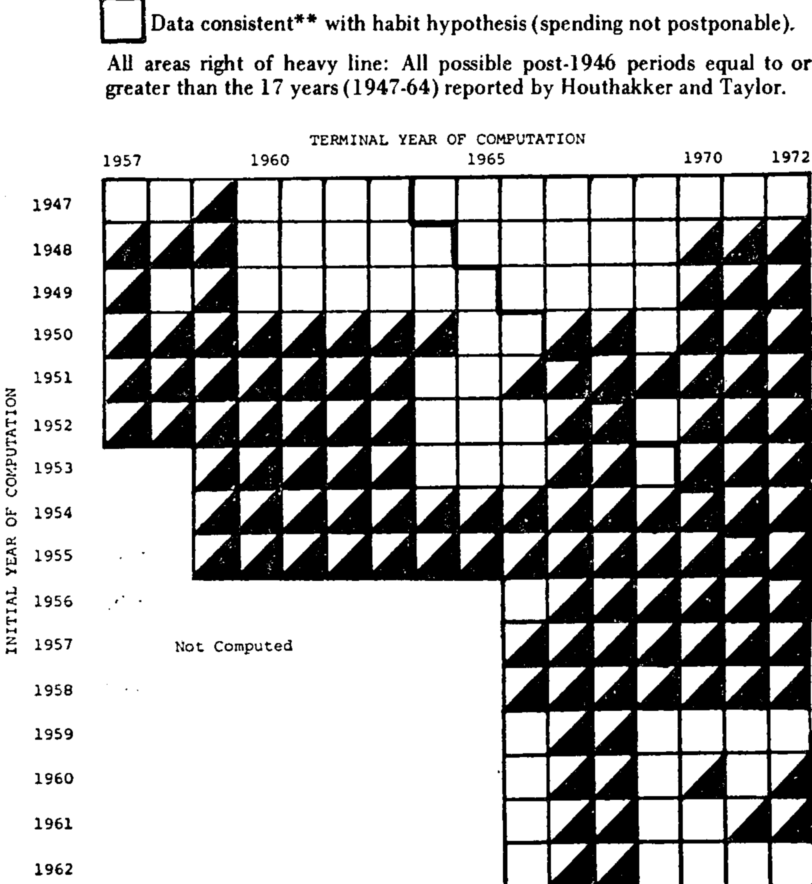
FIGURE 1

Evaluations of the Habit Hypothesis with Annual Data for 187 Different Postwar Periods from Indicated Initial and Terminal Years

Legend: Data inconsistent* with habit hypothesis (spending postponable).

Data consistent** with habit hypothesis (spending not postponable).

All areas right of heavy line: All possible post-1946 periods equal to or greater than the 17 years (1947-64) reported by Houthakker and Taylor.



*Inconsistent case: Negative stock coefficient or SR-MPC greater than the LR-MPC.
**Consistent case: Positive stock coefficient or SR-MPC less than the LR-MPC.

Note: For definitions of all terms and method of computations, see this paper. Estimates of all parameters available upon request from author. Note that both cases—inconsistent and consistent with habit hypothesis—are consistent with alternative model

Indeed, even if one restricts himself to periods 17 years or longer and selects the period for testing at random, the odds heavily favor selecting a period for which the data are inconsistent with the habit assumption. If one excludes as unusual the immediate post-World War II adjustment period and the period of scare buying at the beginning of the Korean War, it is very difficult to produce a result which shows that spending is habit forming. Clearly most of these results are consistent with the view that saving rises, rather than falls, in recessions and that saving falls, rather than rises, in recoveries. Most of these results contradict the assumption that spending is habit forming. Most of these results contradict the textbook model. Most of these results with the test developed by Houthakker and Taylor are consistent with my view and also data of the last 20 years which has the savings ratio rising in recession and falling in recoveries.

At no point in the studies by Houthakker and Taylor does one find even a hint that these tests for most post-war periods yields results that are inconsistent with the habit hypothesis. This suggests the possibility that economists not only look to regression coefficient (rather than data on period-to-period change) to describe data from the past. On the contrary, this result suggests strongly that economists look only to those regression coefficients which confirm accepted or standard theory. Indeed, Houthakker and Taylor write that their model "* * * was designed to represent" the habit hypothesis.[6]

As unscientific as this may seem to the layman, this is not, in fact, the case. Use of postulates as guidelines for analysis of data is the only way scientists can investigate a complex world in which many variables outside his speciality change simultaneously and affect what they study. Perhaps the most important point here is that data which appear to the layman to contradict the scientists's postulates—such as saving and income moving in opposite directions—are often interpreted by scientists as the effect of factors outside his speciality. He may therefore rely on scientists in other fields to explain such inconsistencies.

For example, economists postulate that a change in income cannot cause saving to move in the opposite direction. But they do not postulate that income and saving cannot, in fact, move in opposite directions. If this occurs, the economist's training tells him to look to some external, perhaps non-economic cause, such as Watergate.

The implications of this approach, however, is that one needs a "theory of Watergate" or other outside variables to explain economic data. I prefer the alternative approach. For one thing, the alternative does increase the power of economic analysis and means economists need rely less on other scientists to explain economic data.

V. 1964, 1968, AND 1973: SOME CLUES TO 1975–76 AND BEYOND

Fiscalists argue that the 1964 experience supports their position and weakens the position of the monetarists. Monetarists argue that the 1968 experience supports their position and weakens the position of the fiscalists. The debate and polarization continues. It so happens that both the 1964 and 1968 experiences are consistent with the alternative model that has been used successfully for more than a decade. More important, using this alternative approach, the behavior of the consumer in both 1964 and 1968 was forecast in advance. We now focus on the rationale of those forecasts. Both provide important insight into the shape, not only of 1975 and 1976, but also the shape of 1977 and 1978.

Both the forecast for 1964 and for 1964 and 1968 relied heavily on the role of predetermined repayments already explained. In the more technical NBER paper already cited, it is shown that once there is a recession, predetermined repayments goes through a predictable four year path. It first becomes negative or stimulative late in the recession and the early part of recovery. Then the second year after recession predetermined repayments shifts to moderate restraint. Finally in the third year after recession the restraint rises to a peak, then the variable provides moderate stimulant. Until the next recession the variable can be expected to fluctuate near zero.

The 1964 tax cut came, of course, three years after the 1962 recession. Predetermined repayments, therefore, predictably climbed to a cyclical peak.

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[6] Ibid., p. 282.

In short, there was a sharp acceleration of repayments in 1964 on previous borrowing. This acceleration of repayments acted like a tax increase, offsetting 45 percent of the tax cut in 1964. In an article written in February and March of 1964 and published in a scholarly journal, in September of that year,[7] I predicted that much of the impact of the 1964 tax cut on spending would be postponed until 1965 and that the savings rate would rise in 1964 as income rose. As already mentioned, the consumer did follow this path, a path which also happened to have been called for by the depression, textbook model that year. The CEA and others interpret the increase in saving and the delayed impact on spending as evidence supporting the habit theory—the assumption that spending is habit forming and could not increase as fast as income. As also noted earlier, this is why the CEA, in later Economic Reports, referred to "The Dependable Consumer." What was actually seen, in my judgment, was a fortuitous acceleration of predetermined debt repayments explained, not by textbook theory, but by the fact that the 1964 tax cut came three years after the 1961 recession.

The year of the surtax, 1968, was the first year after what was to be called a mini-recession. From the viewpoint of consumer behavior, and especially the behavior of installment debt variables, 1967 was very much like any other mild post-war recession. On the basis of the four year cycle of predetermined saving, this variable therefore predictably turned negative in 1968, providing stimulant. This, of course, tended to offset the impact of the surtax at least until predetermined saving shifted toward restraint the next year, 1969. It turned out that the reduction in predetermined saving in 1968 amounted to 70 percent of the surtax imposed that year. This may explain why the surtax did not have the effect that so many expected.

This was anticipated with the new model in the spring and summer of 1967 while serving as Economic Advisor to the American Bankers Association. In August, 1967, the U.S. Treasury asked for the views of the ABA on the proposal to impose a 10 percent surcharge. I surveyed members of the Economic Policy Committee, drafted a report to ABA management for transmittal by hand to the Secretary of the Treasury, but added my own comments as follows:

"It is clear that the views of the Committee reflect an assumption of the more or less standard forecast and on that basis they unanimously favor the surtax rate at the full 10 percent rate. There is one aspect of the standard forecast which, I suggest, should be questioned. As reflected in econometric models, rising income following a year of depressed demand is assumed to be accompanied by an even more rapid rate of increase in personal saving.

"This did not occur in 1955, 1959, or 1962. I am convinced that saving via installment debt variables in 1968 will be down and very likely will be down enough to depress total saving below the 1967 level. In other words, consumer demand may provide more stimulus to demand in 1968 than suggested by the standard forecast. Hence the 10 percent surtax rate is minimal."

How did this forecast stand up under the test of time? First, personal saving did fall in 1968, playing an important role in otherwise unanticipated buildup of inflationary pressure. Most would agree that the surtax was not enough. Second, the reduction in personal saving is more than explained by the influence of installment debt variables. Third, the reduction in the installment debt component of personal saving is more than explained by the reduction in the predetermined portion of total repayments.

Without suggesting there are grounds for a strict comparison between the period ahead and these earlier periods, it is suggested than an examination of efforts to forecast the impact of the expected $22-billion tax refund paid to consumers in early 1973 will also prove instructive. This was the last time income increased at a rate anything approaching the rate expected for the recovery period ahead. Moreover, the size of the tax refund, swollen by overwithholding in 1972, falls midway between the $16.2-billion tax cut passed by the House and the total stimulant for the consumer sector for the year beginning July 1, 1975.

Relying on theories of consumer spending and saving developed in the 1930's, the November, 1972 printout of the econometric model of the University of

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[7] Glenn E. Burress, "The Initial Effect of the 1964 Tax Cut on Consumer Spending," National Tax Journal, September, 1964.

Michigan said saving would rise sharply at first. The textbook, depression model, is also evident in the 1973 Economic Report of the President. In early April, 1973, Business Week interviewed several economists, including myself, on the pattern of the saving rate throughout 1973. Other economists, according to Business Week, said the saving rate would indeed be high in the first half.

I told Business Week—and they reported in part—that the saving rate would fall in the first quarter and that the absolute level of saving might even fall. Before first quarter 1973 data were adjusted, primarily to reflect the business profits of the unincorporated farmer, the data showed that personal saving fell $4.1-billion.

Business Week reported that other economists, like those at the CEA and the University of Michigan, believed that as income slowed in late 1973, consumers would dip into their saving and "cushion any tendency towards recession." Under the heading "Which way for saving," Business Week reported my view that this forecast was based on theory "born of depression" and wrong. I forecast that the probability of a 1974 recession was higher than others thought. And rather than cushion any tendency toward recession, I forecast consumers would play a major role in producing that recession.

In the final half of 1973 income slowed as was widely forecast. But saving did not fall as others forecast. The saving rate shot up (as I had forecast) to 9.5 percent. There are few who would argue that the consumer did not play a major role in producing the current recession.

VI. IMPLICATIONS FOR THE ECONOMIC OUTLOOK AND FOR POLICY

Before suggesting the implications for the economic outlook and for policy, it will prove useful to summarize briefly. This paper has shown that the depression, textbook model of how the consumer spends and saves during recessions and recoveries has failed to explain consumer behavior in every recovery period for 20 years. That theory, built into well-known econometric models—including those used by the CEA—suggest an increase percentage of income saved during recoveries. In contrast, in every recovery for 20 years except one, the absolute level of saving fell. Even the one exception, 1962, was inconsistent with accepted theory. The percentage of income saved in 1962 fell. It did not rise. In this paper it has been shown that due to problems in the use and interpretation of standard econometric models, the economics profession is generally unaware of these inconsistencies. This explains why this same theory is evident, not only in recent CEA projections for the impact of the 1975 tax cut, but is also found in the current and earlier Economic Reports.

This paper has concluded that history clearly suggests the impact of the proposed tax cut on spending is being underestimated. Finally, quite aside from errors in estimating how consumers react to rapidly increasing income in recoveries, the paper has shown that the profession has totally overlooked a $15.2 billion stimulant that will flow into the hands of high spending middle-upper income groups during the year beginning July 1, 1975. The total stimulant is, then, not just the $16.2 billion tax cut passed by the House, but this amount plus the $15.2 billion or $31.4 billion.

Turning to the outlook, needless to say, no two recoveries are just alike. But from the observation that recession is so steep and consumer confidence is so low, it does not follow that the recovery will not be sharp. It is my position that the current severely depressed condition of the economy may make consumers more reluctant to spend in very early stages of recovery than in the past. But once it is clear that recovery is under way, I suggest a major acceleration of economic activity, much faster than suggested by current models or the CEA. Much spending has been postponed. The potential for acceleration is great.

Even later this year the economy will be stronger than these models suggest. The saving ratio will not climb to 11.8 percent, or even 11.3 percent. History tells us it should fall from levels reached in the first half of this year. As for 1976, both models used by the CEA (to compare the President's and this Committee's proposed programs) see strong recovery in 1976. As a result, they have disposable income of consumers rising rapidly. To repeat, depression theory, found in textbooks, tells us that when income accelerates,

saving rises faster than income. This doubtless explains why both of these models project a saving rate near or above 9.5 percent every quarter of 1976. Recall that 9.5 percent is the all-time quarterly high for this ratio. It was reached, not in recovery, but as income of consumers (when separated from unincorporated farmers) fell in the final quarter of 1973 when this recession started.

Peak saving rates in recessions, rather than recoveries, are expected and forecast on the basis of the alternative described here. In contrast to the depression textbook model which says rapidly increasing income pushes saving higher, the alternative says that rapidly increasing income brings on an acceleration of spending and drives the saving rate down—if not the absolute level of saving too. I therefore look for a much stronger 1976 than the CEA and others are forecasting. I expect the recovery will be stronger. I expect the sharp increase in output to bring an equally sharp increase in productivity and reduction in unit labor cost. This will push the rate of inflation down to 5 percent by mid-1976, maybe lower.

Perhaps the most important remaining question is whether this strong recovery in 1976 will set the stage for a return to double digit rates of inflation and double digit interest rates in 1977.

One ray of hope is found in current estimates of potential GNP. If these are right, this economy at mid-year will be producing nearly $180 billion below what it would be producing if unemployment were 5 percent. In 1974 dollars, the figure should increase $15 billion per quarter.

But as Mr. Evans said before this Committee, there is evidence that with so much capital spending going to pollution abatement plus the influence of controls and the like, we may not have increased our stock of plant and equipment since 1973. The inflationary bottlenecks hit recently when unemployment was above 5 percent supports this thesis. This, in turn, raises the possibility that a strong 1976 recovery may soon again slam against inflationary bottlenecks in 1977—unless more is done now to expand the capacity of this economy to produce.

But there is another ray of hope that is even brighter. The installment debt forces I have cited as providing stimulant the year beginning July 1 will reverse themselves and provide modest restraint—acting like a tax increase—beginning in mid-1976. The restraint will become even stronger the year beginning in mid-1977. This pattern is suggested by the equations in my model and the pattern has been followed after every postwar recession.

Also half the $16.2 billion stimulant passed the House in a rebate on 1974 taxes will not be a source of further stimulant in 1976. This will leave only the $8.1 billion permanent reduction in taxes in 1976 and part of this will be offset by restraint from installment variables. In this setting Congress will look to ways to stimulate the economy even more. I can only hope you will take the position of the statesman and design fiscal stimulus that will increase the productivity of workers and expand our capacity to produce.

What I am suggesting is that resumption of strong growth with substantially less inflation is a possibility. But these rays of hope, I am afraid, are dimmed, if not totally darkened, by two other considerations.

First, the faster than expected recovery in 1976 will push short-term interest rates up much faster than even the Federal Reserve expects on the basis of their textbook models. I expect short-term rates to start rising rapidly even while the unemployment rate is still rising. If this were fully anticipated with a more realistic model, we might be able to cope with this development. But because it will be, in part, unexpected, there will be pressure both from within the Fed and outside the Fed to moderate the increase in short-term rates, such as the prime rate. The only way the Fed can moderate the increase in short-term rates is through an excessive expansion in the money supply. This, in turn, would almost assure double digit inflation in 1977. And I would expect long term interest rates, which did not fully adjust to recent inflation, to increase even more.

The second and most fundamental reason all rays of hope are almost entirely dimmed is that it will be years before the economics profession reformulates its thinking and methods. The problem is not just a matter of use of a theory which explains the 1930's, but fails to explain the last 20 years. But econometric models—we have seen here by citing Chase and DRI—still tell the economists that, just as in the 1930's, saving still falls in recessions and rises

in recoveries. You yourselves can check the official data and see that the pattern is just the opposite. I suggest this Committee start asking some tough questions of the economists using these theories and econometric models.

I am convinced that we do have an opportunity to resume a strong increase in output with lower rates of inflation. The total $31.4 billion stimulus from the tax cut and the deceleration of debt repayments is not, by itself, too much because it is cut back by three-fourths starting in 1976. But there is little reason for optimism.

We will need statesmen at the Federal Reserve to get the money supply moving much faster now, then provide necessary restraint in 1976 and later. We will need statesmen in the economics profession who will reexamine their theories and methods. And we will need statesmen in Congress who will no longer stimulate consumer spending on goods which pushes us beyond our capacity to produce and create more inflation. We will need a Congress that will do all in its power to increase the productivity of workers and the capacity of industry so that all may enjoy a higher standard of living with less inflation.

Chairman HUMPHREY. We will do it.

Thank you. The committee stands adjourned.

[Whereupon, at 12:35 p.m., the committee adjourned, subject to the call of the Chair.]

THE 1975 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, MARCH 13, 1975

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

The committee met, pursuant to notice, at 9:40 a.m., in room 457, Russell Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey and Javits; and Representatives Bolling and Rousselot.

Also present: Lucy A. Falcone, Robert D. Hamrin, and George R. Tyler, professional staff members; Michael J. Runde, administrative assistant; Leslie J. Bander, minority economist; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. We will open the hearing now, Congressman Dellums.

I want to apologize to you for the lack of our membership here, but I think you know that this morning the Senate is having a Democratic caucus, and I gather from what I have just heard from the House that there are about 25 meetings going on over there about the same time.

I was just saying to one of the former secretaries of HEW, Mr. Wilbur Cohen, that we have organized confusion around here when it comes to scheduling meetings. It is unfortunate, because we ought to do a better job so we can have better attendance.

Let me open the meeting today by saying we are putting together the Joint Economic Committee's response to the President's annual economic report, and we have wanted to cover all possible segments of the American economy and its political social structure in our consideration of the President's budget and the President's annual economic report.

Today's meeting is a part of that general review. We are going to focus on the impact of the President's economic proposals and budget upon the poor and the elderly and the handicapped, those that have had less than fair treatment in our society.

I have had, as I am sure you know, undivided concern with what is being done to assist the poor and the elderly in my public life. I feel it is important to listen to representatives of the poor and the elderly, as this year's proposed budget effects these groups and surely it affects them with a resounding thud.

May I say I was truly shocked by the priorities reflected in the budget. A large increase in defense spending, a large substantial increase in foreign assistance spending, coupled with a hold-the-line position at best with many programs for the poor and elderly and for a substantial section of our programs as presented by the President's budget, no accommodation for what we call the inflation factor.

So in fact in true dollars there have been substantial cutbacks in some of these programs.

I told Mr. Lynn, the new director of OMB, when he was before the Joint Economic Committee a few weeks ago that I thought the administration was being less than forthright in presenting deficit figures which presumed that the food program would be cut back as the administration had wanted it and that the social security recipients would not get their lawful benefit increases in July.

I am confident that no one in the administration or executive level could have believed for a minute that the Congress would permit us to renege on our lawful commitment to the elderly under social security, and yet the proposal in the budget was for but a 5 percent increase. This is unconscienable and obviously unacceptable. There simply was no way Congress was going to impose this additional burden on these people, the poor and elderly who have already been hit so hard by both inflation and recession in the past 2 years.

Let me make clear precisely the group we are talking about. In 1973, the most recent data we have, which itself speaks of neglect, 23 million persons, 11 percent of the Nation's population, were below the low-income level. Given the deteriorating economic conditions since then, the number is no doubt much greater today.

I should also add the trend is disturbing. In 1969 there were 24,129,000 people in poverty compared to 23 million in 1973. his small change is a marked contrast to the sharp decline of poverty in the 1960's prior to 1969. We went from 39,600,000 persons in 1961 in the poverty category to 25,400,000 in 1968. We were making considerable progress in the war on poverty, despite all the complaints about it and despite its underfunding.

Much of the reason for the leveling out after 1968, I believe, is due to the leveling off of efforts by the Federal Government to wage war on poverty. I for one say this is disgraceful and we must never retreat in our struggle to reduce the impact of poverty. Certainly the current proposed budget does not live up to this commitment.

Let me review some of the highlights.

First, the budget requested substantial cuts in Federal health spending for both fiscal 1975 and 1976. In fact the fiscal 1976 request was about $800 million less than fiscal 1974 health spending. The proposed reductions or cuts affected almost every health program. Of course, there is no mention of a new health insurance program, and I mean any kind of health insurance program, not just the health insurance that some Members of Congress have proposed.

I believe that I have made myself clear on how I feel about the priorities in the President's budget. That is what I hope will be the theme for today's discussion, the subject of priorities.

I know that each of our distinguished witnesses have some definite views of what this Nation's priorities should be and we are anxious to hear them.

We will be hearing first from Congressman Dellums of California. I want to say, Congressman, we surely respect your excellent work in the Congress of the United States for all you are doing to speak up for the needs of this country.

Following him will be a panel consisting of Mr. Wilbur Cohen, University of Michigan, former Secretary of HEW; Mr. Nelson Cruikshank, president of the National Council of Senior Citizens; Mr. Eduardo Terrones, deputy director, National Council of La Raza; and Mr. Ralph Borsodi representing the National Retired Teachers Association and American Association of Retired Persons.

Following these witnesses we will hear from Mr. James Peterson of the Pillsbury Co., who will bring us a message today of what one American corporation is planning on doing in the reduction of food costs.

Congressman Dellums, we are eager to hear what you have to say. I have to leave you for a few moments. Just excuse me, please, because I have to go to try to get a budget for this committee.

STATEMENT OF HON. RONALD V. DELLUMS, A U.S. REPRESENTATIVE IN CONGRESS FROM THE EIGHTH CONGRESSIONAL DISTRICT OF THE STATE OF CALIFORNIA

Representative DELLUMS. Thank you very much, Mr. Chairman and my distinguished colleague from Missouri, Mr. Bolling.

At the outset of my statement I would like to introduce the gentleman to my immediate left who has been a staff member with me from day one, Mr. Michael J. Duberstein, who was a former staff member of your committee in 1967 and 1968, and who holds a master's degree in economics from the University of California in Los Angeles.

Mr. Chairman, members of the committee, let me put in blunt terms my perspective on the current economic situation.

Most of America now is experiencing economic conditions which have been the norm for millions of low-income families for at least a quarter century—except that low-income families are now suffering even more.

For an example, take the national unemployment figure—that 8.2 percent level which is the highest unemployment rate in 34 years. That low a rate would be welcomed in virtually every inner city in America. In those inner cities I'd say that unemployment rates haven't been below 10 percent in a generation. Or, on the other hand, if the national rate hits 8.2 percent, it wouldn't be surprising to find the inner city joblessness rate at around 20 percent.

And that is just one example.

Equally important is the dynamics of how a severe economic downturn affects lower income persons.

Because we know that blacks and other minorities usually are victims of the "last-hired, first-fired" syndrome—that is, they are the margin in most enterprises—the absolute rate of unemployment accelerates first and fastest in low-income areas—areas already with the highest joblessness rates.

And just as unemployment is highest in low-income neighborhoods, so also is the rate of inflation. A study released last year by the

National Urban League found that over the 15-month period from December 1972, consumer prices for the black poor and elderly rose 14 to 14½ percent, and that real purchasing power of black families as a whole is on the decline. And, once again, just as with unemployment, price levels in low-income areas are higher to start out with.

The pinch caused by concurrent soaring unemployment and inflation in low-income areas thus becomes intolerable. No jobs means no income. Highest prices prevail. Merchants barely surviving in low-income neighborhoods before now just can't make it at all. And many close down—adding more unemployment and creating additional hardships. City governments—facing major fiscal shortages—begin cutting back vital services—and we know where the cuts come first—in those areas already receiving the worst services. And on and on.

What it comes down to is that while most of us are direly affected by a continuing economic recession, the burden still falls greatest at the low end of the scale—on those persons who can least deal with it in the first place.

And to top everything off the administration wants to impose tight spending limits on those programs which directly affect lower income families more than any other one group. That's best seen by this sort of comparison: The President's budget calls for a 5-percent lid on budget increases for most human needs programs this year; yet, in the same budget message, the President's advisers assume an 11-percent rise in the consumer price level over the same period.

I might add parenthetically and I know you are aware that it is interesting that only one single agency has an absolute built-in inflation factor: Surprise, the Pentagon.

Chairman HUMPHREY. And they justify it every time they are up here.

Representative DELLUMS. Absolutely.

That sort of assumption must be challenged here in Congress. Human needs must be mandated first priority in everything we do. Without that priority—or the percention that we recognize that priority—we face a loss of the consent given Government by its citizens.

For example, how relevant are the 1946 Employment Act goals when this administration has first modified them to read maximum feasible employment—and when that maximum feasible objective still leaves 5.5 percent unemployed 5 years from now?

Or, to go a step further, is the 1946 act itself relevant today? Do we need to go back to the original concept of the full-employment bill from which the actual 1946 act emerged?

I raise these specific points because it is apparent to me that failures of Government policy are primarily responsible for current failures in the economy. That is, Government policies continually have dealt with symptoms—such as unemployment or inflation—and not with overall causes which have disrupted the economy since the beginning of the Vietnam war. If anything, the repeated failures of any combination of fiscal, monetary and income policies to have significant long-term impact on either unemployment or inflation should readily indicate that such solutions which concentrate on symptomatic troubles instead of attacking basic causes not only do

not work, but that such stop-and-go policy applications cause even greater and more difficult problems over time.

It's as if policymakers had been saying that it was possible to put off until some future date the point when serious measures must be taken. Well, that future point is here today, Mr. Chairman, members of the committee, and we are reaping the costs of those past decisions while realizing also that it's no longer possible to push back any longer the day of reckoning. It is upon us.

Given that framework, then, what does the Ford administration propose to do?

First, the President wants to hold down Government spending for human needs programs and he says he will veto any new social programs. Yet, there is no indication whatsoever that Federal spending for health, for housing, for education, for job training, for urban development and rural revitalization, for the whole range of human needs programs is inflationary. The same cannot be said, however, for the military budget.

I am not antimilitary, but I cannot see any valid relationship between the absolute size of the military budget and the quality of America's defense. I believe this country's military should be equal to any other nation in the world. Yet I do not think we must allocate annually between $80 to $110 billion to maintain our military commitments.

I further point out that this should not be viewed as a simple partisan issue. Neither Lyndon Johnson nor Richard Nixon were able to deal with the link between massive military budgets and continuing economic dislocations.

While I can agree with those persons who say there can be reductions in Federal spending, for me the key issue is where cuts should be made. Instead of that old adage "guns versus butter," I say the phrase should be "guns versus schools"—since one recent study showed that for each additional tax dollar allocated to the military budget, the social sector most affected by this tradeoff is education. And a continuing tradeoff between guns and social programs causes major distortions over both the short and long run. Even at pre-Vietnam budget levels, human needs programs hardly met demands put upon them; given inflation and the ever-deepening nature of social problems, even maintaining such programs at constant spending levels means that the programs fall far behind—and that they become more expensive in the future when they must again be tackled. And the returns to society from investment of a marginal tax dollar for, say, a B-1 bomber—or for stationing over 500,000 U.S. troops all over the globe—are very small. Compared to the returns from that same dollar invested in social programs, the value of additional defense spending is miniscule.

At the same time, the absolute size of the military budget creates significant inflationary pressures because both defense and nondefense sectors must compete in the marketplace for the same scarce resources. The more those resources are diverted into the defense sector, or I might say the so-called defense sector—where there are less returns to the overall economy, the greater the inflationary pressures throughout the entire economy. But the main thrust of post-Vietnam, post-SALT, post-detente, and now post-Watergate policy

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has been at the nondefense sector—and more specifically at social programs—while hardly affecting the level of military spending at all.

Second point. Oil is not the key factor in our current economic mess. We were in serious economic difficulties long before the oil cutback, and we also had major energy problems developing long before the current economic downturn.

Next, the administration overlooks what we would term the most important method of revitalizing the economy—the creation of jobs—and hinges its recovery program upon a ponderous tax rebate scheme. Even aside from the rebate system's details—criticisms with which we are all quite familiar—I question whether the boost from such turnbacks would be as positive a stimulus were the same amount of funds used to create jobs for all those persons so desperately looking for employment.

And when I speak of jobs, I mean real jobs, not just some Government make-work project.

Again, I might add parenthetically here that jobs are not created in a vacuum. Jobs flow directly from a society's commitment to adress itself to serious human problems.

If we rebuild our cities which have become monuments to our madness rather than monuments to our genius, if child care becomes a reality in this country, if education were a right and not a privilege, if health care were a right and not a privilege, if we engaged in building homes that are absolutely necessary, in building mass transit systems rather than automobiles and highways which are choking us to death, they would create jobs, technical and nontechnical.

The total cost to society from the current unemployment situation is staggering, and I urge that we direct our energies to coming up with programs designed to meet real needs of our society.

At the same time, there must be increased income protection for persons now out of work. Instead of limiting social insurance programs, we should be expanding them now, and that is a task we here in Congress must accomplish.

Finally, Mr. Chairman, I would like to offer suggestions for programs to bring about long-term economic development and equity. These proposals were originally contained in a letter sent by the Congressional Black Caucus to President Ford on January 16. A copy of that letter has been given to you, and I ask that it be included in the hearing record.

Representative Bolling [presiding]. That will be done.

[The letter referred to follows:]

Congressional Black Caucus,
U.S. House of Representatives,
Washington, D.C., January 16, 1975.

Hon. Gerald R. Ford,
President,
The White House,
Washington, D.C.

Dear Mr. President: Your address to the Congress on the State of the Union was commendable in its recognition of the necessity to extend the 1965 Voting Rights Act. We view this as an important public acknowledgement of your positive attitude toward the voting rights of minority Americans.

We were, however, disappointed in major aspects of your economic proposals. For, once again, your Administration appears preoccupied with current symptoms of economic unrest, rather than with the basic systemic causes which have brought about this period of continuing economic dislocation.

We are concerned that you neglected some of the most critical possible actions that should be taken to begin a substantive, long range economic turnaround, and to measurably improve conditions for millions of low and moderate income families and individuals.

When we last met at the White House, the Congressional Black Caucus proposed policies and programs we felt necessary to move the economy toward long-term stability and equity. Today, with the worsening economic conditions, we offer further proposals for an effective economic policy.

There must be major tax reforms. Studies indicate that close to $50 billion in new revenues can be generated by closing existing tax loop-holes—loopholes which largely benefit higher income groups, wealthy individuals and the corporate sector.

There must be expanded government job creation programs keeping pace with mushrooming unemployment. In August, 1974, we proposed that a minimum of one million public service jobs be federally subsidized—and at that time unemployment within the Black community averaged 9.4 percent. Today, Black unemployment is at 12.8 percent. We repeat the call for at least one million public service jobs. We also reiterate last year's mandate for full employment programs.

There must be not only an expansion and extension of unemployment compensation benefits, but also increases in benefit levels. Average weekly benefits, in all too many states, are not even sufficeint to bring recipients up to the poverty level.

There must be a commitment to instituting a vigorous anti-trust program and to full implementation of existing anti-trust statutes. Many experts have acknowledged that the exorbitant. and frequently extortionist pricing policies of monopolistic industries are robbing millions of Americans of purchasing power.

There must be a concerted effort to curb the ever-rising military budget. In the last weeks, Administration spokespersons have indicated that they would be requesting nearly $100 billion in defense spending for the next fiscal year. In the face of current economic dislocation there is clearly a need to reexamine our national economic priorities.

There must be fulfillment of the mandate of the Housing Act which calls for "a decent home and suitable living environment for every American family". Today, fully 75% of American families with annual incomes of less than $15,000 annually, are effectively priced out of the housing market and over 13.1 million families live in substandard, overcrowded housing or pay an excessive portion of their income for rent. Full implementation of existing housing programs and development of new initiatives is long overdue.

There must be a substantive reduction of interest rates. Monetary authorities are still pursuing a tight money policy which is causing mortgage and other long range interest rates to remain close to all the record highs.

There must be some plan to develop meaningful price controls, fairly administered and comprehensive enough to cover all forms of income—including profits, interest, dividends, rents, and other non-earned income.

There must be a strong effort to relieve moderate and low income consumers of the relentless burden of the high cost of food. Low and moderate income families have been hardest hit by escalating food costs and some experts have reported that increases in food prices alone, in 1974, contributed to an 8 to 10 percent cut in the real income of poor families, in addition, monopoly concentration in the food processing and retail industry has fostered scurrilous pricing policies. The Food Stamp Program, a needed support for working poor and unemployed, through lack of vigorous implementation, is still being underutilized. We call for an accelerated Food Stamp outreach effort and reasonable coupon levels.

There must be an increase in current transfer and income support programs that have failed to keep pace with inflation. Your call for a moratorium on increased spending and your request that substantive increases in social security benefits be halted is ill-advised and would, in effect force the low and moderate income families to foot the bill and bear a excessive burden for

your economic policy. We call for the Administration's support of a comprehensive welfare reform package.

There must be new relief measures for low-income and non-taxpaying consumers burdened by the multiplier effect of the increased cost in goods and services that will be the result of your proposed oil taxes and tariffs.

There must be Federal action to compel energy industries to plow high profits into productive expansion.

There must be a commitment for the United States to reexamine its energy sources in Africa and elsewhere and to seriously re-evaluate its foreign policies in these areas vis-a-vis emerging majority governments, in view of these enormous potential as future suppliers of energy sources.

You have offered a $16 billion tax cut ($12 billion for individuals and $4 billion for business) as an initial stimulus and for that we commend you. Yet even this proposal is replete with inequities and biases toward higher income groups. You mentioned that this initial tax cut could provide rebates this year of $1,000 for individual taxpayers. But you failed to note that only those in higher income brackets—with annual incomes of about $40,000 per year or more—could receive a significant rebate. Under your proposal, a low or moderate income would receive a rebate that is little more than $2 per week or about $150 total. Families with incomes in excess of $25,000—6% of the families in the U.S.—would get more than a third of the rebates from this tax cut.

It has also been determined that a $16 million stimulus is clearly not enough to reverse the current economic down-turn. Ten years ago, President Johnson proposed a $12 billion tax cut, when GNP was scarcely half the rate it is today.

Your future proposal for raising the low income allowance and reducing the tax rebates represents a welcomed effort to bring equity and progressively to our tax system. However, even under this plan the savings to individuals hardly represents enough to recover from the devastating erosion of the purchasing power of their incomes. A married taxpayer with an income of $8,000 may hope to save $210 under your proposal. (a) But the $210 does not begin to recapture the $800 loss in purchasing power as a result of double-digit inflation in 1974, and (b) your proposal places new burdens on those least able to shoulder the cost. Yet the energy taxes you plan would completely wipe out that saving. Increases in gasoline prices would mean an additional $100 per year to the average consumer. Another $100 in increases would result from escalating utility costs. This does not incorporate the multiplier effect of increases in the costs of goods and services dependent on fuel supplies.

We are concerned with a plan that would provide new tax breaks to the oil industry—as chief perpetuator of many of our current energy problems. Experts in the energy field have come up with a host of alternative plans to effectively increase domestic productive and foreign exploration. We encourage you to re-examine these and to develop an energy plan that is more supportive of the public welfare—not the profits of oil interests.

The task of revitalizing our nation's economy and providing meaningful jobs and adequate income for Americans is awesome indeed. We are pleased that you have recognized the need for taking action to combat recession. While we are concerned about the scope and direction your overall economic proposals, the Congressional Black Caucus, is prepared to assist you in the development of creative approaches to critical issues facing us all.

While large segments of the Black community and the poor of every race suffer most during periods of economic dislocation, all Americans—consumers, workers, the elderly and small businesses want a more stable and prosperous economy. We would appreciate your response to the issues we have raised.

Respectfully.

Yvonne Burke, Shirley Chisholm, William Clay, John Conyers, Jr., Ronald Dellums, Charles Diggs, Jr., Walter Fauntroy, Harold Ford, Augustus Hawkins, Barbara Jordan, Ralph Metcalf, Parren Mitchell, Robert Nix, and Charles Rangel; Members of Congress.

Representative DELLUMS. Thank you.

Briefly, here is what the Congressional Black Caucus recommends:

For the long range: (1) Major tax reforms; (2) major reductions in the military budget; (3) a vigorous antitrust program; (4) full implementation of existing housing programs and development of new housing initiatives; (5) programs to reduce high food costs; and (6) reexamination of U.S. foreign policies toward Third World and other developing nations.

And for the immediate situation, the Caucus recommends: (1) Expanded job creation programs; (2) expansion and extension of unemployment compensation benefits and increases in benefit levels; (3) substantive reduction of interest rates; (4) standby price controls; (5) increases in current transfer and income support programs; (6) relief measures for low-income families affected by new energy taxes; and (7) Federal action to compel energy industries to plow high profits into productive expansion.

I would conclude simply my pointing out, Mr. Chairman, that a society's values are reflected in its priorities, and its priorities reflected in its budget. Let our budget reflect priorities directed at human needs. Let those priorities reflect that our values are rooted in humanitarian concerns.

This country and this world is in extreme difficulty. There are millions and millions of people feeling the pain of unemployment and poverty, hunger and disease. These are not rhetorical comments. This is reality all over America; in black, brown, red, yellow, and white communities all over this country.

It seems to me we have to challenge this President, we have to challenge this budget. This is a moment that requires our greatness, not our mediocrity; that requires our principle, not our expediency; that requires courage, not simply compromise for the purpose of reelection.

There are millions of people who turn to us as the last possible place to address ourselves to critical problems. Get the tradeoff in dealing with economic dislocations we face not be the tradeoff that places the heaviest burden upon the poor, the disadvantaged, the elderly, the black and other third world persons who are citizens of this country and who have a right to live in a nation that provides them human dignity, equality, justice, and freedom and peace.

With that, sir, I conclude my formal comments.

Representative BOLLING. Thank you very much, Representative Dellums, for a statement which is worthy of your long effort. I have always admired your passion in support of the weak and disadvantaged, and I feel that I can say perfectly honestly that you have made a very important contribution to the House of Representatives because of the strength of your feeling and the deepness of your commitment to the weak of this country.

It is a privilege and a pleasure for me to listen to your statement.

I am happy to report that this committee, at least the Democrats of this committee, have adopted not all but a good many of the proposals of the Black Caucus, and I think we will continue to pursue an examination of the 1946 act to perhaps bring it more into line with the proposed intentions of those who initiated the act and who had to compromise it down to an unemployment act rather than a full-employment act to get it passed.

I am not going to ask you any detailed questions, because I think the greater burden of your statement is the absolute commitment to the weak or the ones that deserve our attention today and that the strong can take care of themselves.

We thank you very much.

Representative DELLUMS. I thank you very much.

Representative BOLLING. Mr. Cohen, Mr. Cruikshank, Mr. Terrones, and Mr. Borsodi will take their places.

Gentlemen, on behalf of the committee I am delighted to welcome you. It is a very distinguished group, and I think our procedure will be in the order that I read the names earlier. I will ask you to present a summary of your statements, or if you wish you may read your statements. In any event, your full statement and the additional remarks will be included in the record.

With that I will, without going into great detail in introducing you—you need no introduction—I will ask Mr. Cohen to start off.

STATEMENT OF WILBUR J. COHEN, DEAN, SCHOOL OF EDUCATION, UNIVERSITY OF MICHIGAN

Mr. COHEN. I want to first say to Congressman Bolling that I think you deserve a lot of praise for having obtained some reforms in the Congress. I think I ought to say that first, because if the subcommittees on the Ways and Means Committee are successful, we ought to have more social welfare legislation in this and succeeding Congresses. So I thank you very much for that.

Representative BOLLING. Thank you very much. I have been trying to figure out for the past 10 years what is going on in the economy.

Thank you.

Mr. COHEN. The President's budget for human resources programs for 1976 and his proposed rescissions for 1975 include a number of unwise and undesirable recommendations.

In a budget involving hundreds of separate items and programs affecting millions of persons, there is bound to be differences of opinion about priorities and probable effects. I am sure the appropriate congressional committees will weigh the pros and cons on these matters and I hope they will make significant changes in the recommendations made by the President.

ECONOMIC ASSUMPTIONS

The economic assumptions made in the budget with respect to unemployment and prices seem to me to be unacceptable. I believe the Congress must take the initiative to reduce the unemployment and price-rise levels for 1976 and the ensuing years.

I believe this result can be accomplished by changes in the President's tax program and by other fiscal, budgetary, and program changes.

TAX POLICY

I recommend that the temporary tax reduction be increased by about $10 billion and that the permanent tax reduction be reduced by about $5 billion, or more, if feasible.

We need a much larger immediate fiscal stimulus to reduce unemployment. But we must also be very careful not to reduce our longer range revenue yield. In order to implement a national health insurance plan, carry out a welfare reform program, and provide more adequately for our senior citizens, education, and other social programs, we will need more Federal revenues in 1978, 1979, and 1980.

Why give up permanently revenues Congress will most likely need to reenact later on?

UNEMPLOYMENT

We need a much larger public service employment program for the next year or two. We need flexible implemntation, providing jobs for young people with little employment experience, and utilizing both women and men in libraries, day care centers for children, and in colleges, universities, schools, and recreation centers.

Congress should provide promptly for the payment of hospital and physicians' bills for unemployed individuals whose health insurance has been terminated by their loss of employment. Senator Bentsen has introduced a bill which is the most equitable of those introduced in the Senate as of this time.

The inadequacies of our patchwork State-by-State unemployment insurance system have been amply demonstrated during this recession. I strongly urge a congressional investigation into the entire system with a view to making recommendations for revisions.

SENIOR CITIZENS

The President has made a number of recommendations in his budget which represents a major assault on the welfare of our senior citizens. I strongly urge the rejection of these cruel and insensitive proposals. They are:

(*a*) Limiting promised social security and supplemental security income increases to 35 million persons to 5 percent instead of a statutory increase of about 8 percent—$2.6 billion, 1976;

(*b*) Increasing the cost sharing for sick persons in the medicare program—$1.4 billion, 1976;

(*c*) Reducing the Federal share of medicaid payments to States—$600 million, 1976; and

(*d*) Reducing the appropriations available for nutrition and other aging programs—$42 million, 1975.

I feel confident that the Congress will not adopt these retrogressive and heartless recommendations.

The administration's proposed increase in costs for food stamps was in my mind a most inappropriate and undesirable proposal. The congressional veto of this proposal is an excellent illustration of the wisdom of the legislative response to the insensitivity of the executive branch to human need.

Equally unwise but designed to adversely affect even more people is the proposal to limit social security increases this year to 5 percent. This would not only be a moral and legal repudiation of a commitment made by the President of the United States and the Congress in 1972, but is completely inconsistent with the policy of the administration as incorporated in the proposed tax reduction proposal to improve the purchasing power of the people of the Nation.

SUPPLEMENTAL SECURITY INCOME

The supplemental security income program adopted by Congress went into effect on January 1, 1974. It provides cash income to about 4 million needy aged, blind, and disabled persons. The payments are currently set at $146 a month for a single person. These payments are scheduled to increase about 8 percent in July. They still will be below the poverty level. I, therefore, recommend that Congress increase the payment $175 a month as promptly as possible.

These needy beneficiaries are hardest hit by inflation. They should be given a substantial increase which will take them above the poverty line.

I would also increase the disregard of social security payments from $20 to $25 a month, thus providing social security beneficiaries a minimum of $200 a month.

EDUCATION

Another illustration of bad policy and inconsistent philosophy is the administration's proposed reduction in the work-study provisions in the student financial aid of the education budget. The work-study program is based upon endorsement of the work ethic for students. It has been a highly successful program consistent with the most conservative, responsible, and acceptable philosophies in the American economy. It would help the disadvantaged and sustain purchasing power.

I am particularly distressed that the President's budget proposes to reduce the work-study appropriations from $270 million in 1974 and $300 million in 1975 to $250 million in 1976. We could well use $350 million at the present time to help low-income and disadvantaged students, some of whom may have to drop out of college because of the unemployment of their parents. I hope that Congress will increase the appropriation for this very fine program.

Likewise, the President's budget reduces the cooperative education appropriation from $10,750,000 to $8 million. This is a penny-wise-pound-foolish proposal.

Both these programs emphasize work and schooling. The President has said he strongly favors this approach. Then he cuts the very programs he says should have higher priority. It is difficult to accept such inconsistency and such impairment of programs which are sound and constructive.

HEALTH

In addition to the proposed cuts in medicare and medicaid, the President's budget unwisely recommends reductions in the appropriations for neighborhood health centers, for maternal and child health services, and for family planning services.

The budget assumes an estimated increase in non-Federal funding and third-party reimbursements to offset Federal reductions. There is no real evidence that this non-Federal increase will actually be realized. I urge the appropriate committees to examine this hope very critically before making the proposed reductions.

The administration's recommendation to reduce funds for health manpower is based upon the philosophy that Federal financial aid should not be provided for persons who will subsequently earn substantial incomes. Despite the fact that these individuals pay substantial Federal income taxes on these higher incomes, if this policy were carried out across the board in all governmental programs, we would eliminate all subsidy programs to business, and the special tax provisions for businessmen such as the Keogh plan. The recommendation to repeal aid to train nurses is especially shortsighted and unwise.

SOCIAL SECURITY

The increased unemployment and price increases will result in a decline in income and an increase in outgo for the social security system. As a result, the reserves in the trust funds will be drawn down during the next several years.

This is the very kind of economic situation which Congress had in mind in establishing the trust funds. The trust funds can and should be utilized over the short run to assure that payments will be made to the beneficiaries while giving Congress and the executive branch ample time to consider and enact sound measures to remedy the situation.

It would be unwise to enact proposals which would be effective during a recession but it would be desirable to enact legislation next year which would be effective in 1977 which would resolve the current situation.

MODIFICATIONS OF EMPLOYMENT ACT OF 1946

I would like to take this opportunity to stress two additional suggestions relevant to the concern of your joint committee:

One: Modification of the Employment Act of 1946 to require that the President and the Council submit in 1976 an immediate and long-range comprehensive program directed toward the restoration and maintenance of maximum employment, production and purchasing power, and responsibility on the part of the joint committee to hold public hearings on such a program and to publish its evaluation of such a program; and

Two: Creation of a Council of Social Advisers to evaluate the qualitative elements involved in national policy with the responsibility of producing every 2 years a comprehensive social report which would include a discussion of the problems and prospects for social progress and the future of American society.

CONCLUSION

These suggestions are made on the basis that the present recession is but one aspect of a series of monumental changes taking place in our country and in the world.

Professor George Cabot Lodge of the Harvard School of Business recently said better than I can the following thought with which I concur:

> The United States is in the midst of one of the great transformations of Western civilization. What is happening is that the old lines and assumptions

which once made our institutions legitimate, authoritative and confident are fast eroding. They are slipping away to the face of a changing reality and are being replaced by different ideas and different assumptions which are as yet ill-formed, contradictory and shocking.

Our immediate concern must be to get out of this recession, constrain inflation, and restore our economy to a full-employment basis. But at the same time, we must deal with the longer range problems arising out of the inadequacies and inequities in our economic and social system.

The most valuable resources we have is our human capacity. We must preserve, protect, and defend our skills, ability, motivation, innovation, and leadership. This is more important in the long run than the short-run size of the Federal deficit. To allow the Federal deficit to undermine our human capacity is to ultimately cost us more in both monetary and human values.

I have to include two papers that I have. One is a comprehensive paper on the budget of the Department of Health, Education, and Welfare.

And also a paper on the education part of the budget, prepared by a former associate of mine, Ralph Huitt, who was Assistant Secretary of HEW.

Representative BOLLING. They will be included in the hearing record.

[The papers follow:]

ANALYSIS OF FY 1976 PROPOSED BUDGET OF THE DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Prepared by

AMERICAN PUBLIC WELFARE ASSOCIATION
1155 16th Street, N.W.
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March, 1975

THE FY 1976 PROPOSED BUDGET

FOR THE DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

March 12, 1975

The Administration's proposed budget for fiscal year 1976 provides for total outlays of $349.4 billion. The FY 1976 budget proposed by the President would increase Federal spending by about $36.0 billion, or 11 percent over FY 1975 estimated outlays. The projected deficit for the fiscal year is $51.9 billion, the largest deficit in a peace-time year to date. These figures, however, assume that Congress will concur in some $17.0 billion in spending limitations and reductions proposed by the Administration. Approximately $6.0 billion of these limitations and reductions would arise from holding the allowable increase in Federal pay and in benefit payments to individuals that currently are linked to increases in the cost-of-living (principally the Social Security Administration programs and food stamps) to 5 percent, at least through the end of the fiscal year. Other measures -- some of which have been previously proposed or were included in the November 26 budget reduction message -- would account for the remaining $11.0 billion which the proposed budget assumes will be enacted.

This paper places the Department of Health, Education, and Welfare budget within the context of the Federal budget. In general, it has two parts. Section A is an overview of the HEW budget proposed for FY 1976. Section B is a summary and brief analysis of the specific budget reduction proposals of the Administration which relate to HEW programs. A brief section, Section C, on the Administration's proposals for the Department of Agriculture food programs is also included.

Section A:
Overview of the HEW Budget

The fiscal year 1976 budget proposed for the Department of Health, Education, and Welfare calls for $118.4 billion in outlays, an increase of $8.5 billion -- or 7.7 percent -- over the revised estimates of the Department for FY 1975. The proposed outlay level is 33.9 percent of the proposed total Federal outlay level. Table 1 (page 4) summarizes these estimates by operating agency. Table 1 indicates:

** Approximately $85.1 billion -- or 71.9 percent -- of the estimated HEW outlays in FY 1976 are from two trust fund programs, Old-Age, Survivors, and Disability Insurance (OASDI) and Medicare. If these outlays were not considered as a part of total HEW outlays, the HEW share of total Federal outlays would fall to 9.5 percent.

** About $12.7 billion of estimated outlays are targeted for cash assistance to low-income individuals and families;

** $7.5 billion in outlays are estimated for the Medicaid program;

** Outlays for health agencies in FY 1976 are estimated at $5.1 billion;

** Education programs are expected to accrue $6.2 billion in outlays; and

** Other Departmental activities, including the Office of Human Development, are projected to require $1.8 billion in outlays.

Nearly 95 percent of the HEW budget provides payments which are mandated by law -- the so-called noncontrollables. The balance of the budget is for activities of the Department where funding levels are controlled annually through appropriations -- the controllable programs. Although the former programs have a generally open-ended legislative base, HEW no longer considers these programs to be "uncontrollable." They can be controlled through three principal means -- legislative amendments, interpretation through regulations, and recission. HEW has employed this philosophy in the FY 1976 budget proposal. The $118.4 billion outlay level reflects the assumption that Congress will concur in over $8.0 billion in limitations and reductions emanating from such initiatives, and that another $400 million in outlay reductions can be achieved through regulation changes not requiring Congressional approval. In summary, the initiatives assumed in the outlay estimate include:

** Enactment and implementation prior to July 1, 1975, of 15 pieces of legislation affecting outlay levels in the so-called noncontrollable programs. The legislation which the Department will propose includes limiting Social Security Administration program (OASDI and SSI) cost-of-living benefit increases to 5 percent, and reductions in the Federal matching percentage in the Medicaid, Aid to Families with Dependent Children (AFDC), and social services programs. This package of legislation will reduce outlays by $6.5 billion over what they would be in the absence of such legislation, according to the Administration estimates.

** Consent by Congress to $869 million in proposed FY 1975 rescissions. As rescissions effectively terminate the program or a portion of it, FY 1976 savings are assumed to result from FY 1975 rescissions. On the other hand, if Congress does not agree to these rescissions, it may be assumed that outlays will be increased relative to the budget estimates because Congress has demonstrated that it does not intend to cut back these programs. (The $869 million figure does not include $292 million in unobligated 1973 and 1974 hospital construction appropriations which are also proposed for rescission.)

** Action by Congress to reduce or eliminate outlays for certain programs currently operating under continuing resolutions. If the continuing resolution becomes the funding authority for the balance of the fiscal year, the Administration plans to propose rescissions. A difference of $696 million is involved.

** Administrative actions will produce $368 million in savings.

Table 2 (p. 6) indicates the specific initiatives and their dollar impacts. In addition, Table 1 has been adjusted to reflect the position of the HEW budget if the initiatives requiring Congressional action are not adopted.

TABLE 1. Department of Health, Education, and Welfare Outlays by Operating Agency

	FY 1974 Actual	FY 1975 Revised Estimates*	FY 1976 Budget Estimates	FY 1976 Without Initiatives
Health				
Health agencies 1/	$ 4,450	$ 5,340	$ 5,145	$ 6,198
Education	$ 4,983	$ 6,059	$ 6,156	$ 6,871 2/
Income Security				
Social and Rehabilitation service	$13,225	$13,753	$13,853	$15,563
Public Assistance	12,714	13,284	13,412	15,122
Medicaid	5,818	6,589	7,516	8,233
Work Incentives	340	316	315	315
Cuban Refugees	108	86	54	54
Salaries and Expenses	63	67	72	72
Social Security Administration	$65,541 3/	$83,110 3/	$91,526 3/	$96,094 3/
OASDI	54,936	63,511	70,063	73,280
Medicare	11,348	13,904	14,991	16,257
Supplementary Security Income	2,257 4/	4,713	5,457	5,543
Disabled Coal Miners	1,000	964	973	973
Payments to Social Security and Other Trust Funds	3,021	3,367	4,065	4,065
Salaries and Expenses	1,888	2,126	2,373	2,373
Special Institutions 5/	$ 113	$ 135	$ 118	$ 118
Office of Human Development 6/	$ 1,379	$ 1,518	$ 1,557	$ 1,629
Departmental Management 7/	$ 83	$ 153	$ 156	$ 156
Miscellaneous Receipts and Adjustments	$ - 39	$ - 137	$ - 141	$ - 141
TOTAL	$99,553	$109,931	$118,370	$126,488

*Revised FY 1975 estimates reflect Administration supplemental requests and proposed rescissions.

1/ Health agencies include the Food and Drug Administration, the Center for Disease Control, the Health Services Administration, the National Institutes of Health, the Alcohol, Drug Abuse, and Mental Health Administration, the Health Resources Administration, and the Office of the Assistant Secretary for Health.

2/ This figure does not include $2.3 billion in advance appropriations requested for FY 1977.

TABLE 1 -- continued

3/ Adjusted for intragovernmental transfers. In general, payments do not include payments to trust funds and salaries and expenses.

4/ Represents only one-half fiscal year of expenditures. Program implemented on January 1, 1974.

5/ Special Institutions include the American Printing House for the Blind, the National Technical Institute for the Deaf, Gallaudet College, and Howard University.

6/ The Office of Human Development outlays include outlays for the Children and Youth programs, the Aging programs, Rehabilitation Services, Developmental Disabilities, Native Americans, and administration.

7/ Departmental Management includes the Office of Civil Rights, the Office of Consumer Affairs, policy research, Allied Services, and other general departmental management initiatives.

Source: APWA staff, developed from The Fiscal Year 1976 Budget, U.S. Department of Health, Education, and Welfare (February 3, 1975)

TABLE 2. Outlay Reduction Initiatives

	(in millions) FY 1975	FY 1976
Legislation		
A. Public Assistance		
1. Revisions of income disregard and work-related expenses benefit computation provisions Explanation: Would change the present $30 and 1/3 rule to standard $60 disregard, plus child care expenses, with 1/3 applied to remainder (page 18)	$ - 63	$ - 200
2. Revision of AFDC accounting and redetermination periods Explanation: Average income over 3 month period in determining eligibility; redetermination every 3 months; and possible monthly reporting (page 19)	$ - 20	$ - 146
3. Utilization of Medicaid matching formula for AFDC in all States Explanation: The "regular" formula option would be removed and Medicaid formula with 50% floor employed (page 19)	$ - 20	$ - 60
4. Elimination of Federal matching for adult dental care under Medicaid Explanation: Non-emergency dental care for persons 21 or over eliminated (page 16)	$ - 10	$ - 81
5. Revised matching formula for social services Explanation: In FY 1976, matching rate would be reduced from 75% to 65%, and to 50% in FY 77	---	$ - 448
6. Absent parent support (page 21) Explanation: P.L. 93-647 with Administration amendments (page 21)	$ - 10	$ - 90
7. State and local training restrictions Explanation: Change in training emphasis to short-term, in service training (page 27)	$ - 10	$ - 30
8. Reduction in minimum Federal matching provision in Medicaid from 50% to 40% (page 16)	$ -200	$ - 636
9. Other provisions	$ - 2	$ - 6
B. Social Security		
1. Limitation on the automatic cost-of-living adjustment in July to maximum of 5% Explanation: Present law would require about a 8.7 percent increase in OASDI and SSI in July (pages 17 and 28)	---	$-2,654
2. Elimination of rertoactive annuity option Explanation: Removes lump-sum payment option where payment would result in reduced benefits in the future (page 29)	$ - 45	$ - 443

TABLE 2 -- continued

	FY 1975	FY 1976
3. Make retirement test computation annual rather than monthly	$ - 15	$ - 205
Explanation: To prevent large earnings in one month and zero benefit reduction rate in remaining months of the year (page 28)		
4. Provide increased cost-sharing by Medicare beneficiaries but limit total cost-sharing to $750	$ -255	$-1,279
Medicaid offset	$ + 13	$ + 113
Explanation: After initial deductible, individual would begin on next day to pay 10% and continue to pay to $750 maximum (page 29)		
5. Place limits on yearly rate of increase in reasonable costs of Medicare providers (page 30)	---	$ - 100
Subtotal, Public Assistance & Social Security	$ -302	$-4,568
C. Education		
1. Reform of impacted area aid	---	$ - 270
TOTAL, LEGISLATION	$ -642	$-6,538

Rescissions	FY 1975 Appropriation	Proposed for Rescission
A. Health		
1. Health Services	$ 496	$ - 26
2. Preventive Health	$ 136	$ - 10
3. National Institutes of Health		
Cancer	$ 692	$ - 123
Other Institutes	$1,393	$ - 228
4. Alcohol, Drug Abuse, and Mental Health	$ 781	$ - 104
5. Health Resources	$ 155	$ - 25[1/]
Subtotal, Health	$4,149	$ - 516
B. Education		
1. Elementary and Secondary	$4,466	$ - 36
2. Handicapped	$ 299	$ - 103
3. Occupational, Vocational, and Adult	$ 749	$ - 40
4. Higher Education	$2,131	$ - 58
5. Library Resources	$ 167	$ - 49
Subtotal, Education	$7,812	$ - 286

TABLE 2 -- continued

	FY 1975 Appropria-tion	Proposed for Rescission
C. Social Services		
1. Public Assistance (child welfare and training)	$12,112	$ - 13
2. Rehabilitation services	$ 772	$ - 30
3. Aging programs	$ 313	$ - 42
Subtotal, Social Services	$13,197	$ - 85
TOTAL, RESCISSIONS		$ - 869 1/

	Continuing Resolution Level	Reduction
Continuing Resolutions		
A. Health		
1. Comprehensive health grants	$ 90	$ - 22
2. Community mental health center construction	$ 14	$ - 14
3. Regional medical programs	$ 75	$ - 75
4. Nurse capitation, financial distress, trainee-ships, and special projects	$ 59	$ - 59
5. Public health and allied health	$ 56	$ - 56
6. Health training facilities	$ 114	$ - 114
7. Hospital construction	$ 197	$ - 197
Subtotal, Health	$ 605	$ - 537
B. Education		
1. Emergency school aid	$ 234	$ - 159
TOTAL, CONTINUING RESOLUTIONS	$ 839	$ - 696

1/ In addition, $292 million in unobligated 1973 and 1974 hospital construction appropriations are proposed for recission.

Source: APWA staff, developed from The Fiscal Year 1976 Budget, U.S. Department of Health, Education, and Welfare (February 3, 1975)

In the form in which it is presently proposed, the HEW budget represents a decrease in the Federal commitment to meeting the financial and health care requirements of those individuals with the greatest needs in virtually any terms one wishes to use. Despite rapidly rising prices and a continuing lack of employment opportunities:

** In real terms, HEW outlays decrease;

** While HEW outlays are about one-third of the Federal budget, the Department's programs are asked to assume over 45 percent of the total reductions and limitations proposed in the Federal budget for FY 1976;

** HEW outlays have been an increasing percentage of total Federal outlays over the last five fiscal years, but in FY 1976 they show a 1.2 percentage point decline; and

** Outlays for income-tested cash assistance and social services programs were only about 4.1 percent of Federal outlays in FY 1975, but would decrease to 3.6 percent in FY 1976.

In addition, the Administration notes that it now expects that the wages of employees will again begin to keep pace with the rise in the cost-of-living during FY 1976. The reduction of assistance, both in cash and services, available to non-employed individuals and families will place them in an even more disadvantaged position in the market place.

While it is true that the simultaneous impact of inflation and recession have "distorted" Federal outlays to some degree in FY 1976, even if the largest components of this type of "distortion" (i.e., increases in unemployment compensation and interest on the public debt) are removed, HEW outlays as a percent of Federal outlays continue to show a decrease in FY 1976 relative to FY 1975.

The apparent decrease in Federal commitment may be of even greater concern when the budget's economic assumptions are added to the picture. In developing the budget, the Administration assumed:

** A calendar year 1975 increase in the Consumer Price Index of 11.3 percent and a calendar year 1976 increase of about 7.8 percent. The fiscal year aggregate falls in between, but more likely towards the upper end. Even if the magnitude of these estimates were not questioned (and many economists have questioned them, especially in light of the President's energy proposals), it is clear that individuals will face rapidly rising prices in FY 1976; and

** An unemployment rate in the neighborhood of 8 percent. Many economists believe that this figure is substantially understated.

If the Administration's assumptions are overly optimistic, the budget initiatives it proposes will have an even greater potential impact on the low-income population than it now recognizes and the outlays it presently plans for "open-ended" programs would be significantly understated.

The Administration appears to be aware that there is a potential in the budget proposed for the Department of Health, Education, and Welfare to result in a reduction in assistance and services. In dismissing the probability of the realization of this potential, it appears to make two key assumptions:

** Some beneficiaries of assistance and services are currently receiving more than is actually required to meet their needs.

** State and local governments can and will make up for losses in Federal matching funds (e.g., in AFDC, Medicaid, and social services).

The first assumption would hold that benefits have risen in previous years at a rate which outdistances the rise in the cost-of-living over the period (e.g., in the Social Security Administration programs); program "break-even" levels are too high (e.g., the change in the AFDC income disregard computation); or program policies do not result in optimal utilization of services or resources (e.g., the Medicare cost-sharing provisions). While the fact that individuals continue to live in poverty and without adequate medical assistance, even after the receipt of government transfers, <u>generally</u> tends to rebut an assumption that individuals and families are receiving benefits in excess of their needs, the actions of the Administration in this area must be examined in light of data on the distribution of their impacts within the general population. Public welfare programs are not as efficient and equitable as they might be. However, if the distribution of impacts of the Administration proposals does not promote administrative efficiency and equity in the programs, strong arguments should be made for rejecting the proposals.

The second, and more important, assumption made by the Administration in disregarding the potential for a decrease in assistance and services is that State and local governments are in the financial position, and will elect to make up for decreases in Federal matching funds. In his statement on the proposed budget for HEW, Secretary Weinberger noted: "This request of the State and local governments for increased participation reflects their relatively better fiscal position compared with the large Federal deficit..." While it may be that States are <u>relatively</u> in a less negative position, the fact is that State and local governments in FY 1974 registered a $7.5 billion deficit in the National Income Accounts. 1/ This position is not likely to improve. For example,

1/ Reported by the U.S. Conference of Mayors and the National League of Cities. (The National Income Accounts essentially balance receipts-- personal tax and non-tax receipts, contributions to social insurance and the like--against expenditures--purchase of goods and services, transfer payments, and so forth--with a net result of a surplus or deficit.) Although the $7.5 billion deficit is noted for FY 1974, an Associated Press survey reported in March 1975 that 28 States project finishing FY 1975 with a budget surplus. The States generally note, however, that projected surpluses could be eaten up by inflation and that expenditures are rising faster than revenues. (It should also be noted that the survey results may be on a different base than the NIA figure, which considers the limited availability of certain trust fund receipts.)

the cost of running cities is now rising at an annual rate of 11 to 14 percent, but the yield of local taxes is up only 8.8 percent. Therefore, the impact of the Federal approach may be counter-productive:

** It may force State and local governments to raise taxes.1/ Many such taxes are regressive. At the same time, the Federal government, whose basic tax structure is generally progressive, plans to adopt tax cuts as an economic stimulis.

** The displacement of financing responsibility from the Federal to the State and local governments will only heighten the fiscal problems already facing these units of government.

The net result may be a reduction in cash assistance and services to those with the greatest needs.

The Administration, as in every budget cycle, is ultimately faced with a trade-off of limited resources among a myriad of competing demands. It is clear that the financial resources allocated to meet the needs of those with the greatest needs did not receive the highest priority, actually decreasing relative to the previous year's budget proposals. While the possibility of reducing the outlays of the Department of Health, Education, and Welfare is real, such a reduction must be accomplished in an equitable fashion. This is even more critical in a time of increasing living costs and decreasing employment opportunities. The proposed budget does not accomplish this basic objective because some of its stated initiatives are highly regressive in their impacts (for example, the 5 percent limitation on Supplemental Security Income increases due to rises in the cost-of-living). In addition, elements of the budget's basic assumptions are highly suspect in terms of producing the results the Administration anticipates (for example, a continued level of assistance and services despite a decrease in matching rates).

1/ The Associated Press survey reports that 19 States are considering tax increases at the present time, with 2 more States considering "tax adjustments." Proposals under consideration include gasoline tax increases, extension of sales taxes, and, in some cases, introduction of income taxes. Eleven States are reported to be discussing tax decreases.

Section B:
Specific FY 1976 Budget Initiatives

In summary, the proposed FY 1976 budget for HEW would result in the following increases and decreases in outlays.

** Health agencies (excluding Medicare and Medicaid administration) would incur a reduction in outlays of $195 million in FY 1976 relative to FY 1975. This reduction results, in part, from reductions in resources allocated to direct delivery of health care through Health Resources Administration grant programs. Rescissions of FY 1975 appropriations are sought in 5 health program areas and reductions of continuing resolution authority in 7 others.

** Education programs would receive $97 million more in FY 1976 than in FY 1975.

** Income Security programs, including Medicare and Medicaid, and agencies would receive a total of $8.5 billion above their FY 1975 level in FY 1976. /Of the $8.5 billion increase, $7.7 billion (or about 90 percent) is in the OASDI and Medicare programs. Despite this net increase, the budget assumes enactment of some 14 pieces of cost-reducing legislation./ In the absence of this legislation, the increase in outlays would be in the area of $14.8 billion. About $1.7 billion of budget outlay-reducing legislation affects the AFDC and Medicaid programs and $4.6 billion is related to the OASDI, SSI, and Medicare programs.

** Other HEW programs and agencies would experience a total $25.2 million increase in FY 1976 over FY 1975. (It should be noted that various receipts and adjustments to the HEW budget were estimated at $-137 million in FY 1975 and $-141 million in FY 1976.)

The net result, as noted previously, is a $8.4 billion increase in outlays. Table 2 (p. 6) outlines outlay reducing legislative measures and proposed rescissions and reductions sought in continuing resolution authority.

1. Health Agencies

The proposed FY 1976 budget anticipates outlays totaling $5.15 billion for health agencies, or about a 3.7 percent reduction compared to FY 1975 outlays. Including Medicare and Medicaid, the budget totals $27.3 billion for health outlays, compared to $25.8 billion in FY 1975.

While the FY 1976 budget proposal anticipates a net reduction in outlays for health agencies, there are several increases in budgetary authority:

** The Food and Drug Administration is targeted for a $19 million increase in outlays which will, among other things, permit it to undertake studies necessary to assure the therapeutic and chemical equivalence of generic drugs and to enforce new standards for certain over-the-counter drugs.

** A $11 million increase in outlays for the Center for Disease Control is anticipated, focusing primarily on occupational health related studies.

** Outlays for the Office of the Assistant Secretary for Health are expected to increase by $34 million.

An appropriation of $175 million to implement the Health Planning and Resource Act of 1974 (P.L. 93-641) is sought for FY 1976, $100 million for new medical facilities construction and $75 million for other purposes. (The Administration will request $75 million in FY 1975.) Programs under this Act replace Comprehensive Health Planning, Regional Medical Programs, and the Hill-Burton Facilities Construction authorities. While these are new funds and considered by HEW to be increases in health agency resources, programs which are replaced were funded at a minimum of $386.0 million in FY 1975 continuing resolution. (The funds discussed here are in terms of budget authority. Anticipated outlays are not provided at this level of detail.)

The proposed FY 1976 budget includes a proposed decrease in outlays of the Health Services Administration. Under the budget proposal, outlays would decrease from $1.121 billion in FY 1975 to $1.091 billion in FY 1976 primarily as a result of the decision to require increased cost-sharing by States, local governments, and other grantees and increased third party reimbursements in grant programs, e.g., family planning, maternal and child health, migrant health, and neighborhood health centers. The budget assumes a Federal reduction in funding of approximately 20 percent. (It should be noted that the budget authority requested, i.e., authority provided by Congress allowing the Federal government to spend money, decreases by $184 million.) To moderate potential impacts on grantees, HEW plans to provide technical assistance to them in recovering third-party reimbursement for services that are covered by State Medicaid plans, the Medicare program, or private health insurance. It will also propose legislation to amend the Social Security Act to require non-hospital affiliated health clinics to be included in each State Medicaid plan.

As indicated above, the principal budget control method applied to health agencies is the rescission of previous year (i.e., FY 1975) budget authority. (Rescission of FY 1976 budget authority is important to the FY 1976 budget because HEW assumes that if Congress rescinds FY 1975 authority, it will not act to re-establish the program for FY 1976. That is, a rescission of FY 1975 effectively terminates program budget

authority. While a deferral puts off the spending of non-lapsing funds until the following fiscal year, a rescission removes program budget authority and Congress must act to re-establish authority for the following year).

** $26 million in Health Services Administration funds are proposed for rescission. The bulk of rescission, $24.4 million, is related to the maternal and child health program of Community Health Services. Of this amount, $23.0 million is in reductions in grants to States, $0.5 million is in research and training; and $0.9 million is related study and dissemination of information on the Sudden Infant Death Syndrome. The remainder of the proposed rescission affects Patient Care and Special Health Services activities.

** $10 million in Preventive Health Services budget authority is proposed for rescission. Preventive Health Services are a part of the Center for Disease Control. About 55 percent of the proposed rescission relates to project grants (on subjects such as venerel disease, immunization, and blood lead analysis). Another 40 percent of the rescissions relate to occupational health grants and operations.

** $351 million in rescissions are proposed in National Institute for Health funds. Of this amount, $123 million is related to cancer research and $228 million spread over other institutes.

** $104 million in rescissions are proposed for the Alcohol, Drug Abuse, and Mental Health Administration. Approximately $41 million in proposed funds to be rescinded were targeted for research and training in mental health; $9 million for drug abuse research, training, project grants, and management information developments; and $54 million for alcohol research, training, project grants, grants to States and management information system development.

** $25 million in rescissions of Health Resources Administration budget authority is proposed. These funds are all related to the health manpower field.

The latter rescission does not include $292 million in unobligated 1973 and 1974 hospital construction appropriations which are proposed for rescission.

Finally, it must be recognized that the Administration has proposed that budget authority for certain health agency programs operating under continuing resolution budget levels be terminated or substantially reduced. Table 2 includes these proposals. The program of comprehensive health grants to States operates with $90 million in budget authority under a continuing resolution. The Administration seeks to reduce this

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authority by $22 million, to $68 million. Funding levels for 6 other health agency programs operating under continuing resolutions would be reduced to zero. If Congress does not follow the Administration's recommendation, it will submit rescissions for each of the programs not acted on by Congress consistent with Administration desires.

2. Income Security--Means-Tested Assistance Programs (and other supportive elements)

Means-tested income security programs (and their supportive elements) include the Social and Rehabilitation Service's maintenance assistance (Aid to Families with Dependent Children, the adult categories, State and local administration costs, Emergency Assistance, and Aid to Repatriated U.S. Nationals), Medicaid, social services, State and local training, and child welfare services programs plus research and training projects. They also include the Supplemental Security Income and Disabled Coal Miners programs administered by the Social Security Administration.

In FY 1976, projected outlays for means-tested income security programs total $20.3 billion, or a 7.3 percent increase over FY 1975. Of the total nearly $1.4 billion increase in outlays over FY 1975, over $1.3 billion are attributable to increases in Medicaid and SSI program outlays. Outlays for Social and Rehabilitation Service public assistance programs are $439 million below their FY 1975 level in FY 1976. Within these general confines:

** $37 million less in outlays is proposed for maintenance assistance programs in FY 1976 than FY 1975. Of these programs, only AFDC faces a decrease in budget authority, dropping from $4.208 billion in FY 1975 to $4.084 billion in FY 1976. (Outlays in this level of detail are not available. FY 1976 budget authority equals estimated outlays. FY 1975 outlays were less than budget authority for the fiscal year.) While the average monthly number of recipients and the average monthly payments are expected to increase in FY 1976, by 2.2 percent and 7.3 percent respectively, the 4 legislative and 2 administrative actions proposed by the Administration are expected to produce the decreased need for funding.

** Outlays for social services are expected to be about $392 million below the FY 1975 level. This reduction is totally attributable to the proposed matching formula change. In the absence of the change in matching rate, a $56 million increase in outlays would be anticipated.

** While the Work Incentive Program would receive a $120 million increase in budget authority in the proposed FY 1976 budget, outlays would decrease by $1 million, from $316 million to $315 million. WIN supportive services budget authority is $97 million in the budget proposal, with outlays expected to be somewhat higher.

** The budget request for the Cuban Refugee Program reflects HEW's plan to phase out Federal funding for the program by June 30, 1977. Outlays are estimated at $54 million, or a $32 million decrease from the FY 1975 estimate.

** State and local training, child welfare services, and research activities related to public assistance programs would have a combined budget of $88 million in FY 1976, compared to $98 million in FY 1975.

a. Medicaid. While outlays for Medicaid in FY 1976 are expected to reach over $7.5 billion (up from about $6.6 billion in FY 1975), they would be over $600 million higher in the absence of the assumption that Congress will enact a proposed change in the Federal matching rate, and another $80 million higher if it were not assumed that non-emergency adult dental care will be eliminated.

Under the existing provisions of the Social Security Act, the Medicaid matching formula guarantees that a State will receive at least 50 percent matching from the Federal government. The Administration argues that such a floor weights Federal participation disproportionately in favor of the "wealthier" States (i.e., those with higher per capita incomes). Therefore, it proposes to reduce the Federal matching floor to 40 percent for the Medicaid program. If such legislation is approved by Congress, it is estimated that Medicaid outlays would be $636 million below what they would be in the absence of this legislation. The average Federal share would be about 57 percent.

There are 13 States which would be affected by the change in the Medicaid formula. The States, their approximate new Federal matching percentages, and the proposed decrease in Federal matching funds are included in Table 3 (p. 17). Ten of the 13 States affected are reported to have no surplus in their FY 1975 budgets. (Six of these 10 are reported to be considering tax increases.)

As in the November 26 budget reduction message, the Administration has noted plans to submit a legislation proposal which would eliminate the provision of non-emergency dental services to adults (defined as individuals 21 years of age or older) under the Medicaid program. Federal matching for children's preventive dental care would be continued for Medicaid eligible children under age 21. It is estimated that this legislation would reduce Federal program costs by $81 million in FY 1976. The Administration has elected this course because it assigns a lower priority to non-emergency adult dental care expenses compared to other Federally reimbursed program components. In addition, the Administration argues that such an approach recognizes similar coverage policies in private insurance programs.

TABLE 3

States Affected by Proposed Change in
Medicaid Cost Sharing

State	Matching Percentages		Proposed Decrease in Federal Matching Funds (in millions)	
	Present1/	Approximate New	1975	1976
Alaska	50%	40%	$ .3	$ 1.1
California	50	43	39.6	125.9
Connecticut	50	40	5.1	16.2
Delaware	50	43	.4	1.2
District of Columbia	50	40	3.5	11.3
Hawaii	50	42	1.1	3.5
Illinois	50	41	21.5	68.4
Maryland	50	47	1.9	6.0
Massachusetts	50	46	7.0	22.2
Michigan	50	48	4.1	12.9
Nevada	50	40	.6	1.9
New Jersey	50	40	13.4	42.6
New York	50	40	101.5	322.9
Total			$ 200.0	$636.1

1/Percent which would be in effect as of July 1, 1975.

b. Supplemental Security Income (SSI). Outlays for the Supplemental Security Income Program are expected to increase from $4.7 billion in FY 1975 to $5.5 billion in FY 1976. Benefit payments are expected to rise by about $545 million over FY 1975, to about $4.6 billion. The growth in the program outlays is attributable to additional beneficiaries entering this relatively new program and to a projected 5 percent benefit increase. In the absence of enactment by Congress of a proposed "cap" of 5 percent on the program cost-of-living increase, however, the projected 5 percent increase would become approximately 8.7 percent and add $85 million in benefit outlays. The Administration budget levels also assume a savings of $100 million resulting from redeterminations of the eligibility of individuals converted from the adult category programs, as well as accessions to the rolls.

The SSI program has an automatic cost-of-living increase incorporated into its program structure by legislation. In general, when the Consumer Price Index indicates an annual increase of at least 3 percent as of the computation quarter, the automatic cost-of-living increase in the program is triggered. If the provisions of the existing legislation were to go

into effect on July 1, 1975, the increase in the benefit amounts under SSI would be about 8.7 percent. The Administration, as noted above, will propose legislation to limit this increase to 5 percent. The Administration justifies this approach by noting that individuals would receive a benefit increase, not a reduction in the amount they receive. However, the _real_ benefit level would decrease (i.e., the individual's purchasing power declines). For example, if an individual were receiving the average monthly SSI benefit plus food stamp benefits and there was no change in the present law, in July 1975 he would receive combined benefits of about $120 if the cost-of-living adjustment were 9 percent, compared to $110 prior to adjustment. (It should be noted that the Food Stamp Program, which is "indexed" by law, is intended to be subject to the 5 percent ceiling.) Under the Administration proposal, the combined benefit amount would be about $115, or a 4.5 percent increase--about one-half the rise in prices the individual must face.

c. Aid to Families with Dependent Children (AFDC). While AFDC outlays are anticipated at about $4.1 billion in FY 1976, this level would be nearly $500 million higher in the absence of the assumption that Congress will act favorably on four items of legislation to be proposed. In addition, the new incapacity definition for the program is expected to produce a $73 million reduction in outlays relative to what they would have become under the previous definition.

The Administration again plans to submit to Congress legislation which would standardize the amount of work-related expenses disregarded in determining AFDC eligibility and benefit amounts. More importantly, the proposed legislation would apply the one-third disregard of earnings to net income rather than gross income as at the present. It is estimated that such legislation, as described below would result in a $203 million reduction in program outlays.

The legislation which the Administration plans to submit would replace the present "$30 and 1/3" rule with a provision allowing a flat $60 plus child care expenses to be deducted before computing the one-third disregard amount. The Administration argues that this proposal would eliminate the "inequity" of retaining a family on the AFDC roles even though earned income reaches a considerable level and that it would simplify eligibility determinations. The following example, which assumes gross earnings of $600 per month, mandatory payroll deductions and other work-related expenses of $60 per month, and child care costs of $65 per month, might serve to put this provision in context.

	Current	Proposed	
Monthly Gross	$600.00	$600.00	Monthly Gross
Less $30 and 1/3	220.00	60.00	Standard disregard
Subtotal	$380.00	$540.00	Subtotal
Less mandatory payroll		65.00	Less child care
deduction and expense of		$475.00	Subtotal
employment	60.00	158.00	Less 1/3
Subtotal	$320.00		
Less child care	65.00		
Calculated income	$255.00	$317.00	Calculated income

If the State income eligibility standard was $300, the example indicates that the family would become ineligible for assistance under theproposed new formula. Further, the example indicates that the standard disregard would replace the need for calculating work expenses. The 1973 AFDC Survey indicates that, at the point in time of the Survey, 13 percent of the AFDC families had earnings. Of the families with earnings in the AFDC Survey, approximately 45 percent had child care expenses.

A second item of legislation which the proposed budget assumes the Congress will act favorably upon is a change in the AFDC accounting, reporting, and redetermination periods. The accounting period would be changed from one month to three months, at least for initial eligibility determinations. The redetermination period would be reduced to 3 months from 6 months. Although not clearly stated, the intention appears to be to require monthly reporting of income. It is estimated that the passage of such legislation would produce $146 million in FY 1976 savings, primarily through denial of assistance to those who receive assistance only for short periods between jobs and through more accurate and frequent reporting of changes in recipients' circumstances.

Alterations in the accounting, reporting, and redetermination periods have certain consequences not clearly identified by the Administration. Use of a three month accounting period in determining eligibility could result in families with extreme need being denied assistance for up to two months if Emergency Assistance programs are not expanded. It also raises questions of accounting methods, i.e., averaging over the three months, employing the "last in, first out" technique, or the "first in, first out" methodology. Revisions of the income reporting requirements and redetermination period will produce increased administrative costs and probably require substantial Federal assistance. The 5 percent rise protrayed in the budget for State and local administrative costs do not appear to adequately reflect this consideration.

As proposed in the November 26 budget reduction message, the Administration will submit legislative language which will require the use of the Medicaid matching formula in all States in claiming reimbursement for AFDC payments. (This, it should be noted, is the Medicaid formula presently being used, with a 50 percent matching floor.) States are presently allowed to choose between two formulae in determining the Federal matching rate for AFDC payments. The "regular" Federal matching rate is computed by taking five-sixths of the first $18 of the average monthly payment per recipient and 50-65 percent (depending on the State's per capita income) of the next $14 or up to $32. Nothing above a $32 average monthly payment is matched under this formula.

The "Federal medical assistance percentage" (Medicaid formula) has been elected by 42 States under the optional system. It reimburses from 50 to 83 percent of assistance payments (depending on State per capita income), without a limit on the monthly payment level.

The Administration justifies elimination of the formula option on the grounds that States who have elected the "regular" AFDC formula receive a disaproportionately large Federal subsidy and have restricted the level of monthly assistance payments in order to maintain

the higher Federal reimbursement ratio. This argument assumes, in effect, that certain State legislatures allocate funds to the public assistance agency based on the Federal matching rate rather than on the basis of actual dollar amounts available. The price of an error in this assumption is potentially lower payment levels in the 12 States affected.

The following table outlines the States affected by the proposed legislation, their present "Federal percentage," the Federal share of assistance costs under the regular formula (based on August 1974 payments), and their share as it would be under the proposed legislation (both the percentage in effect to June 30, 1975 and that in effect as of July 1 as provided). Seven of 12 States affected are reported to project no budget surplus for FY 1975. (Three of these 7 are reported to be considering tax increases, although one of these is also reported to be considering a tax decrease. One State with a surplus is reportedly considering a tax decrease.)

TABLE 4

State	Federal Percentage	Federal share--Regular formula	Federal share--Medicaid formula To 6/30/75	Federal share--Medicaid formula After 7/1/75
Alabama	65.00%	77.25%	75.93%	73.79%
Arizona	57.69*	65.11	61.92	60.48
Delaware	50.00	43.73	50.00	50.00
Florida	56.61*	71.73	60.95	57.34
Georgia	63.29*	73.06	66.96	66.10
Louisiana	65.00	77.45	72.80	72.41
Mississippi	65.00	83.33	80.55	78.28
Missouri	55.49*	59.22	59.94	58.98
Nevada	50.00	46.29	50.00	50.00
South Carolina	65.00	77.44	75.00	73.58
Tennessee	65.00	73.79	72.28	70.43
Texas	59.47*	73.29	63.53	63.59

*The "Federal percentage" in these five States would change in July 1975 as follows: Arizona (56.09), Florida (52.60), Georgia (62.34), Missouri (54.22), and Texas (59.99). Under the "regular formula," the Federal government pays the "Federal percentage" of the amount of the average monthly payment over $18 and up to $32. The "Federal percentage" is the percentage which bears the same ratio to 50 percent as the square of the State's per capita income bears to the square of the per capita income of the U.S., but in no case is to be less than 50 or more than 65 percent.

The table indicates that the Federal share of assistance costs will actually increase in Delaware and Nevada under the Federal medical assistance percentage. In addition, with the July 1, 1975 changes in the Federal percentage, Missouri may be better off employing the Federal medical assistance percentage.

Finally, the Administration plans to propose amendments to the recently enacted paternity and child support actions of the Social Security Act. While the President noted support for the general concepts of the legislation, he noted in signing it into law that amendments to specific sections would be sought prior to implementation. Although such legislation has yet to be defined, areas which it might encompass include:

** A removal of the HEW Parent Locator Service requirement. The Administration is concerned with the administrative implications of such a requirement. It may suggest that Social Security Administration and Internal Revenue Service information be employed, as is now the case in certain situations;

** A modification of the annual audit provision. The alternative which may be advocated is that audits be conducted "from time to time" as seen necessary by HEW;

** A deletion of the use of the Internal Revenue Service as a collection agent;

** A change in the role of the Federal courts. This change may include a requirement such that all State court remedies must be exhausted prior to entering the Federal courts; and

** A reduction in the Federal matching percentage from 75 percent as provided in P.L. 93-647 to 50 percent.

No matter what these amendments are, HEW assumes they will reduce outlays by $90 million in FY 1976.

d. Social Services. Title XX of the Social Security Act, established with the signing of P.L. 93-647, retained the 75 percent matching rate (90 percent for family planning) which had existed under Titles IV and VI. Based on these matching rates, it was estimated that Federal payments for services would reach $1.95 billion in FY 1976. (The ceiling on Federal payments is $2.5 billion.)

The Administration plans to introduce legislation which would reduce the Federal matching rate for services under Title XX from 75 percent to 65 percent (presumably, including family planning) in FY 1976 and to 50 percent for FY 1977 and subsequent years. The rationale offered by the Administration for this approach is that it would bring social services matching into line with the Federal participation rates for cash assistance and the Medicaid program. The legislation--coupled with clear Federal guidelines and the obligation for States to plan and account for their social services programs under Title XX--will, it is argued, "lead to a more efficient use of resources since the States will have a greater financial stake in the programs for which Federal matching is provided."

The implication of a reduction in an "across-the-board" matching rate is either (1) that the Federal government perceives that financial incentives are no longer necessary in order to induce desired behavior or (2) a decrease in commitment to the program. In the first case, the assumption is that the State will trade-off the necessary funds for services against other State programs (or remove "unnecessary" services) in order to maintain the same effective level of program operation. This trade-off may be possible where (1) there is a surplus in the State budget or (2), in a limited resources budget, social services can be demonstrated to have a higher rate of return to the States than do other competing State programs (e.g., highway construction).

Table 5 on the following page outlines the impact HEW anticipates the proposed change will have on the program. HEW assumes that States which are expected to expend up to their Federal ceiling will appropriate sufficient funds to reach that level even at 65 percent matching rate. States not at their matching ceiling are expected to appropriate the same actual dollar amount of funds they would have appropriated at the 75 percent rate. These assumptions result in projected Federal savings of $448 million.

Table 6 (pp. 24-26) provides a set of alternative assumptions:

** Assumption A is that all States will maintain the same program level at 65-35 percent matching as they were expected to have under 75-25 percent matching. Under this assumption, State expenditures would increase by about $250 million over what they were estimated to be at the 75-25 percent level.[1/]

** Assumption B is that States would only expend State funds equal to the actual dollar amount they would have expended at the 75-25 percent level (i.e., if a State would have expended $10 million under the 75-25 formula, it would also expend $10 million at the 65-35 matching rate). This would result in a drop in the total program level of nearly $720 million from what it was anticipated to be under 75-25 percent matching.

** Assumption C suggests that all States would use their full Federal allocation.

It is clear under any set of assumptions that either (1) State costs will increase significantly if program levels are to be maintained, or (2) program levels will drop, implying a decrease in available services.

1/ The following chart provides the totals derived from Table 6 (all figures are in millions). Note that Guam, Puerto Rico, and the Virgin Islands are not included.

	Federal	State	Program Level
At 75-25	$1,883.1	$ 627.6	$3,649.6
Assumption A	1,631.9	878.8	2,510.7
Assumption B	1,165.4	627.6	1,793.0
Assumption C	2,373.6	1,276.0	3,649.6

TABLE 5. Estimated Changes in Social Services
Matching -- FY 1976
(in millions of $$)

State	@ 75%	65%	State	@ 75%	@ 65%
Alabama	$ 24.0	14.9	Nebraska	$ 15.0	$ 9.3
Alaska	4.0	4.0	Nevada	2.5	1.6
Arizona	4.0	2.5	New Hampshire	7.0	4.3
Arkansas	10.0	6.2	New Jersey	65.0	40.3
California	245.5	245.0	New Mexico	12.0	7.4
Colorado	26.4	16.4	New York	217.5	217.5
Connecticut	36.8	36.8	North Carolina	27.0	16.7
Delaware	5.0	3.1	North Dakota	4.5	2.8
District of Columbia	9.0	9.0	Ohio	60.0	37.2
Florida	91.5	91.5	Oklahoma	22.0	13.6
Georgia	41.0	25.4	Oregon	26.5	26.5
Hawaii	9.5	5.9	Pennsylvania	124.0	76.9
Idaho	8.5	5.3	Rhode Island	11.5	11.5
Illinois	115.0	77.5	South Carolina	20.0	12.4
Indiana	8.0	5.0	South Dakota	5.0	3.1
Iowa	24.0	14.9	Tennessee	24.0	14.9
Kansas	13.0	8.1	Texas	134.0	83.1
Kentucky	29.0	18.0	Utah	5.5	3.4
Louisiana	27.0	16.7	Vermont	5.0	3.1
Maine	8.0	5.0	Virginia	30.0	18.6
Maryland	45.0	27.9	Washington	40.8	40.8
Massachusetts	60.0	37.2	West Virginia	15.0	9.3
Michigan	90.0	55.8	Wisconsin	54.1	33.5
Minnesota	46.5	46.5	Wyoming	2.0	1.2
Mississippi	7.0	4.3	Guam]	Approximate --	]
Missouri	20.0	12.4	Puerto Rico]	4.9	2.3]
Montana	5.5	3.4	Virgin Islands		
			TOTAL	$1,948.0	$1,500.0

Source: Department of Health, Education, and Welfare

TABLE 6. Social Service Matching Under Alternative Assumptions (in millions)

	@ 75 Percent					@ 65 Percent		
	Ceiling	Federal	State	Program Level	Assump-tion	Federal	State	Program Level
Alabama	$ 42.25	$ 24.0	$ 8.0	$ 32.0	A	$ 20.8	$ 11.2	$ 32.0
					B	14.9	8.0	22.9
					C	42.3	22.8	65.1
Alaska	$ 4.00	$ 4.0	$ 1.3	$ 5.3	A	$ 3.4	$ 1.9	$ 5.3
					B	2.4	1.3	3.7
					C	4.0	2.2	6.2
Arizona	$ 24.50	$ 4.0	$ 1.3	$ 5.3	A	$ 3.4	$ 1.9	$ 5.3
					B	2.4	1.3	3.7
					C	24.5	13.2	37.7
Arkansas	$ 24.25	$ 10.0	$ 3.3	$ 13.3	A	$ 8.6	$ 4.7	$ 13.3
					B	6.1	3.3	9.4
					C	24.3	13.1	37.4
California	$245.50	$ 245.5	$81.8	$327.3	A	$ 212.7	$114.6	$327.3
					B	151.9	81.8	233.7
					C	245.5	132.2	377.7
Colorado	$ 29.00	$ 26.4	$ 8.8	$ 35.2	A	$ 22.9	$ 12.3	$ 35.2
					B	16.3	8.8	25.1
					C	29.0	15.6	44.6
Connecticut	$ 36.75	$ 36.8	$12.3	$ 49.1	A	$ 31.9	$ 17.2	$ 49.1
					B	22.8	12.3	35.1
					C	36.8	19.8	56.6
Delaware	$ 6.75	$ 5.0	$ 1.7	$ 6.7	A	$ 4.4	$ 2.3	$ 6.7
					B	3.2	1.7	4.9
					C	6.8	3.7	10.5
District of Columbia	$ 9.00	$ 9.0	$ 3.0	$ 12.0	A	$ 7.8	$ 4.2	$ 12.0
					B	5.6	3.0	8.6
					C	9.0	4.8	13.8
Florida	$ 91.50	$ 91.5	$30.5	$122.0	A	$ 79.3	$ 42.7	$122.0
					B	56.6	30.5	87.1
					C	91.5	49.3	140.8
Georgia	$ 57.00	$ 41.0	$13.7	$ 54.7	A	$ 35.6	$ 19.1	$ 54.7
					B	25.4	13.7	39.1
					C	57.0	30.7	87.7
Hawaii	$ 10.00	$ 9.5	$ 3.2	$ 12.7	A	$ 8.3	$ 4.4	$ 12.7
					B	5.9	3.2	9.1
					C	10.0	5.4	15.4
Idaho	$ 9.25	$ 8.5	$ 2.8	$ 11.3	A	$ 7.3	$ 4.0	$ 11.3
					B	5.2	2.8	8.0
					C	9.3	5.0	14.3
Illinois	$133.75	$ 115.0	$38.3	$153.3	A	$ 99.6	$ 53.7	$153.3
					B	71.1	38.3	109.4
					C	133.8	72.0	205.8

TABLE 6 -- continued

	@ 75 Percent					@ 65 Percent		
	Ceiling	Federal	State	Program Level	Assumption	Federal	State	Program Level
Indiana	$ 63.25	$ 8.0	$ 2.7	$ 10.7	A	$ 7.0	$ 3.7	$ 10.7
					B	5.0	2.7	7.7
					C	63.3	31.1	97.4
Iowa	$ 34.50	$ 24.0	$ 8.0	$ 32.0	A	$ 20.8	$11.2	$ 32.0
					B	14.9	8.0	22.9
					C	34.5	18.6	53.1
Kansas	$ 27.25	$ 13.0	$ 4.3	$ 17.3	A	$ 11.2	$ 6.1	$ 17.3
					B	8.0	4.3	12.3
					C	27.3	14.7	42.0
Kentucky	$ 39.75	$ 29.0	$ 9.7	$ 38.7	A	$ 25.2	$13.5	$ 38.7
					B	18.0	9.7	27.7
					C	39.8	21.4	61.2
Louisiana	$ 44.75	$ 27.0	$ 9.0	$ 36.0	A	$ 23.4	$12.6	$ 36.0
					B	16.7	9.0	25.7
					C	44.8	24.1	68.9
Maine	$ 12.25	$ 8.0	$ 2.7	$ 10.7	A	$ 7.0	$ 3.7	$ 10.7
					B	5.0	2.7	7.7
					C	12.3	6.6	18.9
Maryland	$ 48.50	$ 45.0	$15.0	$ 60.0	A	$ 39.0	$21.0	$ 60.0
					B	27.9	15.0	42.9
					C	48.5	26.1	74.6
Massachusetts	$ 69.25	$ 60.0	$20.0	$ 80.0	A	$ 52.0	$28.0	$ 80.0
					B	37.1	20.0	57.1
					C	69.3	37.3	106.6
Michigan	$107.50	$ 90.0	$30.0	$120.0	A	$ 78.0	$42.0	$120.0
					B	55.7	30.0	85.7
					C	107.8	58.0	165.8
Minnesota	$ 46.50	$ 46.5	$15.5	$ 62.0	A	$ 40.3	$21.7	$ 62.0
					B	28.8	15.5	44.3
					C	46.5	25.0	71.5
Mississippi	$ 27.25	$ 7.0	$ 2.3	$ 9.3	A	$ 6.0	$ 3.3	$ 9.3
					B	4.3	2.3	6.6
					C	27.3	14.7	42.0
Missouri	$ 56.75	$ 20.0	$ 6.7	$ 26.7	A	$ 17.4	$ 9.3	$ 26.7
					B	12.4	6.7	19.1
					C	56.8	30.6	87.4
Montana	$ 8.50	$ 5.5	$ 1.8	$ 7.3	A	$ 4.7	$ 2.6	$ 7.3
					B	3.3	1.8	5.1
					C	8.5	4.6	13.1
Nebraska	$ 18.25	$ 15.0	$ 5.0	$ 20.0	A	$ 13.0	$ 7.0	$ 20.0
					B	9.3	5.0	14.3
					C	18.3	9.9	28.2
Nevada	$ 6.50	$ 2.5	$ 0.8	$ 3.3	A	$ 2.1	$ 1.2	$ 3.3
					B	1.5	0.8	2.3
					C	6.5	3.5	10.0
New Hampshire	$ 9.50	$ 7.0	$ 2.3	$ 9.3	A	$ 6.0	$ 3.3	$ 9.3
					B	4.3	2.3	6.6
					C	9.5	5.1	14.6
New Jersey	$ 87.75	$ 65.0	$21.7	$ 86.7	A	$ 56.4	$30.3	$ 86.7
					B	40.3	21.7	62.0
					C	87.8	47.3	135.1
New Mexico	$ 13.25	$ 12.0	$ 4.0	$ 16.0	A	$ 10.4	$ 5.6	$ 16.0
					B	7.4	4.0	11.4
					C	13.3	7.2	20.5

TABLE 6 -- continued

	Ceiling	Federal	State	Program Level	Assump-tion	Federal	State	Program Level
New York	$217.50	$ 217.5	$72.5	$ 290.0	A	$ 188.5	$101.5	$290.0
					B	134.6	72.5	207.1
					C	217.5	117.1	334.6
North Dakota	$ 62.75	$ 27.0	$ 9.0	$ 36.0	A	$ 23.4	$ 12.6	$ 36.0
					B	16.7	9.0	25.7
					C	62.8	33.8	96.6
Ohio	$ 7.50	$ 4.5	$ 1.5	$ 6.0	A	$ 3.9	$ 2.1	$ 6.0
					B	2.8	1.5	4.3
					C	7.5	4.0	11.5
Oklahoma	$ 31.75	$ 22.0	$ 7.3	$ 29.3	A	$ 19.0	$ 10.3	$ 29.3
					B	13.6	7.3	20.9
					C	31.8	17.9	49.7
Oregon	$ 26.50	$ 26.5	$ 8.8	$ 35.3	A	$ 22.9	$ 12.4	$ 35.3
					B	16.3	8.8	25.1
					C	26.5	14.3	40.8
Pennsylvania	$141.75	$ 124.0	$41.3	$ 165.3	A	$ 107.4	$ 57.9	$165.3
					B	76.7	41.3	118.0
					C	141.8	76.4	218.2
Rhode Island	$ 11.50	$ 11.5	$ 3.8	$ 15.3	A	$ 9.9	$ 5.4	$ 15.3
					B	7.1	3.8	10.9
					C	11.5	6.2	17.7
South Carolina	$ 32.50	$ 20.0	$ 6.7	$ 26.7	A	$ 17.4	$ 9.3	$ 26.7
					B	12.4	6.7	19.1
					C	32.5	17.5	50.0
South Dakota	$ 8.25	$ 5.0	$ 1.7	$ 6.7	A	$ 4.4	$ 2.3	$ 6.7
					B	3.2	1.7	4.9
					C	8.3	4.5	12.8
Tennessee	$ 49.25	$ 24.0	$ 8.0	$ 32.0	A	$ 20.8	$ 11.2	$ 32.0
					B	14.9	8.0	22.9
					C	49.3	26.5	75.8
Texas	$140.50	$ 134.0	$44.7	$ 178.7	A	$ 116.2	$ 62.5	$178.7
					B	83.0	44.7	127.7
					C	140.5	75.7	216.2
Utah	$ 13.75	$ 5.5	$ 1.8	$ 7.3	A	$ 4.7	$ 2.6	$ 7.3
					B	3.3	1.8	5.1
					C	13.8	7.4	21.2
Vermont	$ 5.50	$ 5.0	$ 1.7	$ 6.7	A	$ 4.4	$ 2.3	$ 6.7
					B	3.2	1.7	4.9
					C	5.5	3.0	8.5
Virginia	$ 57.25	$ 30.0	$10.0	$ 40.0	A	$ 26.0	$ 14.0	$ 40.0
					B	18.6	10.0	28.6
					C	57.3	30.9	88.2
Washington	$ 40.75	$ 40.8	$13.6	$ 54.4	A	$ 35.4	$ 19.0	$ 54.4
					B	25.3	13.6	38.9
					C	40.8	22.0	62.8
West Virginia	$ 21.50	$ 15.0	$ 5.0	$ 20.0	A	$ 13.0	$ 7.0	$ 20.0
					B	9.3	5.0	14.3
					C	21.5	11.6	33.1
Wisconsin	$ 54.50	$ 54.1	$18.0	$ 72.1	A	$ 46.9	$ 25.2	$ 72.1
					B	33.4	18.0	51.4
					C	54.5	29.3	83.8
Wyoming	$ 4.25	$ 2.0	$ 0.7	$ 2.7	A	$ 1.8	$ 0.9	$ 2.7
					B	1.3	0.7	2.0
					C	4.3	2.3	6.6

e. State and Local Training Restrictions. The Department of Health, Education, and Welfare intends to propose legislation which would restrict the training eligible for Federal matching to short-term, in-service courses which could be directed at high priorities for Federal and State welfare agencies. It is estimated that such legislation would decrease Federal program costs by about $30 million in FY 1976.

f. Work Incentives. While the HEW budget indicates an increase in budget authority for the Work Incentive Program, it is important to note that the child care and supportive services component continues to be inadequately funded.

The FY 1976 budget proposal provides $97.0 million for the WIN child care and supportive services component. Because of inadequate funding in FY 1975, there are no available "carry-in" funds to FY 1976. While supplemental appropriations are under consideration for FY 1975, the most optimistic estimate would provide about $8.0 million in carry-in funds, or a maximum total of $105.0 million to operate the program in FY 1976. In FY 1974, States expended about $114.9 million in Federal funds (not all of which were ultimately matched). It was estimated Federal funds totaling over $152.0 million would be required to operate this component of the WIN program in FY 1975 without a cut-back in planned services. Therefore, the maximum $105.0 million made available by the budget is insufficient to meet State needs.

Rescissions. Rescissions totaling about $85 million for FY 1975 have been proposed in several HEW components which include:

** $4.0 million in child welfare services funds and $8.9 million in funds for training projects are proposed for rescission. The child welfare service funds are distributed to jurisdictions on a formula basis. The Administration argues that if these funds are obligated, their use could not be determined and they might simply be used to replace State funds. The rescission in training funds reflects a decision to phase out special categorical training and would affect about 800 students funded through projects under Sections 707 and 426 of the Social Security Act.

** $29.8 million in Rehabilitation Services funds for innovation and expansion grants, for a deaf-blind center, and for training are proposed for rescission.

** $41.6 million in State and community services, nutrition, and training funds for programs for the aging are proposed for rescission. The reduction in nutrition funds is estimated to reduce the number of meals which can be provided to the aged by 40,000-50,000 per week (5 days). The resultant level of services would be the same as FY 1974.

3. Social Insurance Programs

Outlays for the Old-Age, Survivors, and Disability Insurance (OASDI) and Medicare programs total about $85.1 billion, or nearly 72 percent of total HEW outlays. This is an increase of $7.6 billion, or 9.9 percent over FY 1975. OASDI outlays are estimated to increase by $6.6 billion, or about 10.3 percent. The $1.1 billion increase in Medicare outlays is a 7.8 percent increase. However, these increases would have been significantly higher in the absence of initiatives to control their growth.

Old-Age, Survivors, and Disability Insurance. The Administration will propose three items of legislation aimed at controlling the expansion of outlays in the OASDI program:

** A 5 percent limit on the automatic cost-of-living adjustment due in July 1975;

** Elimination of the program's retroactive annuity option; and

** Replacing the monthly retirement test computation with an annual computation.

The 5 percent limitation has essentially the same impacts, although over a broader spectrum of the population, as in the Supplemental Security Income Program. As these were noted above, they are not repeated here. Suffice it to say that real purchasing power of those receiving OASDI benefits only decreases. The anticipated reduction in outlays resulting from this provision is nearly $2.7 billion.

The Administration plans to resubmit a legislative proposal under which OASDI benefits would not be paid retroactively for months before an application is filed when such a payment would result in a permanent reduction in future monthly benefits. Under existing law, an applicant who is entitled to retroactive benefits faces a choice of receiving a large lump-sum payment to cover retroactive benefits to which he or she is entitled and a permanently reduced monthly benefit in the future; or, getting no lump-sum payment and a higher (relative to the first case) monthly benefit beginning with the month in which the application is filed. The legislation which the Administration suggests would eliminate the lump-sum payment option. It would produce a reduction in outlays totaling $443 million. Such a provision was also recommended by the 1971 Social Security Advisory Council.

The argument which the Administration uses to support this legislation is that many individuals elect the lump sum payment and quickly spend it. These individuals are then faced with living on reduced benefits over the remainder of their life span. In addition, the Administration notes that while such legislation would reduce outlays in the short-run, benefits the individial would receive over a lifetime would not decrease. (In the long-run, this provision could increase system costs.) The counterpoints to these arguments are:

** Is it appropriate for the Federal government to attempt to control the financial decisions and judge the expenditure patterns of a beneficiary, especially in an "earned entitlement" program; and

** The second element of the Administration argument assumes that the individual will at least achieve the life expectancy on which social security life expectency tables are based.

The Administration also will introduce legislation to annualize the social security retirement test, at a FY 1976 outlay reduction of $205 million. At the present time, an individual may earn a substantial amount of money in one month (or a few months) and receive unreduced OASDI benefits for the remainder of the year. The measure the Administration will propose would make all retirees subject to the same annual measure of income (currently $2520, and adjusted annually for inflation).

Medicare. The Administration plans to introduce two major legislative items affecting the Medicare program:

** A requirement for increased cost-sharing by Medicare beneficiaries, but with a limit on total cost sharing of $750 per year; and

** A limitation on the rate of the annual increase in "reasonable costs" of Medicare providers.

In addition, planned administrative actions will cover these areas: utilization review; limitations on hospital costs recognized by the program as being "reasonable;" the elimination of an allowance for higher than average nursing costs for Medicare patients; a reduction in Medicare bank balance held by intermediaries; and a limitation on reimbursement for drugs to the cost of less expensive generic equivalents where, they are available.

The Administration's primary legislative initiative in the Medicare program is a modification of the hospital insurance programs (Part A) cost-sharing structure by requiring a coinsurance equal to 10 percent of hospital charges above a deductible amount. (The hospital insurance program covers the cost of hospital, skilled nursing facility, and home health services with specified deductibles and coinsurance amounts.) It would also limit increases in the Part B supplemental medical insurance deductible to the rise in OASDI cash benefits. Further, this legislation will encompass the establishment of a maximum cost-sharing liability of $750 per benefit period under Part A and $750 per calendar year under Part B. It is estimated that this legislation would reduce outlays by nearly $1.3 billion in FY 1976. However, it could result in a $113 million increase in Medicaid costs.

Under the present law, a Medicare beneficiary pays an initial deductible amount (currently $92) based on the national average cost of one day's stay in a hospital. Nothing more is paid towards covered expenses until after the beneficiary has been in the hospital for at least 60 days (or a patient in a skilled nursing facility for at least 20 days). After this period, the beneficiary pays a per diem coinsurance related to the deductible amount. For example, the beneficiary would pay $23 per day for the 61st to the 90th hospital day in 1975 and $46 per day from the 91st to the 150th day. There is no maximum liability under the present law.

If we assume that $92 per day is the cost of covered expenses for an individual who has been hospitalized, the present law can be compared to the proposed legislation as follows:

		Day 2-60		Day 61-90		Day 91-150	
	Deductible	Per Day	Total	Per Day	Total	Per Day	Total
Present law	$92	$0	$0	$23.00	$690	$46.00	$2,760
Proposed legislation	$92	$9.20	$572	$ 9.20	$178*	$0	$0

*In this example, the individual would pay the 10% coinsurance for 79 days.

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The example indicates that where an individual is hospitalized for short periods, personal expenditures for services will increase. If an individual had $750 to spend on hospitalization, he would exhaust this amount after 79 days under legislation to be proposed; but not until after 91 days under existing law. (However, after reaching $750 under the proposed legislation, the individual's liability would cease. Liability would continue to accrue under existing law.)

The Administration's rationale for introduction of legislation such as that described above is that it will discourage over-utilization of hospital services and that it will place the burden of payment at the point where the individual can best afford it (i.e., at the front end of the hospital stay). The large reduction in outlays associated with this legislation indicates that hospital stays are generally under 90 days. The question of the need for utilization of hospital services, especially in the 2 to 60 day range, is, therefore, important in analyzing this proposed legislation. The argument made by the Administration on the burden of payment is not necessarily valid, however. If the individual is not spending down resources while hospitalized in the zero cost period (e.g., if the individual owns a home and is not paying rent and is not required to purchase food while hospitalized), he might be in a better position to pay at a later point in hospitalization because of accrued interest, or at least in no worse position.

The proposed legislation as it relates to Part B (supplementary medical insurance covering the costs of physicians' services, outpatient services, and certain other medical costs) would allow the deductible to increase as medical care costs rise, but would attempt to assure that the increases in the deductible would not exceed the beneficiary's ability to pay. The $750 liability limit is designed to replace the present unlimited liability and protect against potentially costly chronic conditions which, while not requiring hospitalization or other such institutionalization, may involve a high volume of medical services.

The second Medicare legislation proposal which the Administration intends to introduce would limit the yearly increases in hospital costs recognized as "reasonable" by the Medicare program. These limits are to be based on rates of cost increase over a base period. Any costs in excess of the limits would not be reimbursed. This proposal is estimated to produce a reduction of outlays in FY 1976 of $100 million.

The administrative actions noted above are expected to reduce Federal outlays for the Medicare program by $236 million in FY 1976.

** The new utilization review regulations require that a hospital conduct a review concurrent with the patient's admission to attempt to indicate and assure that the admission is necessary and to determine the maximum length of stay in the hospital (based on norms for the particular diagnosis). The hospital also is to review the necessity of extended stays and the quality of the professional care provided to patients. Savings are expected to result from more efficient utilization of services.

** The Social Security Administration is required by law to establish the upper limit on the amounts which the Medicare program will recognize as "reasonable" and will reimburse to hospitals. At the present time, the limit is set at about the 90th percentile for groups of comparable hospitals (e.g., what 90 percent of the similar hospitals charged for routine costs). This limit will be reduced. It is intended that no routine costs above what the majority of comparable hospitals charged will be automatically recognized as reasonable.

** At the present time, Medicare reimburses hospitals 8.5 percent more for routine nursing care for aged beneficiaries than for other patients. The Administration believes this differential is no longer justified and would remove it.

** The objective of actions which will be taken to reduce the balances held by banks that service Medicare intermediaries is to increase the amount of funds held by the Medicare trust fund and, therefore, increase the interest earned by these funds.

** Similar to the Medicaid program initiative, the Medicare program will limit reimbursement for drugs to the cost of less expensive generic equivalents if they are available.

Section C:
The Administration Budget for FY 1976 and Food Assistance Programs

There are two basic elements in the Administration's Department of Agriculture food assistance program proposals for FY 1976:

** The Administration plans to seek legislation to limit the cost-of-living adjustments in all Federal food programs to 5 percent over the 18 month period from July 1, 1975 to June 30, 1976; and

** It will propose to replace existing child nutrition programs with block grants to States to provide meals to children in certain families.

Table 7 (p. 35) provides a summary of food assistance program levels from FY 1974 to FY 1976. FY 1976 is shown both under existing law and with adjustments for Administration proposals. It is estimated the 5 percent limitation would produce $217 million in savings to the Food Stamp Program and block grants would add another $168 million in savings.

Legislation limiting the cost-of-living admustments in food assistance programs to 5 percent over the 18 months period beginning in July may severely disadvantage low-income families because it has been estimated that food costs may rise by 20 percent or more over this period. Food stamp households may be especially hard hit by this Administration proposal. The food stamp coupon allotment for a family of four is currently $154 per month. Under the Administration proposal it would increase to $158 per month on July 1, 1975 and would not be permitted to rise at all on January 1, 1976. (January 1, 1976 would be the next date at which food stamp coupon allotments could be automatically adjusted under existing law.) Without the proposed limitation, the Department of Agriculture estimates that the allotment for a family of four would rise to $164 in July and to $172 in January.

(The 5 percent limitation would also hit school food programs--if these were allowed to continue instead of the proposed block grant program. School food reimbursements rose by more than 5 percent on January 1, 1975. Therefore, there would be no possibility for an increase in reimbursements for 18 months--or until July 1, 1976.)

The effect of the reduction in food stamp allotments would be permanent. The percentage increase that would be allowed in July 1976 would cover increases in the Economy Food Plan only for the preceeding six months, and not for the entire 18 month period. There would be no "catch-up" for potential increases not realized between July 1975 and July 1976. This means that food stamp allotments could remain permanently about 10 percent below what they would have been in the absence of such legislation. (A similar result would occur if the school food reimbursements remained in place.)

Under the Administration's block grant proposal, States would be permitted to use block grant funds to provide meals meeting one-third of the U.S. Recommended Daily Allowances (RDA's) of basic nutrients line. Children could receive meals provided under such grants in schools, day care centers, summer recreation programs, or other institutional settings. About $1.7 billion in block grants are proposed for FY 1976. State allocations would be determined on a formula basis. The formula would be $202 (90 cents per meal times 225 days) multiplied by the number of children in the State who are between the ages of one and 17 in families below the poverty line. However, part of the State's allocation could be withheld if it had low-income children in schools where no food program existed. Funds would be released only if the State used them to establish food programs in these schools.

If the block grant program is adopted by Congress, the Department of Agriculture estimates that the prices charged for school lunches would rise by about 22 cents. This could drive several million children who are currently paying for lunches out of the program. In 1973, the Senate Nutrition Committee estimated that a one cent increase in the price of school lunches causes one percent of the paying students (or about 145,000 children) to leave the program. In addition, if the number of children who purchase lunches declines substantially, the per-lunch preparation costs may rise. This could necessitate additional increases in meal prices.

Even if the block grant proposal is not enacted, the Administration will allow the school breakfast, summer feeding, and day care programs to die. That is, legislation governing to programs expires on June 30, 1975 and the Administration will not seek to have them renewed. In addition, while authority for the special supplemental food (program for women, infants, and children--WIC), supplemental feeding, and special milk programs does not expire, the Administration will request no funds for these programs, even if the block grant approach is not adopted. Relative to FY 1975, these initiatives would produce a reduction in outlays of over $437 million. In addition to the $168 million reduction attributable to the proposed institution of block grants, some $604 million in outlay reductions for child nutrition programs are anticipated.

The Administration also proposed to terminate all commodity deliveries to orphanages, children's homes, homes for the aged, and other institutions. These institutions will receive an estimated $22.3 million in commodities during FY 1975.

TABLE 7. Food Assistance Programs --
FY 74 to FY 76
(in millions)

Program	FY 1974 Actual	FY 1975 Estimate	FY 1976 Under Existing Law	FY 1976 Under Proposed Law
Child Nutrition Programs:				
Cash grants to the States				
School Lunch (Section 4)	$ 412	$ 444	$ 498	
Free and Reduced Price Lunches	683	751	865	
School Breakfast	61	73	---	
Nonfood Assistance	29	28	28	
State Administrative Expenses	4	7	7	
Nonschool Food Program	70	117 1/	---	
Grants in lieu of Commodities	---	---	73	$ 1,683 4/
Commodities to States	348	361	365	
Nutrition Training Survey and Operating Expenses	8	11	14	
Special Milk Program	62	120	---	
Special Supplemental Food Program	15	127	---	
Subtotal	$1,692	$2,039	$1,850	$ 1,683 4/
Food Stamp Program	$2,865	$3,703	$3,859	$ 3,642 5/
Direct Distribution to Families	$ 194	$ 43 2/	$ 3 3/	$ 3 3/
Food Donations Program	$ ---	$ ---	$ 6 3/	$ 6 3/
Direct Distribution to Institutions	$ 20	$ 22	$ ---	---
Elderly Feeding	$ ---	$ 6	$ 6	$ 6
Section 32 Operating Expenses (AMS and FNS)	$ 7	$ 7	$ 7	$ 4
Nutrition Education (Extension Service, including administration)	$ 47	$ 47	$ 47	$ 47
TOTAL, Food Assistance	$4,825	$5,867	$5,778	$ 5,391

1/ Includes $64 million for day care feeding and $53 million for summer feeding.

2/ Includes $6.4 million for supplemental feeding.

3/ Both the $2.8 million under "Direct Distribution to Families" and the $5.8 million under "Food Donations Program" are for commodity distribution to needy families on Indian Reservations.

4/ USDA is proposing to substitute a comprehensive block grant program for the present child nutrition programs, special milk, special supplemental food (WIC), and commodity supplemental food programs. A total of $ 1,682.5 million is being requested for the block grant program in FY 1976.

5/ USDA is proposing to limit cost-of-food adjustments in all food programs to 5 percent over the 18 month period from January 1, 1975 to June 30, 1976. This proposal would reduce food stamp expenditures by $217.3 million to a total of $ 3,641.6 million.

Source: Community Nutrition Institute Weekly Report, February 6, 1975, p. 2.

NATIONAL ASSOCIATION OF STATE UNIVERSITIES AND LAND-GRANT COLLEGES

Office of the Executive Director
Suite 710, One Dupont Circle
Washington, D.C. 20036

Circular Letter No. 3

Febuary 27, 1975

TO: *Heads of State Universities and Land-Grant Institutions*

FROM: *Ralph K. Huitt, Executive Director*
Christian K. Arnold, Associate Director and Editor

SUBJECTS:

1. *ADMINISTRATION PROPOSES TO RESCIND ONE-HALF BILLION IN HIGHER EDUCATION FUNDS.*
2. *BANKHEAD-JONES FUNDS TO BE RELEASED MARCH 18?*
3. *NASULGC INSTITUTIONS AND THE NIH GENERAL SUPPORT GRANT PROGRAM.*
4. *BUDGET ASKS $2 BILLION FOR HIGHER EDUCATION, SEEKS REPEAL OF LAND-GRANT PROGRAMS.*
5. *NSF BUDGET REQUEST BARELY KEEPS PACE WITH INFLATION.*
6. *NIH OTHER HEALTH AREAS TAKE A BEATING IN THE BUDGET REQUEST.*
7. *RESEARCH KEEPS PACE WITH, EXTENSION FALLS BEHIND INFLATION IN AGRICULTURE BUDGET.*

1. ADMINISTRATION PROPOSES TO RESCIND ONE-HALF BILLION IN HIGHER EDUCATION FUNDS

Almost simultaneously with the 1976 budget request, the Ford administration sent to Congress a rescission/deferral message requesting the repeal of $531.3 million in appropriated 1975 funds for programs of major concern to higher education. The total includes $450.3 million of project research, training, and other programs in the health professional area, largely involving the National Institutes of Health programs, and $81 million for higher-education programs administered for the most part by the U.S. Office of Education. These proposed rescissions, along with others, inform the "revised" 1975 budget with which the 1976 budget requests are compared.

In seeking the rescissions, the administration falls back essentially on language in the conference report on the Labor-HEW appropriations bill, even though executive officials have in recent years tended to maintain that Congressional intent as expressed in committee reports have no standing in law, as in, for instance, the writing of the rules and regulations for the anti-sex discrimination provisions

of the Educational Amendments of 1972. Mr. Ford, in his introduction to the rescission message, pointed out that in that conference report the Congress "... indicated its willingness '... to give full consideration to such rescissions and deferrals...' as might be required to keep 1975 spending within the total estimate for the bill.... I ask the 94th Congress to give full consideration to the question of whether increased Federal spending -- with its associated inflationary effects and implied longer-term commitments -- is warranted for these programs at this time."

There are some several things wrong with this rationale, some trivial, some important. For one thing, almost none of the programs involved in the rescission requests were scheduled for "increased" Federal spending: they were appropriated at or below the 1974 level. For another, the proposed rescissions would not simply reduce spending to "the total estimate" originally proposed by the administration, but would reduce it below that level. The proposed rescissions, for instance, would reduce the total amount originally requested for higher education for fiscal 1975 by $34 million. In NIH, the proposed rescissions would cut $102 million below the original 1975 budget request.

More important, the language in the conference report on the HEW money bill was clearly not intended to provide the executive branch with the authority for an *ex post facto* line-item veto of appropriations with the effect of attempting to legislate by the appropriations route in order to kill whole programs. The Congress wrote into the continuing legislation that the administration could not eliminate any single program in HEW by the simple expedient of denying funding for it, and the administration would not find a single Congressman willing to sponsor its 1975 request for the repeal of the land-grant Bankhead-Jones instructional funds program. The rescission requests, however, are exercised selectively to achieve legislative results, if the rescissions are approved (that is, the veto sustained, in effect), to which the Congress has already given "full consideration" and has denied.

Even the deferrals that preceded the rescission request may have been illegal under the Budget Control and Impoundment Act. As Senator Thomas Eagleton has pointed out in protesting the impoundment of library funds, the timing of the deferral messages has been such that they constitute announcements of deferments already consummated rather than requests for deferments to be made (see Item 5, *Circular Letter* No. 2). Even though funds should have been allocated for many of the programs under the continuing resolution, President Ford froze the money to, he said, provide the Congress with "flexibility" in determining final appropriations. Even though the Congress has now acted, the January 30 rescission/deferral request does not represent a revision of previous submissions; it simply now requests rescission (repeal) of funds for which no allocations have yet been made during fiscal 1975.

For many of the proposed rescissions, the rescission request lists a "total reduction" and a "net amount proposed for rescission." The difference between the two is an amount of a proposed rescission the administration plans not to return to the Treasury but to place in reserve to meet Federal pay costs, sometimes not even in the same department for which the rescission is requested. Senator Eagleton commented "I do not believe that it was the intent of the Congressional Budget and Impoundment Control Act to allow the President to shuffle funds appropriated by Congress for a particular program into an entirely different category."

The rescission request may not do violence to the letter of the Budget and Impoundment Act; it clearly does violence to the spirt of that Act.

For USOE and other education programs, the proposed rescissions would eliminate all funding for the Bankhead-Jones land-grant program ($9.5 million, Title I community services program ($13.4 million), the Veterans cost-of-education program ($23.8 million), public service fellowships ($4 million), mining fellowships ($1.5 million), EPDA college fellowships ($2.1 million), library resources ($10 million), undergraduate instructional equipment ($7.5 million), library training and demonstrations program ($3 million), and the state postsecondary commissions ($2.2 million). For the language and area studies program, $4 million would be rescinded.

For some programs, specific reasons are given for the proposed rescission. College fellowships under part E of EPDA are no longer needed because "of a general surplus of persons available to teach at the postsecondary level and because funding of general student support ... will enable students to finance their own education." Title I "fails to direct aid to areas of greatest need" and the program "is regarded primarily as a State and local concern." Bankhead-Jones "represents a very small percentage of the operating costs of recipient schools." Planning of State postsecondary education "is regarded as a State responsibility." "The high point of need for the funds has already past" in the veterans cost-of-education program. As for fellowships, "career selection is better left to the individual...."

Rescission cuts are requested for all the institutes within NIH, ranging from $125.2 million for the National Cancer Institute to $6.7 million for the National Eye Institute. The message states that "for new and competing research programs, funding is being restricted to the highest priority projects. For continuation costs of ongoing projects, a reduction of approximately five percent is being made." There is one important exception to this: the proposed rescission of $46.9 million for NIH Research Resources would completely eliminate the General Research and Biomedical Science Support programs (see Circular Letter No. 1). According to the request, "The original intent of the ... program ... has been largely accomplished" and, further, "the institutions which are best able to compete for regular NIH project support -- usually the wealthiest institutions -- are also the ones which receive the largest formula awards through the program." (See Circular Letter No. 2 for changes being proposed for the programs.)

In the health professional area, the following rescissions are proposed: Maternal and child health research and training -- $4.7 million, cancer -- $125.2 million, heart -- $38.9 million, dental -- $7.9 million, arthritis -- $29.3 million, neurological -- $31 million, allergy -- $14.7 million, general medical science -- $31 million, child health -- $24.7 million, eye -- $6.7 million, environment -- $7.1 million, research resources -- $46.9 million, Fogarty -- $1.1 million, mental health -- $28.3 million, and health manpower -- $28.3 million.

The sustaining of a rescission requires positive Congressional action, as opposed to a deferral, which is in effect unless Congress opposes. If Congress takes no action by the end of the 45-day deadline (March 18), the administration will have to spend the funds proposed for rescission.

Hearings for government witnesses have already been held in the House Subcommittee for HEW appropriations, but have not yet been scheduled for the Senate Subcommittee. Positive rejection by the Congress could speed the allocation of the funds. The members of the jurisdictional subcommittees are listed below.

SENATE LABOR/HEW APPROPRIATIONS SUBCOMMITTEE

Chmn. Warren Magnuson (D-Wash.)
John Stennis (D-Miss.)
Robert Byrd (D-W.Va.)
William Proxmire (D-Wis.)
Joseph Montoya (D-N.M.)
Ernest Hollings (D-S.C.)
Thomas Eagleton (D-Mo)
Birch Bayh (D-Ind.)
Lawton Chiles (D-Fla.)

Edward Brooke (R-Mass.)
Clifford Case (R-N.J.)
Hiram Fong (R-Hawaii)
Ted Stevens (R-Alaska)
Richard Schweiker (R-Pa.)

HOUSE LABOR/HEW APPROPRIATIONS SUBCOMMITTEE

Chmn. Daniel Flood (D-Pa.)
William Natcher (D-Ky.)
Neal Smith (D-Iowa)
Bob Casey (D-Tex.)
Edward Patten (D-N.J.)
David Obey (D-Wis.)
Edward Roybal (D-Cal.)
Louis Stokes (D-Ohio)

Robert Michel (R-Ill.)
Garner Shriver (R-Kan.)
Silvio Conte (R-Mass.)

2. BANKHEAD-JONES FUNDS TO BE RELEASED MARCH 18?

Under the continuing resolution, Bankhead-Jones land-grant instructional funds should have been allocated (at the fiscal 1974 appropriated level) at the beginning of fiscal 1975 under the continuing resolution, which specifically prohibited the elimination of any program through zero funding. The President, however, deferred allocation to provide the Congress, his message said, the needed "flexibility" in arriving at a final "determination." That "final determination" was signed into law by President Ford on Dec. 7, 1974, but the administration continued to freeze funds for programs for which it had recommended no funding.

In this situation, NASULGC Executive Director Ralph K. Huitt wrote Secretary of Health, Education, and Welfare Caspar W. Weinberger concerning the release of these funds on Jan. 27. He received a response from U.S. Commissioner of Education T.H. Bell dated Feb. 4 stating that the funds will be allocated "promptly" if Congress does not approve the pending rescission request (see another article in this Circular Letter). Deadline for Congressional approval is March 18; that is, if Congress has not approved the rescission request by that time, the machinery for allocation presumably will be set in motion immediately.

Dr. Huitt's and Mr. Bell's letters are reproduced below.

The Honorable Caspar W. Weinberger
Secretary
Department of Health, Education, and Welfare
Room 5246 HEW Building, North
330 Independence Avenue, S.W.
Washington, D.C. 20201

Dear Secretary Weinberger:

I am writing on behalf of the 73 land-grant colleges who are members of this

Assocaition to inquire about the Department of Health, Education, and Welfare's schedule for releasing FY 1975 appropriations for the Bankhead-Jones land-grant colleges program. As you know, although the law mandates that these funds be distributed shortly after the beginning of the new fiscal year, this year President Ford requested Congress to consider deferring allocation of these appropriations, pending actual enactment of appropriations legislation. Such action has not taken place, with the Congress appropriating $9.5 million for the current fiscal year for this program. The President has signed that legislation.

Bankhead-Jones funds, in keeping with the intent of the legislation as "further endowment," are regularly budgeted for expenditure over the entire fiscal year for the instructional purposes of the land-grant institutions. Consequently, the Association has received many inquiries about HEW's schedule for the allocation of the funds. I would appreciate information about that schedule.

Sincerely yours,

Ralph K. Huitt
Executive Director

Dr. Ralph K. Huitt
Executive Director
National Association of State Universities
and Land-Grant Colleges
One Dupont Circle
Washington, D.C. 20036

Dear Ralph:

Secretary Weinberger has asked me to thank you for your letter of January 27, pertaining to the schedule for releasing Fiscal Year 1975 funds under Section 22 of the Bankhead-Jones Act of 1935.

The President has requested the Congress to rescind this $9.5 million appropriation. The anticipated recision of the Bankhead-Jones funds, therefore, will delay or block the release of the funds, depending upon a decision by Congress within the time limitation required by the Congressional Budget and Impoundment Control Act.

If Congress does not approve the recision of these funds, they will be promptly released and distributed.

Sincerely,

T.H. Bell
U.S. Commissioner of Education

3. NASULGC INSTITUTIONS AND THE NIH GENERAL SUPPORT GRANT PROGRAM

Between 1962, when the program was started, and 1974, inclusive, 404 health professional schools, hospitals, health departments, and research organizations shared $524 millions in the flexible institutional grants provided through the General Research Support program of the National Institutes of Health. Between 1966, when it was started, and 1974, 132 colleges and universities shared a total of $60 million in the companion NIH Biomedical Sciences Support program.

For several years now, the administration has recommended zero funding for these programs in its budget message, stating that higher priority should be given to "targeted" agency-directed project support, especially in times of fiscal constraint. Most institutions protest that these flexible and predictable (up to now) funds are the most valuable, dollar-for-dollar, they receive from the Institutes. Congress has consistently denied the administration's request for eliminating the programs, but this year the administration seems unwilling to accept the Congressional action. Even though the President signed the HEW appropriations bill that provided $43 million for the two programs for fiscal 1975, it is confidently expected that the President, in his next deferral-rescission message due to go to the Congress early in February, will again ask for the impoundment of the entire amount. No funds have yet been allocated through the program, even though the appropriations bill was signed Dec. 7 (see Circular Letter No. 1).

(It is also known that the President will ask for the rescission of the $9.5 million appropriated for the land-grant Bankhead-Jones instructional funds for fiscal 1975 and will again ask for the repeal of both the second Morrill Act and the Bankhead-Jones program in the fiscal 1976 budget request.)

The rescission request goes to the Appropriations Committee in both the House and the Senate, although the new budget control committee in the Senate is asking to have joint jurisdiction in that body. What with the organizational traumas the new Congress must endure, committee membership and structure are still in disarray, and quick action on anything is hardly likely. However, a rescission action can become effective only on positive approval action by both houses within 45 days of the receipt of the request.

Between 1962 and 1974, member institutions of the National Association of State Universities and Land-Grant Colleges received a total of $230 million, or almost 40 per cent of the total $584 million granted for the NIH General Research Support and the Biomedical Sciences Support programs. For the General Research Support program alone, 127 health professional schools connected with NASULGC institutions received a total of $194.7 million during the 12 years; that is, NASULGC institutions comprised not quite 33 per cent of the participating institutions but received 38 per cent of the funds allocated. For the Biomedical Sciences Support program, 72 NASULGC institutions (56 per cent of the participating colleges and universities) received a total of $35 million (almost 61 per cent of the total allocated in the nine years of the program).

The following table shows the total participation of NASULGC institutions during the history of the two programs. For the General Research Support program, the figure includes the total of several programs (school of medicine, school of dentistry, school of veterinary medicine, etc.) for some institutions.

Institution	Program	Amount
U. of Alabama		
	General	4,802,815
U. of Alaska		
	Biomedical	378,591
U. of Arizona		
	General	827,131
	Biomedical	416,896
	Total	1,244,027
Arizona State U.		
	Biomedical	252,431
U. of Arkansas		
	General	2,054,123
	Biomedical	71,594
	Total	2,125,717
Auburn U.		
	Biomedical	64,933

Institution	Amount
U. of California, Berkeley	
General	2,014,091
Biomedical	1,809,405
Total	3,823,496
U. of California, Davis	
General	3,872,696
Biomedical	765,906
Total	4,548,602
U. of California, Irvine	
General	903,453
Biomedical	517,079
Total	1,420,532
U. of California, Los Angeles	
General	7,211,454
Biomedical	901,899
Total	8,113,353
U. of California, San Diego	
General	1,709,875
Biomedical	873,904
Total	2,583,779
U. of California, Riverside	
Biomedical	528,845
U. of California, Santa Barbara	
Biomedical	481,546
U. of California, San Francisco	
General	6,845,633
City U. of New York	
General	2,545,031
Biomedical	859,790
Total	3,404,821
Colorado State U.	
General	1,516,774
Biomedical	249,364
Total	1,766,130
U. of Colorado	
General	4,057,353
Biomedical	598,076
Total	4,655,429
U. of Connecticut	
General	1,181,302
Biomedical	597,209
Total	1,778,511
Cornell U.	
General	6,582,174
Biomedical	963,454
Total	7,545,628
Florida State U.	
Biomedical	538,306
U. of Florida	
General	3,117,928
Biomedical	630,496
Total	3,748,424
Georgia Inst. of Technology	
Biomedical	341,200
U. of Georgia	
General	490,051
Biomedical	483,345
Total	973,396
U. of Hawaii	
General	1,499,635
Biomedical	492,950
Total	1,992,585
U. of Houston	
Biomedical	60,230
U. of Illinois	
General	5,747,559
Biomedical	1,086,757
Total	6,834,316
Indiana U.	
General	5,049,502
Biomedical	755,927
Total	5,805,429
Iowa State U.	
General	788,664
Biomedical	552,340
Total	1,341,004
U. of Iowa	
General	4,546,377
Biomedical	439,775
Total	4,906,152
Kansas State U.	
General	84,099
Biomedical	377,506
Total	461,605

Institution	Category	Amount
U. of Kansas	General	3,181,959
	Biomedical	722,904
	Total	3,904,863
U. of Kentucky	General	2,666,195
	Biomedical	216,865
	Total	2,883,060
Louisiana State U.	General	2,235,170
	Biomedical	92,489
	Total	2,327,667
U. of Maryland	General	3,614,035
	Biomedical	453,874
	Total	4,067,909
Massachusetts Inst. of Technology	Biomedical	1,521,525
U. of Massachusetts	General	117,986
	Biomedical	552,441
	Total	670,427
Michigan State U.	General	1,617,693
	Biomedical	631,039
	Total	2,248,732
U. of Michigan	General	9,393,029
	Biomedical	874,331
	Total	10,266,360
U. of Minnesota	General	7,383,540
	Biomedical	861,018
	Total	8,244,550
U. of Mississippi	General	2,758,344
U. of Missouri	General	3,346,853
	Biomedical	358,280
	Total	3,705,133
Montana State U.	Biomedical	34,380
U. of Montana	Biomedical	59,633
U. of Nebraska	General	2,112,755
	Biomedical	314,696
	Total	2,427,451
U. of Nevada	Biomedical	37,464
U. of New Hampshire	Biomedical	124,352
U. of New Mexico	General	1,100,125
State U. of New York Medical Centers	General	6,288,423
State U. of New York, Albany	Biomedical	328,975
State U. of New York, Buffalo	General	5,530,872
	Biomedical	524,501
	Total	6,055,373
State U. of New York, Stony Brook	General	73,842
	Biomedical	432,376
	Total	506,218
North Carolina State U.	Biomedical	614,191
U. of North Carolina	General	5,520,215
	Biomedical	511,050
	Total	6,031,265
U. of North Dakota	General	566,666
Ohio State U.	General	5,581,940
	Biomedical	595,727
	Total	6,177,667
Oklahoma State U.	General	526,427
	Biomedical	342,285
	Total	868,712

Institution	Amount
U. of Oklahoma	
General	2,407,597
Biomedical	30,493
Total	2,438,090
Oregon State U.	
Biomedical	644,005
U. of Oregon	
General	3,953,343
Biomedical	622,786
Total	4,576,129
Pennsylvania State U.	
General	978,817
Biomedical	603,632
Total	1,582,449
U. of Pittsburgh	
General	7,245,839
Biomedical	592,183
Total	7,838,022
Temple U.	
General	3,881,382
Biomedical	287,226
Total	4,168,608
U. of Puerto Rico	
General	2,463,932
Purdue U.	
General	844,896
Biomedical	795,941
Total	1,640,837
Rutgers U.	
General	974,224
Biomedical	1,203,591
Total	2,177,815
U. of South Dakota	
General	534,781
Southern Illinois U.	
Biomedical	168,302
U. of Tennessee	
General	3,793,005
Biomedical	244,646
Total	4,037,651
Texas A&M U.	
General	166,953
Biomedical	347,213
Total	514,166
U. of Texas	
General	12,289,605
Biomedical	254,836
Total	12,544,441
U. of Texas, Austin	
Biomedical	803,340
Utah State U.	
Biomedical	266,534
U. of Utah	
General	3,265,403
Biomedical	575,109
Total	3,840,512
U. of Vermont	
General	2,108,154
Biomedical	168,693
Total	2,276,847
Virginia Polytechnic Inst.	
Biomedical	324,731
U. of Virginia	
General	2,457,815
Biomedical	499,307
Total	2,957,122
Washington State U.	
General	740,235
Biomedical	461,622
Total	1,201,857
U. of Washington	
General	5,800,419
Biomedical	741,539
Total	6,541,950
Wayne State U.	
General	3,225,769
Biomedical	473,542
Total	3,699,311
West Virginia U.	
General	1,814,591
U. of Wisconsin	
General	4,768,650
Biomedical	1,275,645
Total	6,044,295

4. BUDGET ASKS $2 BILLION FOR HIGHER EDUCATION, SEEKS REPEAL OF LAND-GRANT PROGRAMS

The President's 1976 budget requests a total of $2.006 billion for higher education. This is $125.8 million less than the 1975 appropriation enacted by the Congress and signed by the President, but only $70 million below the '75 figure as "revised" by the President through deferrals and proposed rescissions. Briefing materials state that the "budgets for most (higher) education programs remain at or near the proposed 1975 level -- while a number show increases." The word "proposed" seems particularly operative: the budget would eliminate completely a total of 11 authorized higher-education programs, many of which (including the Bankhead-Jones Land-grant instructional funds program) will have already been eliminated before fiscal 1976 if Congress agrees with some $58.3 million in rescissions of 1975 appropriations the President has asked for (see another article in this Circular Letter).

Student Aid

According to briefing materials, the administration "... continues to place priority on programs which help equalize postsecondary educational opportunities. This is done principally through student assistance programs which provide students the opportunity to choose the type of education which is best suited to their needs." As presented, the Office of Education budget is particularly confusing, but it is clear that it reflects the priority for student aid. According to the "Program and Financing" listing in the Budget Appendix, the administration is asking for $1.6 billion for student undergraduate aid in fiscal 1976. This is 80.5 per cent of the total $2 billion higher-education budget. It is also $251.8 million (or 13.5 per cent) less than the comparable sum for 1975. According to briefing papers and other text material, student aid is set for $2 billion for '76, 91 per cent of the $2,213 million for higher-education in USOE. The difference in the two figures is explained as an accounting device to adjust Federal fiscal year with the academic year in actual obligation of funds, and OMB officials insist that the larger figure is the accurate "working" amount.

Basic and Supplemental Education Opportunity grants. The administration to flout the law requiring basic funding for the Supplemental Educational Opportunity and the Direct Student Loan programs before the Basic Educational Opportunity grants program can be legally funded. The President's 1976 budget asks no funds for either of these programs, stating only that "the principal forms of student assistance are basic educational opportunity grants and guaranteed student loans."

For BOG's for fiscal '76, the budget requests $1,050 million, which the budget points out, is $390 million more than the 1965 appropriation. It is, however, only $150 million more than the combined $900 million for BEOG's and SEOG's this year. According to budget information, this amount will fully fund 1,323,600 full- and part-time students in all four undergraduate years with an average entitlement of $785. The budget information also states that "eligible students can attend some 5,500 postsecondary education institutions" under the program in 1976. This means an average of $190,910 in BEOG money for each institution, or an average of 243 students aided at the average grant of $785. There is no mention of students who would have been aided under the SEOG program, nor is there any mention of funding for the statutorily authorized institutional cost-of-instruction allowance.

Loan programs. As indicated above, the administration requests no funds for capital contributions to the direct loan program, even though, by law, no funds can be appropriated to the BEOG program unless the direct loan program capital contribution is funded at $238 million. The budget states, however, that student loans amounting to $164 million will be made in fiscal 1976 out of repayments into institutional revolving funds.

The administration places all its student loan eggs into the subsidized insured student loan basket. For this program, the budget requests a total of $654 million -- $267 million for interest subsidies, $182 million for the special allowance to lenders, $202 million for default payments, and $3 million for death and disability payments. The program was originally appropriated $315 million for fiscal 1975, but default payments and other cost increases have raised the 1975 program total to $580 million, and a $150 million supplemental appropriation for the program is pending.

According to the budget, the proposed budget for the guaranteed student loan program is expected to make possible loans totalling $1.65 billion available to 1.1 million students in fiscal 1976. Direct loans are expected to be made to 728,000 students during the same year.

Budget materials indicate considerable difficulties with the guaranteed student loan program, especially in connection with claims for defaulted loans, which are now expected to total over $200 million in 1976, with a 14 per cent default rate. New rules for the program, expected to be issued in February, aimed at reducing the default rate will "provide for procedures for limiting, suspending or terminating the eligibility of an educational institution or a lender for failing to comply with the rules and regulations, of the program, including failure to provide information about the program to prospective students and failure to keep adequate records and reports." In addition, "high dropout rates and high default rates which involve program abuses could cause the school or lender to be excluded from participating in the program." USOE states that "to further improve the management of the Guaranteed Student Loan Program and to increase collections on defaulted loans, the budget include a request for 117 additional positions": 62 for program compliance activities to ensure that schools and lenders comply with the new rules and regulations, 40 for collection of defaulted loans, and 15 to "strengthen overall management of the program." A total of 64,470 defaulted loans are expected to be converted to repayment status in 1976, with total collections amounting to $17 million.

Special Programs for the Disadvantaged.; The budget sets funding for Upward Bound, Talent Search, and other programs for the disadvantaged at $70.3 million, the same as for 1975.

Institutional Support

The budget request practically eliminates institutional support (if rescissions and deferrals have not already done it by the time the budget is finally enacted by Congress). The request would reduce support in this category from $255 million in 1974 to $134 million in 1976, with all but $24 million concentrated in the Developing Institutions program.

Second Morrill and Bankhead-Jones Acts. No funds are requested in fiscal 1976 for either the annually appropriated Bankhead-Jones land-grant instructional funds program or the permanently appropriated Second Morrill Act endowment funds (and the President has asked for rescission of the funds already appropriated for 1975 for the Bankhead-Jones Act). The budget lists the programs as among the "outmoded, inefficient or marginal" programs and states that legislation will be submitted to repeal them. Budget materials repeat the language of the last two years: "This program ... represents a very small portion of the recipient colleges' and universities' operating budgets. The program provides support to some of the strongest and most prestigious institutions of higher learning in the country which no longer need this special subsidy," a judgment unique to the Office of Management and Budget.

Aid to Developing Institutions. The budget requests $110 million, the same as for 1975. Within the program, $52 million would be earmarked for 165 grants averaging $315,000 each in the basic program. The amount is the same as for 1975, but the number of grants will decline from 190 in '75 to 165 in '76 since, as stated in the budget materials, "more institutions qualify for the Advanced Program and a greater effort is made to speed development through larger average grants." The $58 million earmarked for the Advanced program will provide 21 institutions with grants averaging $2.8 million "to accelerate the development schedule of a selected number of institutions which enroll significant percentages of blacks, Spanish Americans, native Americans, and other minorities." Twelve grants will be awarded through the program this year.

University Community Services. Another of the "outmoded, inefficient or marginal" programs in OMB classification for which the budget requests no funds in 1976 (and rescission of already appropriated funds in 1975). The program had been funded at $14.3 million in 1974 and 1975. According to budget materials, "projects supported under this program have been generally small. The program content has been diverse, and the national impact has been minimal. The campus and community cooperation which was supposed to be fostered by this program could be effectively achieved at State and local levels without this incremental support." Project funding has been small, reflecting the chronic funding malnutrition under which the program has suffered from the beginning.

State Postsecondary Education Commissions. After having encouraged the states to establish state postsecondary planning commissions adhering to Federal rules and guidelines, the administration proposes to eliminate Federal funding for them in 1976 (and to rescind the remaining $2 million of the $3 million appropriated for the program in fiscal 1975). "Planning of State postsecondary education," the budget now states, "should be carried out at State initiative," but with boards designed to Federal prescription.

Language and Area Studies. The budget requests $10 million for 1976, the same as for 1975. The amount includes $1.36 million for Fulbright-Hays fellowships.

Veterans Cost of Instruction. Althbugh only recently authorized, this program is listed among the "outmoded, inefficient or marginal" programs scheduled by OMB for extinction. Zero funding is requested for fiscal 1976, and the $24 million appropriated for 1975 is scheduled for rescission, if the Congress agrees. "The high point of the program has passed," budget materials state, "and existing programs should now be absorbed into ongoing institutional budgets."

Cooperative Education. The budget requests $8 million for the program in fiscal 1976, $2.75 million less than the $10.75 million appropriated for 1975. According to budget materials, this reduced funding will provide 130 continuation grants and 100 new grants averaging $35,000 each.

Loans and Grants for Facilities Construction. Budget information states that "the major reductions in this area (institutional support) are in construction: $31 million for interest subsidies, for which ample budget authority has been made available to support the program until 1978; and $43 million for facilities grants, for which the need has greatly diminished." No new starts will be made in either program, and no funds were appropriated for either program for fiscal 1975.

Personnel Development

The budget includes a total of $2.3 million for "personnel development," a category for which $10.8 million was appropriated for fiscal 1975, $5.5 million of which the President has asked to be rescinded.

College Teacher Fellowships. This last vestige of the once proud graduate fellowship program is scheduled in the budget for $1 million in fiscal 1976, down from the $4 million appropriated in fiscal 1975, to "continue" the program's phase out. The sum requested will provide support for some 150 returning veterans whose fellowships were interrupted by military service.

Fellowships for the Disadvantaged. The budget requests $750,000, just half the amount of the 1975 appropriation. The amount, according to the budget, will support 544 minority students entering law school under the auspices of the Council on Legal Education Opportunity.

Ellender Fellowships. The budget again requests $500,000 to support 1500 fellowships for economically disadvantaged secondary school students and their teachers to "enable them to increase their understanding of the Federal government...."

Mining and Public Service Fellowships. Last year Congress appropriated a total of $5.5 million for these newly authorized programs, which together would have provided over 500 graduate fellowships. The administration has proposed to rescind these funds, under the assumption that "Federal funds should be concentrated on general aid to students, that career selection is better left to the individual, and that institutions can and have established programs in response to student needs without the stimulus of a Federal program." Budget materials hint that the Harry S. Truman Scholarship Fund makes the public scholarships unnecessary. Fifty-three scholarships are to be awarded annually under that program.

Ethnic Heritage Studies Program. Although $2.4 million was appropriated for this newly authorized program in 1974, but no funds were requested or appropriated in 1975. None has been requested for 1976.

Library Resources

The President's 1976 budget request asks nothing for college library resources, library training and demonstration, and library undergraduate instructional equipment. A total of $20.5 million was appropriated for these programs for fiscal 1976 -- $9.975 million for college library resources, $7.5 million for training and demonstrations, and $3 million for instructional equipment -- but the administration has proposed to "revise" this sum out of existence through rescission. The administration says that the zero-funding request for these programs "... is consistent with the general policy of moving away from categorical programs and institutional support and toward general student aid. In addition, grants of up to $5,000 for the college library resources program are allocated among all institutions of higher education, regardless of size or need. and represent a marginal form of assistance." This seems to be a way of saying "they don't need it because it's not enough to do the job that needs to be done."

National Institute of Education

For NIE, the budget requests a total of $80 million for 1976, $60 million less than the original budget request for 1975 but $10 million more than the Congress finally allowed. Budget materials seem to agree with the Congressional assessment of this beleaguered agency: "The results of educational research," these materials state, "have been far less helpful than they might be."

To attempt to correct this, the budget request earmarks $18 million of the $80 million requested for information dissemination activities. A total of $14 million will be used for research and development involving basic skills. Another $18 million will be used for research and development involving school financing, productivity, and management. For research and development involving "equity," the budget requests $5 million. Most of this will support "research on student learning characteristics and effective instruction and ... development of curriculum materials based on research, in order to improve bilingual programs in elementary and secondary schools." Ten million dollars are earmarked for "education and work" research and development.

Fund for the Improvement of Postsecondary Education

The budget proposes an increase of $6 million -- from $12 million this year to $18 million in 1976 -- for the Fund for the Improvement of Postsecondary Education. The budget states that the program will concentrate on the support for projects in the "area of education and work, including attention to the field of public service.' The Fund, the budget says, will also sponsor "national projects dealing with the issues of accreditation and licensing which have an important impact on the educational programs of colleges and universities."

Program Administration

Although a central characteristic of the proposed budget (and the "revision" of the 1975 budget) is that of the elimination of many programs, the 1976 budget request asks for $101 million, an increase of $8 million over 1975 and of $24 million over 1974, for program administration in the Office of Education. The $101 million will, according to the budget, support 162 new positions. "These new positions," budget materials say, "are for meeting increased workload requirements in areas such as the Guaranteed Student Loan Program and the new Special Projects Act...."

5. NSF BUDGET REQUEST BARELY KEEPS PACE WITH INFLATION

The administration has requested a total of $775.4 million for fiscal 1976 for the National Science Foundation, an increase of $78.3 million above the 1975 program level of $697.1 million. This is an increase of slightly more than 11 per cent, barely enough to keep pace with the ongoing doublt-digit inflation. Of the total, $755.4 million is requested in new funds (appropriation), with the remaining $20 million to come from the release of funds for which the administration has sought deferral from the 1975 program.

(The original 1975 NSF appropriation of $768.2 million -- see Circular Letter No. 1 -- was reduced by the transfer of $51.7 million to the new Energy Research and Development Administration and by the administration's request to defer $20 million of fiscal '75 program funds.)

Briefing materials protest more than anytime in recent years that the Foundation's basic function is the support of basic research. Even so, both the budget and the briefing materials stress that there will be "particular emphasis on basic investigations in those areas most likely to contribute to the solution of major domestic problems...," and on "problems of national concern...." There seems to be evidence in the budget request that the Foundation wants, at one and the same time, to recognize the reminders of the National Science Board and the academic community that the Foundation has only limited statutory authorization for the support of

applied research and to serve the administration's desire for immediate solutions to immediate problems through "targeted" research.

Details of the 1976 budget as submitted by the President are shown in the following table.

BUDGET PROGRAM COMPARISONS FY 1974-1976
(Millions of Dollars)

	Actual FY 1974	Current Estimate FY 1975	Budget Request FY 1976
Scientific Research Project Support	$289.8	$340.6	$380.0
National & Special Research Programs	85.6	86.5	116.0
National Research Centers	43.2	50.4	62.2
International Cooperative Scientific Activities	6.3	8.0	8.0
Research Applied to National Needs	75.1	82.7	79.5
Intergovernmental Science & Research Utilization	11.5	2.0	3.0
Institutional Improvement for Science	10.0	-0-	5.5
Graduate Student Support	13.0	13.2	14.8
Science Education Improvement	67.7	61.2	54.0
Planning & Policy Studies	2.6	2.9	2.7
Science Advisory Activities	3.5	6.0	4.0
Program Development & Management	31.7	38.7	41.7
Special Foreign Currency Program	5.6	4.9	4.0
Total NSF Programs	$645.6	$697.1	$775.4

For research project support, the budget requests a total of $380 million, up $39.4 million, or almost 12 per cent, from the $340.6 fiscal 1975 effective level.

Within the total, support for environmental (atmospheric, earth, and oceanographic) sciences are budgeted for $45.1 million, an increase of $3.2 million (7 per cent) over the $41.9 million for 1975. In the atmospheric sciences, emphasis will be given to cloud physics, mesoscale weather, forecasting theory, and efforts to advance the understanding of the earth's outermost atmosphere. The earth sciences' program will stress support for the International Geodynamics program to explore and test the plate tectonics theory to better understand earthquakes and volcanoes, the formation of ore deposits, and mountain-building mechanisms. In oceanography, there will be increased studies of the physical and chemical processes in coastal areas and ocean basins.

The biological sciences are scheduled for a total of $88.1 million, an increase of $9.1 million, or 11.5 per cent, from the 1975 level of $79 million. In biochemistry and physiology, the emphasis will be on research in plant science to contribute "significantly" to efforts to find solutions to food and energy problems. Research on cellular biology, scheduled for a whopping 27 per cent increase, is to be concentrated on plant development and cell structure and regulation of gene structure. Support will also be given to cell and tissue culture facilities. Fundamental processes of ecosystems and their response to stress.

The mathematical and physical sciences are budgeted at $118.5 million, an increase of $15 million, or 14.5 per cent, over the $103.5 million 1975 level. There is provision within the budget for the support of research that "will make it possible to achieve increased utilization of national accelerators to exploit new physics research opportunities." In chemistry, there are provisions for "frontier type instrumentation, expanded research in catalysis and other energy-related chemistry areas, and studies of chemical separation, liquids, and the chemical/biological interface.". The focus in astronomy will be on studies of binary stars, mechanisms of solar births and deaths, and the development of millimeter wave instrumentations. Research in mathematics will be intensified in such areas as complex function theory, differential geometry, dynamical systems, functional analysis, and finite groups. There will also be emphasis on control and optimization theory and in the application of mathematics to biological and social phenonema.

The support of research in the social sciences is budgeted for an increase of $2.6 million, from the present level of $26.3 million to $28.9 million. Increased emphasis will be given to the study of economic theory and measurement techniques to analyze energy, resources, productivity, and international economic problems. Expanded support is also planned for research employing mathematical models of social change to provide improved understanding of the social impact of technology and limitations in raw materials and food supplies.

Engineering is scheduled for an 11-per cent cost-of-living increase, from $35.1 million this year to $39.1 million next year. Emphasis will be on providing basic engineering information on the various aspects of production, materials properties, and processing techniques. Industrial processing, food engineering, material resource technology, fluid mechanics, mining processing techniques, wind engineering, bio-engineering, and automation will also be stressed.

Materials research support will be increased from $43.3 million to $47.3 million. It will provide intensified research of the fundamental properties of materials to increase the understanding of the behavior of materials in complex environments of technological importance.

Computor sciences support will go from $11.5 million to $13 million for studies in theoretical computer science, computer system fault tolerance, increased quality of software, and technical aspects of privacy and security.

Budget allocations for project research support are shown in the following table.

BUDGET ALLOCATIONS
BY MAJOR ACTIVITY AND PROGRAM
(Millions of Dollars)

	Actual FY 1974	Current Estimate FY 1975	Budget Request FY 1976
Scientific Research Project Support			
Atmospheric Sciences	$ 12.3	$ 13.8	$ 14.8
Earth Sciences	11.0	13.0	14.6
Oceanography	13.3	15.1	15.7
Biochemistry & Physiology	32.8	37.7	41.8
Cellular Biology	13.1	14.8	16.9
Ecology & Population Biology	21.8	26.5	29.4

	Actual FY 1974	Current Estimate FY 1975	Budget Request FY 1976
Physics	$ 36.7	$ 42.6	$ 49.2
Chemistry	26.6	33.5	39.5
Astronomy	9.3	10.8	11.8
Mathematical Sciences	14.5	16.6	18.0
Social Sciences	24.9	26.3	28.9
Engineering	28.1	35.1	39.1
Materials Research	35.6	43.3	47.3
Computer Research	9.8	11.5	13.0
TOTAL	$289.8	$340.6	$380.0

The next largest dollar increase is for the National and Special Research programs, which are budgeted for an increase from $86.5 million this year to $116.0 million in fiscal 1976, an increase of 34 per cent. The total includes $4 million for a Climate Dynamics program as a separate subactivity focusing on the understanding of global climate processes. Other increases include $3.6 million for the Ocean Sediment Coring program and $1.9 million for preliminary work on the Arctic Offshore program. Well over half the increase -- $18 million -- is for the one-time purchase of aircraft for the Antarctic Research program.

The budget for the National Research Centers is scheduled for an $11.8 million increase, from $50.4 million this year to $62.2 million in 1976.

International Cooperative Scientific Activities is scheduled for $8 million, the same as for this year. Briefing materials say, for the first time, the international effort will "be expanded to include the Middle East and the Far East but without execution of formal agreements." This expanded effort will include "a significant role in the scientific and technical aspects of broad cooperative programs with Saudi Arabia, Egypt, and India." The program will also include "partial support of exchanges of scientists between the U.S. Academy of Sciences and the Science and Technology Association of the People's Republic of China...."

The administration has requested a $3.2 million cut in appropriation -- from $82.7 million (after a $2.5 million deferral) in 1975 to $79.5 million for 1976 for the Research Applied to National Needs program. However, according to briefing materials, the program level will remain at the 1975 figure, with the appropriation augmented with the addition of $8 million in deferred 1975 funds. (The original RANN budget for 1975 of $142.1 million was reduced to the $82.7 figure through transfers to the Energy Research and Development Administration, deferrals, and internal shifts in budget allocations.) The budget states the "thrust" of the RANN program will be on "productivity (industrial and public service) and resources including food and materials." Within the RANN budget, energy research is scheduled for $22 million focused on "innovative systems and component research in energy resources, as well as in energy conversion, storage, and transportation, and energy systems." Environment research is scheduled for $27 million, a 22 per cent increase over the $22.1 million allocated in 1975. Emphasis will be on the "Trace Contaminants Program element to expand research on the growing impact of organic chemicals on the environment and health; on weather modification research to permit more extensive field experimentation in hail suppression; and on continued investigation on inadvertent weather modification in dense urban areas." Research on productivity is budgeted for $20 million, up 34 per cent from the 1975 program

level. Research on "public sector technology," "public policy and economic productivity," and "public policy and human resources" will be increased "in recognition of a serious decline in the rate of U.S. productivity growth along with simultaneous inflation and recession.... Special consideration will be given to systems analysis and the role of new technology to improve service productivity, as well as to the effectiveness of the Nation's regulatory structure and the need for better measurement technology for input and output." Exploratory research and problem assessment will be increased from $8.6 million to $10.5 million.

The budget calls for $3 million in fiscal 1976 for Intergovernmental Science and Research Utilization. In the state government area, emphasis will be placed on the evaluation of model organizations already funded. Some additional demonstrations to increase legislative science capabilities are planned, and local government science and technology demonstrations will be re-oriented and expanded to a regional approach "in order to promote the transfer of results between similarly structured cities." Briefing materials state that "a new thrust will be developed in the area of academic public service to respond to growing expressions in State and local government and academic communities for improved means for using the academic community in decision-making and for communicating government needs to universities and colleges."

The budget request for the Institutional Improvement for Science program is a furious one. Despite a Congressional mandate, signed by the President, that the program be funded in fiscal 1975 at "not more or less" than $5.5 million, the budget request lists no funds appropriated for the program in 1975 but does list a request for $5.5 million for the program in fiscal 1976. Budget briefing materials, however, state that the mandated $5.5 million for 1975 was actually deferred, that no 1976 funding is requested for the program, but that the deferred 1975 funds "are planned" for allocation in 1976. Even though the Foundation did not pay any attention to the Congressional directive to allocate the funds, it did eliminate the Institutional Grants for Research Management program because of Congressional directive, and the entire $5.5 million will be allocated, if it is allocated, through the formula-based Institutional Improvement for Science program, with $3 million earmarked for institutions receiving $1 million or less in Federal research funds.

The budget requests $14.8 million for Graduate Student Support for fiscal 1976, $1.6 million above the $13.2 million for this year. The total provides $11.2 million, up $1.7 million from 1975, for the basic graduate fellowship program (traineeships are not mentioned), and $3.6 million for energy-related traineeships and fellowships ($2.2 million for graduate traineeships and $1.4 for post-doctoral fellowships). The $11.2 million will provide for 500 new graduate fellowships and slightly more than 1,000 continuing fellowships and traineeships.

For the Science Education Improvement program, the budget asks $54 million, down $13.7 million, or over 20 per cent, from the $67.7 million 1974 level. Even though Congress had mandated $65.2 million for the program for this year, the administration has so far impounded $4 million of that sum, bringing the 1975 program level to $61.2 million, $7.2 million more than the budget request. The total includes $26.2 million for Careers in Science (down $1.9 million from 1974), $15.3 million for Science Literacy (down $8.3 million from 1974), $10.5 million for Educational Processes (down $3.4 mfrom 1974), and $2 million for experimental projects. To reflect "overall budgetary priorities," two programs, according to the budget, will be dropped: Faculty Fellowships and Foreign Energy Scholars.

6. NIH OTHER HEALTH AREAS TAKE A BEATING IN THE BUDGET REQUEST

The administration's budget request for the National Institute of Health for fiscal 1976 totals $1,805 million, an increase, by the solidest comparison, of $19 million, or just over 1 per cent, over the 1974 appropriation, which translates into a solid decrease when inflation over the past two years is taken into account.

It is next to impossible to make any meaningful comparisons with the fiscal 1975 figure, simply because the figure is not yet known with any reasonable degree of certainty, even though we are now in the third quarter of the fiscal year. Congress passed and the President signed an HEW fiscal 1975 appropriations bill that provided a total of $2,090 million for NIH, an increase of $304 million over 1974 and of $255 million over the original $1,835 million budget request. The budget, however, compares the 1976 request with a "revised" 1975 budget totaling $1,733 million, $102 million less than the original budget request. This "revised" total, which is presented in the budget as an accomplished fact with no explanation, is brought about by a unilateral Office of Management and Budget decision to rescind $357 million (17.5 per cent) of the 1975 appropriation. That rescission is not yet law, and will not be unless Congress approves it within 45 working days of the Jan. 30 submission. (See another article in this Circular Letter.)

The $1,805 million 1976 request, then, is $29.8 million less than the original 1975 budget request, $285 million (14 per cent) less than the 1975 appropriation, but $71.7 million (4 per cent) more than the "revised" 1975 budget.

(In the last several years, only the National Cancer Institute and the National Institute for Heart and Lung Disease have received any significant increases in funding. Excluding these two institutes, NIH received an appropriation of $970 million in 1973 and will receive $907 million in 1976 if the administration's budget is approved. That is a decrease of $63 million, or a decrease of 6.5 per cent, between 1973 and 1976, without taking inflation into consideration.

National Cancer Institute. The budget requests $605 million, $78 million more than 1974, $5 million more than the original 1975 budget request, $86.7 million less than the 1975 appropriation, and $36.4 million more than the "revised" 1975 budget. The increase over the revised budget for 1975 represents more than 53 per cent of the total increase of $68.5 million for research, leaving only $32 million for increases for all 11 other institutes. Of the total, $492 million is earmarked for research, a $35 million increase over the revised budget, and $21.1 million is for research fellowships and traineeships.

National Heart and Lung Institute. The budget requests $292.8 million, $6.5 million more than in 1974 and $6.4 million more than the revised budget for 1975, but $31.3 million less than the 1975 appropriation and $16.5 million less than the original budget request. Of the total, $251 million ($167 for heart, $40 million for lung, and $44 million for blood diseases and resources research) is scheduled for research. This is barely $1 million more than the 1974 amount.

National Institute of Dental Research. The budget requests $43.5 million, $413,000 less than 1974, $6.3 million less than the 1975 appropriation, and $432,000 less than the original 1975 budget request, but $1.2 million more than the revised budget. This is a cut of almost 13 per cent below the amount actually appropriated for the Institute for 1975.

National Institute of Arthritis, Metabolism, and Digestive Diseases. The request is for $148.4 million, $5 million less than for 1974, $4.5 million less than the original 1975 budget request, and $24.7 million less than the 1975 appropriation, but $3.8 million more than the revised 1975 budget. The impoundment cut proposed for 1975 amounts to 16.5 per cent of the amount appropriated.

National Institute of Neurological Diseases and stroke. The request is for $115 million, $6.3 million less than for 1974, $5 million less than the 1975 budget request, and $27.5 million (19.3 per cent) less than the 1975 appropriation, but $3 million above the revised budget. The proposed impoundment cut amounts to more than a fifth of the '75 appropriation.

National Institute of Allergy and Infectious Diseases. The budget requests $108.7 million, $2.3 million less than 1974, $1.7 million less than the 1975 budget request, and $10.7 million less than the 1975 appropriation. The largest cut is indicated for research on genetics (down $5.2 million, or almost 11 per cent, from 1974).

National Institute of General Medical Sciences. The request is for $161.6 million, down $6.7 million from 1974 and the original budget request and $25.8 million from the 1975 appropriation, but up $5 million from the revised 1975 budget. The proposed impoundment cut is 16.4 per cent of the 1975 appropriation. Large cuts are indicated for research on genetics (down $5.2 million, or almost 11 per cent from 1974) and on cellular and molecular bases for disease (down $12.6 million, or 21.5 per cent, from 1974).

National Institute of Child Health and Human Development. Requested is a total of $122.3 million, including $16.2 million for the new Institute on Aging. This is $3 million less than the 1974 appropriation, $2.6 million less than the original 1975 budget request, and $19.7 million less than the 1975 appropriation, but $4.2 million above the revised request. The proposed impoundment cut from the 1975 appropriation is almost 17 per cent.

National Institute on Aging. For the fist appropriation of the new Institute, the budget proposes $16.2 million. Budget materials say this is an increase from $14.1 million this year. Research emphasis is to be placed on menopause, aging of the immunologic system and cellular aging, and the impact of improved health and increased longevity on society and individuals.

National Eye Institute. The request is for $39.2 million, $2 million less than the 1974 appropriation, almost $750,000 less than the original 1975 budget request, and $4.9 million less than the 1975 appropriation, but $1.6 million more than the revised 1975 budget.

National Institute of Environmental Health Sciences. The request is for $31.1 million, $3.8 million less than the 1975 appropriation, but $2.7 million more than the 1974 appropriation, $2.4 million more than the 1975 budget request, and $3.1 million more than the revised 1975 budget. Largest increases are for the Environmental Health Sciences Centers ($1 million) and ontramural research ($855,000).

Research Resources. The request is a disastrous $81.1 million, down $47 million from 1974, $46.1 million from the 1975 appropriation, and $1.6 million from the 1975 budget request (but up $423,000 from the "revised" budget). The 1975 impoundment cut was a whopping $46.6 million (almost 37 per cent), largely

occasioned by the threatened rescission request of the entire $43 million appropriated for the General and Biological Sciences Research programs (see Circular Letter No. 1). According to budget materials, "the original intent of the program -- to build up institutional research capabilities -- has been largely accomplished." The Minority Biomedical Support program will be continued -- at the same funding level as for last year, which, with inflation, translates into a cut of something over 10 per cent.

Research Training. NIH expects to allocate about $124 million for research training in fiscal 1976, down from $131 million in the revised 1975 budget. The bulk of this sum -- $111 million -- is designated for continuing commitments for training awards, with the remaining $13 million earmarked for "1,000 new postdoctoral research trainees in biomedical research shortage areas." HEW states that "legislation will be proposed to extend and modify the authorities of the National Research Service Award Act in accordance with the 1976 budget proposals."

Mental Health

The budget requests $81.4 million for research sponsored by the National Institute of Mental Health for fiscal 1976. This is $6.8 million (almost 8 per cent) less than the 1974 appropriation. It is also $12.8 million (13.6 per cent) less than the original 1975 appropriation of $94.2 million. Here, as elsewhere in the HEW, the administration has elected to "revise" the 1975 budget enacted by Congress and signed into law by the President, and has proposed to rescind the $12.8 million. According to budget materials, the proposed 1976 amount provides only $14 million for new competing awards, which is $6 million more than the administration's revised budget allowed this year. The new funds will be concentrated on research involving schizophrenia, depression, aging, child and family mental health, minority problems, crime and delinquency, and metropolitan, social and service delivery problems.

The budget requests $45.5 million for training in the National Institute of Mental Health. This is a cut of $54.6 million(and per cent) from the $100 million allocated for training in 1974, and a cut of $18.6 million (29 per cent) from the revised 1975 budget. This, according to budget materials, "will permit the continued phaseout of categorical training programs based on the belief that mental health training programs have been developed to the point that Federal subsidies are no longer required, particularly in those fields for which there is a relatively high earning potential." The recommended funding will support all continuing awards, plus $1.3 million for 100 new postdoctoral fellowships in "selected shortage areas."

Drug Abuse and Alcoholism

For drug-abuse research, the 1976 budget requests $32 million, $5 million less than for 1974 and the same as the 1975 revised budget. Training in the area of drug abuse is set for $3 million, down $12 million from 1974 and $7 million from the revised budget for 1975. It is anticipated, budget materials say, "that States and localities will provide increased financial support for maintaining their own training capability."

Alcohol research funding for 1976 is set at $9 million, the same as for the last two years, and training at $7 million, the same as for 1974 but $5 million more than the revised 1975 budget (the 1975 appropriation figure was $11.4 million). Again, states and localities are supposed to pick up the tab.

Health Resources

Capitation Grants. Funding for formula capitation grants for health professional schools is in sad disarray, due in part to the fact that authorizing legislation expired last summer and re-authorizing legislation has not yet been enacted and, in part to the administration's objective of phasing out this and all other forms of institutional support. Authorization of support is provided through the continuing resolution.

The 1976 budget requests $101 million for health-professional capitation grants, down $156 million (61 per cent!) from the last regular appropriation for the program -- $257 million -- in 1974. The budget request "... reflects the continued (administration) policy of gradually phasing down this particular form of institutional and student subsidies, in view of the high earnings potential of health professionals and the general excess of qualified applicants for the number of places in health professional schools." The request "assumes" the following amounts per student for the capitation request: $1,000 for each student of medicine, osteopathy, and dentistry; $300 for each student of veterinary medicine; and $200 for each student of optometry and podiatry. Pharmacy is not mentioned. (For capitation recommendations of the Institute of Medicine of the National Academy of Sciences, see 1974 Circular Letter No. 9.)

Student Assistance and Special Projects. The budget requests $67.5 million for student assistance, of which $22.5 million is for National Health Service Scholarships and $8.5 million is for repayment of educational loans on behalf of students practicing in medically underserved areas. Budget materials state that "traditional direct loans and general scholarship programs, which do not require public service from recipients, are proposed to be phased out."

The budget requests $155 million for "various special project grant activities." Priority areas for these funds "... will be to increase the quantity and distribution of primary care physicians; establish, strengthen and expand educational opportunities for physician assistants, dental auxiliaries, and nurse practitioners; and help solve the serious problem of geographic maldistribution of health professionals."

Altogether, the budget requests $339 million for health manpower programs, $11 million less than the revised budget for this year and $220 million less than the comparable appropriation for 1974.

7. RESEARCH KEEPS PACE WITH, EXTENSION FALLS BEHIND INFLATION IN AGRICULTURE BUDGET

With a recommended increase of 10 per cent, payments to the states through the Hatch Act for cooperative agricultural research perhaps stays even with inflation. With a budget recommended increase of 6 per cent, the cooperative agricultural extension service definitely does not.

For the Cooperative State Research Service, the administration's fiscal 1976 budget requests a total of $114.5 million, an increase of $12.7 million over the $101.8 million appropriated for 1975. Within this total, $84.1 million is for payments to the states for "regular" agricultural research at the experiment stations and for penalty mail. This total, however, includes $1.5 million that the administration proposes to "merge" with the regular Hatch Act funding. The

comparable figure for 1975 is $76.5 million, for an increase of $7.6 million, or almost 10 per cent. Formula funds for forestry research under the McIntire-Stennis program is set for $7.5 million, an increase of $392,000 from 1975, or 5/5 per cent.

For direct grants and contracts, the budget requests a total of $19.5 million, an increase of $4.3 million (28 per cent) over the $15.2 million appropriated for fiscal 1975. The total includes $12.7 million (up $882,000, or 7.5 per cent, from the 1975 appropriation of $11.8 million) for research support at the predominantly black 1890 land-grant institutions and Tuskegee Institute. Special project support is set at $6.8 million, up $3.4 million (100 per cent) from the 1975 level. Major increases include $750,000 for beef and pork production research, $500,000, for transportation and storage research, $1 million for forest and range research, and $500,000 each for research on genetic "vulnerability" and pesticide clearance.

The budget requests a total of $223.8 million for fiscal 1976 for the Extension Service, an increase of $8.4 million, or 4 per cent, over the $215.5 appropriation for 1975. Within the total, $132.2 million is for payments to the states through the $3.95 million the administration proposes to transfer from the Agricultural Marketing Act, rural development, and community research development. This means that, for "regular" agricultural extension activities through Smith-Lever, the budget actually requests $128.2 million, an increase of $7.2 million, or 6 per cent, over the appropriated $121 million level.

For nutrition education, the budget requests $47.4 million, the same as for 1975 _if_ Congress agrees to an administration proposal to rescind $3.2 million of the $50.6 million appropriated for the program for 1975. For support of extension activities at the 1890 land-grant institutions and Tuskegee Institute, the request is for $6.8 million, an increase of not quite 6 per cent for perhaps half of the "increased operating costs." Pest-management extension activities is set at $2.9 million, up $1.2 million (70.5 per cent) from 1975. The increase is earmarked for the development of an 11-state "integrated" pest management program for the suppression of the boll weevil and other major pests affecting cotton production. The budget requests $910,000 for agricultural extension activities in the District of Columbia, another 6 per cent increase for "increased operating costs." Penalty mail is scheduled for $11.2 million.

Transfer of the rural development section 3(d), the Rural Development Act, and the Agricultural Marketing Act programs would presumably wipe out any earmarked funding for them. The 1975 appropriations were $1 million for rural development, $1.5 million for the rural development extension, and $1.45 million for marketing extension.

Mr. COHEN. I will just go down my statement, Congressman Bolling, and make a few comments about various points, and they can be elaborated later.

First: I believe that the economic assumptions used by the administration, and shown at page 14 of the budget, are very unfortunate assumptions. I believe that Congress must take the initiative to reduce the unemployment price rise levels for 1976 and the ensuing years. I hope your committee will not accept those assumptions as the basis for economic and social policy of this country for 1975, 1976, or the ensuing years.

Representative BOLLING. I think there is no possibility the committee will accept those assumptions.

Mr. COHEN. I believe that, therefore, you have to undertake a series of economic and social changes.

In connection with tax policy if, there are any permanent tax reductions in the tax bill I hope that those will be minimal. The reason I say that is I strongly believe there should be substantial reductions and they should be largely temporary, because we will need a much larger fiscal yield in the next 5 years to undertake the major social reforms that are necessary. A national health insurance plan, welfare reform measures, measures to adequately deal with our senior citizens, education and other social programs will need more Federal revenues in 1978, 1979, and 1980. I am reluctant to see any permanent tax reductions that will reduce the fiscal yield and thus impair the ability of Congress to act on these other measures in the next 3 or 4 years.

So, therefore, I hope that any such tax policy items will be temporary, giving Congress an opportunity to reexamine tax reductions later on when our gross national product is higher.

With regard to unemployment, I certainly favor a much larger public service employment program for the next year or two. I might say I was very chagrined to see the present Secretary of HEW talk in the House about how inefficient public service employment expenditures are. May I give you analogy? Living in a house is much more costly and inefficient than living in a tent, but obviously that is not the sole criteria for determining a housing policy. I believe that in this situation we must expand public service employment to give people jobs, because that is wholly consistent with the work ethic, and while I do not have any conflict with Secretary Weinberger's view that we should have more efficient income maintenance programs, I think those should not be undertaken at the expense of giving people work opportunities during this period of time.

Second: I want to point out that I strongly favor congressional action immediately to take care of the health insurance coverage of unemployed individuals. I think here is a great illustration of the failure of our health insurance programs under private auspices or collective bargaining to adequately protect people and as an indication how the private sector has not satisfactorily dealt with one of the key problems. Now Congress is being asked to put a $1½ billion of general revenues to bail out private insurance in this situation because they have not adequately protected the health insurance of the unemployed.

Next I want to say, I favor the bill introduced by Congressman Corman in the House, and Senator Bentsen in the Senate which

would provide this protection, would be through the medicare program rather than through subsidizing private insurance.

I would also like to add that this situation has demonstrated adequately to any fair minded persons that our State-by-State unemployment insurance system is completely inadequate to even deal with recession unemployment, not to say depression unemployment.

I hope the committee will seriously recommend, and if there is any subcommittee to deal with income maintenance programs, I hope you will reexamine the State-by-State unemployment system and to try to find a good way, which I think there is one, to fix up this patchwork State-by-State system.

We have the problem of fixing the leaking roof. When things are good we don't fix up the unemployment system and when they are bad we have to put massive amounts of Federal money in it. I think you ought to fix it up permanently and soundly.

With regard to senior citizens, I must say as the Chairman, Senator Humphrey said, the administration's recommendations on senior citizen representatives are a major assault on the welfare of our senior citizens. I have never seen, in the 40 years I have been here, such a calloused and insensitive budget for senior citizens as this one. I won't enumerate them because they are all in my testimony as Senator Humphrey summarized them. I hope that the Congress will not even seriously consider adopting any of those problems affecting social security, medicare, medicaid and the administration on aging.

With regard to one aspect, I want to say that I believe that Congress ought to do something immediately to improve the supplemental security income program. That is a program, as you know, Congress adopted in 1972 which became effective January 1, 1974, in which payments for a single person are $146 a month. That was a compromise to get the program started. It was set even below the poverty level at that time and is certainly below the poverty level at this time. I urgently and strongly recommend that Congress immediately raise that level to at least the poverty level. I think that is urgently needed for our senior citizens.

In my statement I deal with the administration's recommendations in the field of education. I must say, now being a dean of education, the education proposals of the administration are miserable. That is the only way that I can characterize them. For instance, one that is absolutely inconsistent with what the President has already said is their cutback of work study programs. Now, if there is any program that emphasizes work and the work ethic, and career education which the President has stressed, it is this one. It has been one of the most highly successful programs in education, permitting students to earn money while they work in college and universities. Everybody agrees it is a successful program, and yet the President's budget proposes to reduce the work study appropriations which were $200 million 1974 and $300 million in 1975, to cut it back to $200 million in 1976. We could use $350 or $400 million to help poor, disadvantaged students by permitting them to go to college in the work-study program. I find it incomprehensible to me how this kind of program could be cut back.

Similarly, the President cuts the cooperative education program from $10.75 million to $8 million. I think this is a very pennywise and pound-foolish recommendation.

So I am very disturbed by the education proposals, and I hope your committee will go into more detail on them. My statement indicates a number of other educational programs which are being cut.

Now, in the health field, Senator Humphrey has already enumerated them. The President unwisely recommends reduction in the appropriations for neighborhood health centers, for parent and child health centers and family planning centers, three areas of programs which have been successful. In other words, if you cut back programs which you could show had had a very low incidence of success you might have felt that it had some merit. But the budget cuts back the most successful programs in a way, again, that I think is incomprehensible, particularly where the administration is recommending cutbacks in health manpower. I find that very difficult to accept.

I hope Senator Javits, who is on the committee that deals with that legislation will certainly look into that. This is no time when we are going to have a health insurance program in the next couple of years to cut back on the manpower aspects that are needed to prepare for that program. When the administration says that these individuals get substantial incomes, I would like to remind you that the higher their income the more income tax they pay. So they will pay back to the Federal Government a very large proportion of what they ultimately earn.

But if this policy were carried out and the administration says don't give Federal grants to anybody that would make substantial income they would have to cut back Federal subsidies to businesses, airlines and airports, and you would certainly massacre the Federal budget if the administration's policy were carried out consistently, and I don't think they mean that. But when they apply it particularly to nurses I find that again incomprehensible. Certainly nurses don't earn the kind of income that neurologists and surgeons do. To advocate repealing the nurse training act, as they do, I find very, very unfortunate.

I conclude my statement on matters of social security, which perhaps we will discuss later, but I want to add two points about the Employment Act of 1946, Mr. Chairman.

In the first place, I would like to recommend that you consider amending the Employment Act of 1946—after all these years of experience—to provide that the President and the council must in the future submit an immediate and longrange comprehensive program directed toward the restoration and maintenance of maximum employment and purchasing power and responsibility on the part of the joint committee to hold public hearings on these matters and publish its evaluation.

I think section 2 of the Employment Act of 1946 now needs major rewriting to create a responsibility on the President and the council to focus on a specific program of full employment, maximum employment, present it to the country, the Congress and this committee to evaluate it and make it possible for us to evaluate what the cost and impact will be of a full employment program. The act of 1946 is, if I can say it this way, deficient in not making that responsibility more specific.

Second, this kind of a budget impresses upon me even more so, the need for the legislation that Senator Javits and Senator Mondale have recommended in the past for the creation of a Council of Social

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Advisers to evaluate the qualitative elements involved in national policy. The trouble with the present situation, in my opinion, is that there are too many economists in the Council of Economic Advisers who believe that the deficit and matters of macroeconomics are the sole determinations of public policy in the United States. This budget illustrates a failure to include what I call a human orientation, the impact on people. You are not going to get that result as long as the three people who are picked by the President and the Senate are all macroeconomists.

I believe it would be a great contribution if Mr. Greenspan would resign and the President would put somebody in as Chairman of the Council of Economic Advisers who is interested in human values. The only way I think that can be done is to create a Council of Social Advisers or have social advisers added on the present Council, much like Senator Javits and others have recommended, to, give us a complete turnaround in dealing with the problems of the quality of life and not be solely concerned about the deficit and other matters which, while valid from an economic point of view, don't take into account the human side of the equation of the national budget.

Thank you.

Representative BOLLING. Thank you, Mr. Cohen.

Next is Mr. Nelson H. Cruikshank, president of the National Council of Senior Citizens.

STATEMENT OF NELSON H. CRUIKSHANK, PRESIDENT, NATIONAL COUNCIL OF SENIOR CITIZENS

Mr. CRUIKSHANK. Thank you, I am happy to be here.

We now have branches in every State in the Union, and I am happy to have the opportunity to present the views that we have gathered from a great many of these people.

With your permission, Congressman Bolling, I would like to have placed in the record my prepared statement, and in the interest of time I will try to hit just some of the highlights in it.

Representative BOLLING. Without objection, that will be done. We will place it in the record at the end of your oral statement.

Mr. CRUIKSHANK. I want to hit just some of the highlights here.

I have spoken in support of a number of the issues which my longstanding friend, Dean Cohen, has spoken to. I am sure it is a surprise to nobody, since I owe a great deal of what I know about these subjects to having sat at his feet over the years.

I would like to just hit two or three highlights and then introduce one thing, with your permission that isn't in my prepared statement.

I agree that this is a heartless budget that has been presented. I am not sure I agree entirely with Dean Cohen that Mr. Greenspan is not aware of the human element, as he has expressed deep concern for the Wall Street brokers. So we can't say he is completely devoid of any concept of the element.

Also, I am not sure I agree that there are too many economists. That is a play on words, perhaps. But it seems to me that some of the budget represents not so much economics, as it does bookkeeping. and there is a difference. The budget is a year-by-year intake and outflow, and consequently it shows up things in a distorted view. If,

for example, we should build or have government funds to build 2,000 or 3,000 publicly owned and operated nursing homes, which are desperately needed in the United States to take care of the older people who are no longer in a position to take care of themselves, and get out of this for-profit area in operating nursing homes, if we should do that, it would show up in the budget simply as an expenditure for 1 year but nothing on the other side of the balance shows it.

Now, any corporation that would make this kind of an expenditure in plant equipment would show an asset on the other side. This, to my mind, is an economic aspect as contrasted to simply a bookkeeping aspect. The bookkeepers are always the ones that throw us deeply into debt and raising up the scare—inflation because we don't balance the intake with the outflow this year. They never mention the tremendous assets which society develops and which will continue to yield valuable services and goods to people and thus should be entered on the other side of the balance sheet.

We are deeply grateful to the Congress that we have already stepped in, and you people here this morning are a part of that and we appreciate it. You have already stepped into prevent the unconscionable increase in the cost of food stamps that was proposed.

But I am sorry to report that the action of the Congress does not seem to be adequate, because Secretary Butz has once again seemed to step in to countervene the action of the Congress and he is now doing, by administrative fiat, what he was told by the Congress not to do. He has refused to employ the people—to hire the people and cut back the redtape.

I have visited a couple of these food stamp areas and I see these long lines of elderly people standing in the snow and the sleet simply because the Department of Agriculture has not staffed the food stamp offices adequately to carry out the mandate that Congress has given. So you did well, and we are grateful for you having annulled the action on the food stamp program. But until Secretary Butz gets the idea of the purpose of the program and develops some dedication to carrying it out, you will not reach the people who need it.

To help balance the budget by reducing the mandated increase in social security, Federal retirement employment, and railroad retirement employment by a 5-percent arbitrary ceiling instead of allowing the congressional action of 1972 to be carried out and provide the automatic increase in these benefits, seems to me to be an unconscionable thing and one with far-reaching consequences.

We have heard the President tell us if we don't put in these $200-odd million immediately to Cambodia that people will not believe the Government of the United States and its commitments. But Congress passed a bill and the President signed a bill in 1972 that committed this Government to keeping these retirement benefits equal to the cost of living as well as they could, disallowing the lag period, which is to a large part unavoidable. It is always behind. But Congress committed this Government, the older people on social security, its own employees and the military and the others, in saying that these retirement benefits would keep pace with the rising cost of living and now the President has come in and disregarded that commitment.

What is happening to the credibility of the U.S. Government if the older people in this country can't believe it when Congress passes a bill saying they will not allow the inflation to erode further their already eroded standard of living.

I wonder sometimes if the people realize the importance of this proposal on the part of the President. Senator Javits, I know, is one of the coauthors that worked very hard on the development of a reform of the pension plans, the private pension plans, in the United States. We are indebted to him for having done that. I know a little bit about pensions. For 22 years I was the director of the Social Security Department of the AFL-CIO. I have now been appointed as one of the members of the National Advisory Council which was set up under the act. I am the member, Senator Javits, that you designated as being the one retiree member. I am sure I don't know as much about the act as you do, as one of its authors, but I do know this, and I have checked this statement out. It is a hard statement, but I have checked it out with some prominent labor lawyers. If a private employer having a pension plan, either negotiated with his union or instituted unilaterally by him, had in that pension plan an escalator clause, and then reduced the benefits and used the improved position of his reserve pension trust fund to reflect a better position of his corporation in his annual report to the stockholders under the new pension plan, he would be in jail. This is exactly what the President of the United States has proposed to do.

Now, fortunately, he can't do it without an act of Congress, but I think we have to think of the enormity of this. He doesn't propose to cut down the tax, the social security tax, on the workers. He doesn't propose to cut down the medicare tax. He proposes to allow these funds to continue to roll in, but he proposes to cut down the benefits; and then with that improved position in the consolidated budget, to present less of a deficit to the people of the United States and to the Congress of the United States than would have otherwise been presented.

Now, this seems to me, to point up the importance of another very significant piece of legislation that is before us, and this is where I would like to depart a bit, with your permission, from my prepared statement and introduce something that is not new in subject matter but new by way of illustrations.

I appeared yesterday before the Senate Budget Committee and I developed this for them, and if you don't mind I will try to give you also what I presented them because I think it is relevant to these hearings.

The difficulty is the consolidated budget, which includes all of the income of the trust funds and other kinds of tax income as if it were one kind of a tax is, misleading on several counts to the public and to some Members of Congress, perhaps, who do not have the opportunity to go too deeply into it. It really adds apples and oranges. Congress has always referred to social insurance taxes as contributions, and this isn't just a play on words, because these taxes are different in kind from the other taxes that are levied, the excise taxes and the income taxes and so forth, that are levied to build up the general revenues of the U.S. Government.

They are different in kind because they are reserved by act of Congress for a particular purpose and cannot be used for anything else. They are different in kind because the social insurance programs are different in kind from other Government programs. In reality, social security and railroad retirement are different in kind because actually these are huge self-help programs in which the people covered by these programs use the machinery of Government to provide against certain contingencies.

So when these contributions are lumped in with all of the other taxes you are really adding apples and oranges, and it leads to some false conclusions.

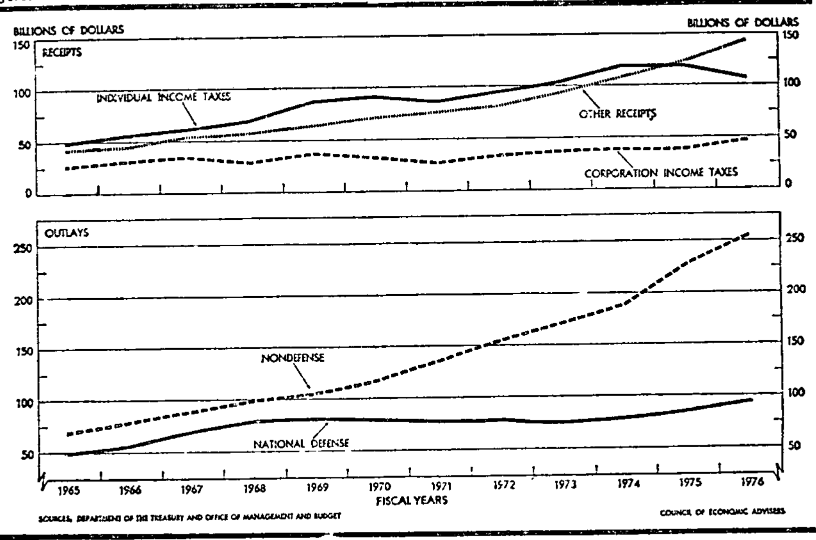
Now, one of the false conclusions it has led to are statements we have had from people like the former Director of the Budget, Roy Ash, who says we have developed and expanded the social aspects of our budget enormously in contrast to the defense budget. He can arrive at that conclusion only by including the Social Insurance Trust Funds Act in the general budget.

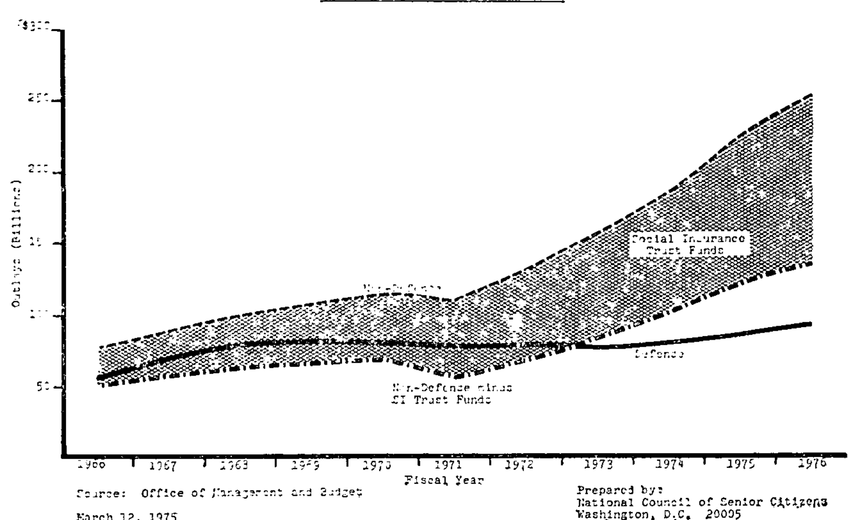
This is reflected—I am sure you are all aware since it has been prepared for your information—in the Economic Indicators for February 1975—the summary of the budget receipts and outlays by function in the chart on page 36. I would just use this to remind you of this, since you probably don't have it with you. I want to give you two charts, this one, which is taken from that page, and then the same chart on which I have superimposed the social insurance trust funds. I think these illustrate the way the consolidated budget is misleading.

[The charts referred to follow:]

FEDERAL BUDGET RECEIPTS BY SOURCE AND OUTLAYS BY FUNCTION

Fiscal 1975 budget receipts are estimated at $278.8 billion and budget outlays at $313.4 billion. The corresponding figures for fiscal 1976 are $297.5 billion and $349.4 billion, respectively.





Mr. CRUIKSHANK. If you look at the chart, without the imposition, it appears to support Mr. Ash's contention. You see the nondefense items going up and up and up compared to the defense items. But look at the chart that we have prepared which is the same chart, using the same raw data from the Treasury and the Office of Management and Budget. Take out the social insurance trust funds, and it wasn't until 1973 that nondefense items grew to be more than the defense items, and even in the 1976 proposed budget there is nothing like the nondefense compared to defense. This would have been the old administrative budget that was presented to Congress separately from the social insurance trust fund budget until the year 1969.

So it gives, without this separation, a false view of the priorities of the country, and as the previous speaker said, I think Congressman Dellums pointed out very well that the budget reflected priorities of a government. Lumping these all together, adding these apples and oranges gives a distorted view as reflected by the budget.

There is a bill, and over half the Members of the Senate have already joined in this, to set up a separate authority for the whole social security program, something like the Tennessee Valley Authority, which would take these funds out and reflect in its structure the financing of these programs. The funds would be protected against the kind of shell game that goes on when you can reduce benefits. Any President will be, as long as you have this consolidated budget, tempted to play this game of reducing benefits to make the overall budget picture better.

I hope there is time for the Members of the Senate and the House and this committee to look at this other matter of concern which is reflected here.

I spoke longer than I intended to because I got kind of carried away.

I will say at this point that is all for the time being, and thank you very much.

[The prepared statement of Mr. Cruikshank follows:]

PREPARED STATEMENT OF NELSON H. CRUIKSHANK

Mr. Chairman, members of the Joint Economic Committee, my name is Nelson H. Cruikshank, and I am the President of the National Council of Senior Citizens, an organization of older people that works for older people.

Gentlemen, I am pleased to appear before you today and present the views of our membership, but I am very unhappy about the economic conditions which have made your hearings necessary.

The days in this city and throughout the country are dark; daily up-dates about the condition of the economy are provoking despair; the combination of inflation and recession, previously thought "impossible", are tearing at our social fabric.

Although these problems are complex, my message is relatively simple—President Ford, with his present economic proposals, is sounding the death knell for the hopes of secure and dignified retirement years for older Americans.

Today's older Americans have indeed struggled through worse economic crises. Having stood in the soup lines of the Great Depression they know how to submit to President Ford's exhortations—"tighten your belt" and "bite the bullet".

However, the situation that most of our members now find themselves in is quite different from that they faced forty years ago. They find their incomes relatively fixed with employment a practical option to but a handful. They endure a marginal existence, living "hand to mouth" with the highlight of their days being the third of every month when they receive their Social Security or Supplemental Security Income checks.

But probably more damaging to their well-being is the prospect that they may never enjoy better days.

Senior citizens provided the brain and brawn which built this highly industrailized and prosperous country. In part, they sweat and toiled so that they could enjoy their just reward of happy retirement years.

It is difficult to comprehend fully the despair that occurs when a retiree finds that the promised gold of the retirement he has worked for turns out to be mere dross.

Young and middle-aged people have hopes that our present economic crisis will be resolved and that our standard of living will improve. But these expectations are not shared by their elderly parents.

Older Americans are a proud people. Self-reliance is one of the virtues that has guided their lives.

As a result, it is a better disappointment when they find that those benefits which they have earned such as Social Security, private pensions, and Medicare are inadequate during this economic crisis. They consider it degrading when they are forced on to the public assistance programs of Supplemental Security Income (SSI), food stamps, and Medicaid.

To these problems, President Ford and his Administration do worse than turn deaf ears or wag patronizing fingers—they propose, either out of ignorance or as a result of enslavement to an archaic ideology, to rob older people of any chance to have a decent retirement.

Inflation—a serious burden for all our people—inflicts special anguish on the elderly living on fixed low incomes. The basic essentials of daily living—food, shelter, medical care and transportation, items that the escalating at especially high rates—claim virtually all of their resources. Since it is necessary for most of the elderly to spend their entire incomes to meet their basic needs, price rises result immediately in a reductions in the goods and services they can purchase—in other words, a cruel reduction in their standard of living.

From the vantage point of day-to-day contact with thousands of elderly groups throughout the country, the National Council of Senior Citizens is made very much aware that older Americans can not be expected to do more than they are already doing in this period of general belt-tightening. Yet Mr. Ford is not content to let old people keep what little they have.

He is not content to permit the elderly to have cost-of-living adjustments under Social Security, civil service, or SSI promised them by Congress, much less to make slight improvements in those keystone programs. He is not content to leave Medicare alone with its inadequacies and gaps but proposes

to increase drastically out-of-pocket payments for medical care. He is not content to leave the food stamps, as meager as they are, but prefers to increase the purchase price and keep the benefits artifically low. He would like to kill the older worker community service employment programs rather than even maintain the relatively few job opportunities.

We are indeed grateful that the Congress is hearing our pleas and is acting responsibly in addressing the economic problems facing older Americans.

Specifically, on behalf of the National Council of Senior Citizens, I want to thank you for rescinding President Ford's ill-conceived order to increase the purchase price of food stamps. When I last appeared before you on December 16, 1974 on the impact of non-competitive practices of food processors and retailers on the budget of the elderly, I took the opportunity to mention the then announced food stamp change. I asked that you make a first order of business of the 94th Congress the cancellation of this ill-advised scheme. We were pleased with the promptness with which you responded to our appeal. Your action not only has prevented hardship and hunger for thousands of American families, but has demonstrated to them that Congress can act swiftly and decisively to meet human needs.

I shall not pretend to present fancy macro-economic models or sophisticated quantification of the impact that Mr. Ford's economic policies would have on older people. But I can describe the human realities overlooked in statistics of the Office of Management and Budget or Council of Economic Advisors.

Millions of poor, elderly Americans watched the State of the Union presentation and the earlier "library chat" given by President Ford over national television and were indeed appalled by his continued lack of sympathetic understanding of the problems of older people. It was clear from the President's speech that he had no feelings at all for the suffering of the country's older people.

Older Americans who listened to the television speeches were startled by the President's recommendation for "a 5 perecent limit on pay increases in 1975 * * * in all government programs tied to the Consumer Price Index—including Social Security, civil service and military retirement pay, and food stamps."

Millions of Social Security beneficiaries, hard hit by spiralling inflation, were grateful for the 11 percent Social Security boost received in two payments of 7 and 4 percent in April and July last year. But the truth is by the time beneficiaries received the July payment the galloping speed of inflation had already increased by more than 11 percent, so there was already a shortfall.

To be more specific, the Consumer Price Index rose at the rate of 15.2 percent from January, 1973 through June 1974. Thus, even while the last stage of the 11 percent cost-of-living benefit increase was being paid it had already been outstripped by 4.2 percent by the runaway inflation.

In addition to this shortfall, there was a long wait until July, 1975 when the next cost-of-living increase is due under the law. Many seniors had written to urge their Congressmen—because of the double-digit inflation—that Congress might advance the Social Security boost to April as was done in 1974. Many affiliated clubs of the National Council of Senior Citizens asked their lawmakers to make sure that this time that there was no shortfall in the next cost-of-living boost.

The staggering increases in the cost of food, health care, shelter and transportation—which normally take up about 80 percent of the older American's budget—make it imperative that the elderly poor get help as quickly as possible.

This was the message which the National Council of Senior Citizens' leaders gave to President Ford in a special meeting last August at the White House and at the "summit" meetings which followed. It was the message the President heard many times in oral presentations. And the President and his staff were supplied with abundant documentation.

A very important feature of Social Security is that its benefits are a matter of earned right and written into law. The presently scheduled Social Security cost-of-living increase is a part of the law enacted by Congress in 1972. Clearly the intent of Congress in adopting the "escalator clause" benefit increases into Social Security was to insure that all beneficiaries would be protected from the ravages of inflation. To millions of elderly poor this Social Security amendment was the only sivler lining in the brooding black clouds of 1975. My generation of Americans has always believed that we could rely on the promises of our government.

It is understandable, therefore, that President Ford's proposal to limit the cost-of-living increase to only 5 percent has caused incalculable fear and worry among the nation's Social Security recipients.

There is increasing support among lawmakers for the NCSC position that—while the current formula provided in law will allow for an approximate 9 percent increase payable in July for the nine-month period between July, 1974 and March, 1975—what is needed is a cost-of-living boost of between 11 and 13 percent payable July 1 and covering a full year since last July.

While we believe that the projected 9 percent increase may well be too small and too late to help thousands of financially repressed seniors—the President's planned lid of 5 percent would be disastrous.

We are hopeful that the members of the 94th Congress will not approve the change in law required to implement such an artificial ceiling.

Senior citizens throughout the land are heartened by immediate and strong opposition to the President's proposal expressed by many members of Congress.

For example, Representative James A. Burke (D., Mass.), new chairman of the subcommittee which will have the responsibility for Social Security cash benefit issues in the House Ways and Means Committee, has said he doubts that the President's proposal will win Congressional support.

Mr. Burke said: "The President's suggestion to limit the cost-of-living increase in Social Security payments this year is misapplied thrift at its worst. Even aside from the obvious matter of social equity, an increase in pension payments would push the country toward economic recovery by supporting demand just as a tax cut does."

In addition, the Concurrent Resolutions introduced with overwhelming bipartisan sponsorship in both the Senate and House indicate to the public that the Congress finds no economic justice in Mr. Ford's proposal.

It appears that a majority of Cogress realizes there is not equity in asking people to suffice with a ceiling of 5 percent after they were shortchanged last year by more than 4 percent and they face another rise of unknown proportions of which at least 4 percent is due to the pervasive effects of the President's energy proposals.

President Ford and his advisors should know that the funds contributed by America's workers for Social Security are not part of the general revenues of the United States. He should know that the Social Security Trust Funds are protected from actual expenditure for any purpose but for Social Security benefits. If the funds are not spent according to law they will show up as surplus in the President's unified budget—but they will not place further dollars into the nation's depressed economy.

Surely the President must realize that this proposal is seen for what it is—an attempt to balance his budget on paper while dipping into the pockets of workers and simultaneously denying benefits to senior citizens. This plan to deny older people some $2.5 billion in Fiscal Year 1976 benefits doesn't save workers a cent since there is no plan to reduce worker's contributions to Social Security. It's nothing more than a double rip-off aimed at the older retireee and the younger worker who makes the contribution.

What the President's plan would do, if enacted, is to allow the Administration to use the improved financial position of the Social Security Trust Funds, that would result from the cut back in benefits, to offset part of the deficit in the overall budget, thus make the general budget appear better than it is in fact. This is not only bad social policy—increasing the hardship of older people and the widows, orphans and disabled to reduce budget deficits—but it is dishonest accounting practice. If the head of a business corporation would use the same device in reporting corporation assets to his stockholders, he would be subject under the new Pension Reform Act, to all the penalties of the law.

The clear evidence of impracticality and political chicanery in the Ford budget-cut proposals calls for early action by the U.S. Congress to protect the Social Security Trust Fund from White House manipulation.

There is already a bill before Congress —to protect the Social Security Trust Funds from such manipulation. It has been reintroduced in the 94th Congress by Senator Frank Church, Chairman of the Senate Special Committee on Aging. This bill is the same as that introduced in the 93rd Congress with the support of more than half the Senate and the Chairman of the House Ways and Means Committee. The bill—S. 388—should be enacted by Congress as quickly as possible.

S. 388 would accomplish two important things. First of all, it would remove the Social Security Administration from the Department of Health, Education, and Welfare and establish it as an independent agency of the Federal government. Secondly, it would remove the Social Security Trust Funds from what is commonly referred to as the Federal budget.

This legislation would help to insulate the Social Security Administration and Trust Funds from further political tampering or bookkeeping "shell games".

We were concerned last year by a flood of sensationalist and panicky commentaries on the Social Security system.

At that time we suspected the Nixon Administration was fueling this kind of journalism. And I must say that time seems to have borne out these suspicions.

Many of our members and the general public wrote to us asking, "Why are they attacking Social Security" Is the program another government fraud or cover-up of mismanagement?"

We tried to explain that we thought the primary motive of the White House in encouraging such articles was related to the economic problem of runaway inflation and the former President's proposals for combatting it.

On July 25, 1974 President Nixon made a major economic speech in California in which he outlined his steps to stop galloping inflation. To no one's surprise, his prime recommendation was that it was up to hard-pressed individuals and families to bear the burden of inflation fighting—that every family should have an anti-inflation lobby.

Other than that, then President Nixon proposed some legislative solutions to inflation. Chief among these, he urged that Congress grant him the authority to cut back on the spending of funds for so-called "mandated" programs. Of course the biggest of these mandated programs is Social Security.

The Chief Executive is not allowed under law to touch Social Security Trust Fund monies. It would take special permission from Congress to grant him that authority. But what if the public were convinced that the Trust Funds were in danger from over-spending? Might not many Congressmen and Senators, bending under complaints and fearful letters from constituents, be willing to let the President manage the monies in the Trust Funds in whatever way he saw proper?

Mr. Ford's recent rhetoric is merely a follow-through on his predecessor's policies.

But ought we to allow any President control over monies entrusted to the government for the purpose of providing income security?

Obviously, no.

The purpose of these Funds—a purpose repeatedly underscored by Congress—is to safeguard for the American people their expenditure solely for the provisions of the Social Security system and not to offset other deficits under the unified Federal budget.

A similar raid on the Social Security monies is embodied in the President's proposed cut-backs in Medicare coverage.

On the day before Thanksgiving, President Ford proposed that some $4.6 billion be cut from the Current Federal budget which expires June 30, 1975. Of that amount, some $3.1 billion would come from programs administered by the Department of Health, Education, and Welfare and the Veterans Administration.

The most outrageous of the specific proposed cuts would come in the Medicare program whereby the President would cut $465 million in the next six months from the program—all of that money eventually having to be made up from the pockets of the poor elderly using Medicare.

Under the planned Medicare cutbacks, the President would call upon poor older people—who now pay a $92 deductible—to increase their out-of-pocket expense by 124 percent to $205.65 for the average stay. The Ford plan continues to cost the Medicare hospital patient more for increasingly long stays in the hospital until the 90th day of any one stay in the hospital.

For instance, the Ford plan would have an individual who now pays that same $92 for a sixty-day hospital stay, pay $712.80—an increase of 675 percent. There would be no saving under the Ford plan until the patient had spent $750 out-of-pocket under Medicare. At that stage a "cap" would be put on patient spending.

Further, the Ford plan would also increase older person's costs under Part B (physician's insurance) of Medicare from a deductible of $60 a year to $67 a year—an 11 percent increase.

All of this increased cost to poor older people would have the effect over a one-year period of "saving" the government some $930 million because, while benefits paid out would be reduced, there would be no compensating reduction in workers' contributions to Medicare through the Social Security system.

You will remember that back in January 1973, President Nixon put forth almost an identical plan to make poor old sick people bear the brunt of cutting government expenditures. That plan was greeted with derision on Capitol Hill—so much so, that the Minority leader of the U.S. House of Representtives, one Gerald R. Ford, refused to introduce the President's proposal presumably because he knew then the disastrous effects that such a plan would have on the old and the sick in his district.

Now we see President Gerald R. Ford putting forth this proposal as if it were the saving grace of the nation's economy. Once again, it seems, he has accepted bad advice. These shop-worn ideas will not help the economy. We hope the President will learn that Congres will find this proposel, to rob sick elderly people of their Medicare benefits, as repugnant in 1975 as it was in 1973.

Another major concern of the National Council of Senior Citizens is with Title IX of the Older Americans Act.

The Title IX Older Workers Community Service Employment program provides needed part-time jobs for poor people 55 years of age and over to supplement their rock-bottom incomes as well as to be of service to their communities.

Two years ago when this Title became law, the National Council had high hopes that, at last, many older poor Americans would have a choice—a choice between welfare and a job, a choice between loneliness and involvement, a choice between worthlessness and usefulness, a choice between desperate poverty and making ends meet, a choice between hopelessness and hopefulness.

Title IX, modeled after the very successful Operation Mainstream Older Workers Program, was viewed by us as the Title that could have an impact on many problems in the aging field.

We have made this judgment not on the basis of sideline speculation but from 6 years' operational experience as a national contractor of the Senior AIDES program. We have striven to make this program successful and I can confidently state that under this program we have been able to improve the condition of thousands of older people. Here is a program where every dollar works double. The Aides who are employed have found new meaning to life, and they have found it in rendering, under the sponsorship of local community non-profit agencies, much needed services to the even less fortunate elderly.

Unfortunately, almost 2 years after Title IX was signed into law only $10 million has been allocated to operate this program. That amount of funding limits the program to providing only about 3,300 older unempolyed people 55 years and over, with the opportunity to work part-time for one short year.

That number combined with the Operation Mainstream older workers program only gives older workers a total of 12,674 part-time job opportunities for the whole nation including Puerto Rico and the trust territories. As of June 30, there may be *no* job opportunities left for older workers as the U.S. Department of Labor is terminating Operation Mainstream and the Title IX appropriation of $12,000,000 is on the Administration's rescision list. These two moves will abolish over 12,000 jobs for older poor people leaving them without any hope of ever earning a living for themselves again. During good times the regular labor market didn't want them and now with so many unemployed people, they will never stand a chance.

It is disturbing that two years after the fact, Title IX is not securely funded at a level that would enable it to pick up the Operation Mainstream enrollees who will be terminated in less than five months. The delaying tactics used by the Department of Labor to stop the commencement of Title IX and their continued fight to kill this good program is a discredit to our country.

Considering the nation's high unemployment rate and the fact that older workers have a very tough time finding jobs during good times, it is extremely hard to understand why the Department of Labor and this Administration is

completely bent on reducing the budget by taking dollars and opportunities away from older poor people.

Another area of great concern to older citizens is the debate over methods to be used to free this country from the yoke of dependence upon imported energy resources. There is no disagreement from older Americans with the President's contention that we must make America independent from pressures which the Middle-East oil producing nations can now bring to bear through cost increases, embargoes and other forms of economic blackmail.

But there is considerable concern that, as in other phases of the President's proposals, a disproportionate amount of the burden for fighting this battle will fall on the backs of those least able to afford it.

We are hearing, for instance, a lot about the relative merits of oil allocation and cost increases versus rationing as alternative methods of reducing our dependence on Arab oil. The fact is that rationing already exists in this country—dollar bills are the rationing coupons. Such a method of rationing is unrelated to a program of allocating energy sources with any regard to national goals or legitimate priorities of need. Another trouble is that senior citizens—and all those living on fixed incomes—have too few of those ration coupons. A method must be developed in consultation between Congress and the Administration to insure that whatever form our energy belt-tightening takes, those who can not take the belt in another notch are not placed in the position of suffering even further.

A related energy issue with which older people vigorously oppose the President's position, is the de-regulation of our own natural gas prices.

In the waning days of the last Congress, an attempt was made to enact the President's previously proposed de-regulation of natural gas prices. The National Council sent letters of opposition to every member of the Senate, opposing this proposition.

In that letter we pointed out that the best information available indicated that total de-regulation of natural gas prices woulld result in increasing the gas prices that the average home owner who uses natural gas by about $65 a year immediately and by $270 within five or six years.

We went on to declare that older home owners simply cannot stand yet another massive increase in prices for the goods and services they must have to maintain themselves.

This statement remains true today. In fact, recent downturns in the purchasing power of the dollar make it even more imperative that older home owners not be saddled with this increased burden.

Older people, and younger people alike—it seems to us—just cannot afford this additional energy price burden at this time.

Although I have tried to limit my statement to a few of the major Ford proposals which affect older people, in no way do I mean to indicate a lack of concern about the other Presidential proposals.

We are also very concerned with the following:

Income tax rebates that will benefit only about one-half of the elderly and then in a very small way.

The feeble attempt at equity represented by a proposed negative income tax of $80 which fails by far to offset the increases in living costs arising from the inevitable rise in utilities and petrochemical products caused by the energy proposals.

Proposed rescision of one-third of the appropriations for the Title VII nutrition program for the elderly at the same time attempting to increase the purchase price of food stamps.

White House and Department of Housing and Urban Development resistance to implement fully the Section 202 program for contruction of senior citizen housing.

Mr. Chairman, I thank you for the opportunity to appear before you and outline the concerns of our membership about Mr. Ford's disastrous economic game plan. I hope that this series of hearings will further Congressional efforts to formulate a more effective and reasoned attack on our economic ills.

Representative Bolling. Next, Mr. Eduardo Terrones, deputy director, National Council of La Raza.

STATEMENT OF EDUARDO TERRONES, DEPUTY DIRECTOR, NATIONAL COUNCIL OF LA RAZA

Mr. TERRONES. Thank you, sir.

I have never appeared before this committee or the other committees, so I am not quite sure of the rules.

I did bring a short prepared statement and copies of it——

Representative BOLLING. We will be glad to include that in the record, or you may proceed as you wish.

Mr. TERRONES. I will read it, if I may.

My name is Eduardo Terrones. I am the deputy director of the National Council of La Raza. On behalf of my organization and myself, I would like to thank you and the other members of the Joint Economic Committee for inviting us to present our findings on the administration's proposed budget.

Although I will be presenting some pertinent economic data, I am by no means an economist nor a national budget expert. As a staff member of a Chicano organization that is concerned with civil rights and public policy, however, we do have some insights that should be useful to your deliberations.

First of all, we believe that it is appropriate to briefly review with you some basic data regarding our people: Mexican-Americans.

According to the Bureau of the Census who now openly admits that they have undercounted our people, there are about 6.3 million people in this country who are Mexican-Americans or about 60 percent of the total Hispanic population. We are a very young population with a median age of 18.8 years. Our education level is about 8.2 years, which means that we have the dubious distinction of being the group of people that the educational system has neglected the most.

Over 44 percent of the Mexican-American families in this country had a total annual income from all sources and from all the family workers of about $4,000. Only 12.6 percent of our families earn what we consider an adequate income; that is, over $15,000 per year.

The point of all this is to simply indicate to you that we are already at the bottom rung of the economic ladder and the current recession will undoubtedly hit our people the hardest.

But the fundamental question before this committee is to what degree is the administration's proposed budget appropriate to and commensurate with the enormous economic crisis that this country is enduring? Our responsibility is to try to answer that question in terms of our own people primarily, but also paying attention to the Nation as a whole.

In gross terms the proposed budget is greater than the current budget by some $36 billion and there is an anticipated deficit of some $51.9 billion. Both the increase and the deficit are, on first glance impressive figures. Much of the proposed budget increase however, is attributable to inflation, thus raising the question of whether or not the budget reflects the tremendous needs caused by the economic crisis.

The projected deficit presents a compelling reason for budgetary restraint. It is certainly not in the public interest to be continually operating in the red. This projected deficit, however, must be related

to the capacity of the economy to absorb a deficit. We would suggest that an economy that is currently operating at over $1 trillion can readily absorb such a deficit. Conversrely, one has to ask the question: What will be the social and economic consequences of not spending enough resources to deal with the current crisis?

We believe that the consequences of inaction or business-as-usual are great indeed—much greater than the consequences of deficit spending.

We cannot answer that question for the entire country, but the economic consequences of this crisis upon our people will be gravely damaging. If I may explain.

According to official figures, there are 2,100,000 Mexican-Americans in the labor force. Of this total labor force, 140,000 or 6.7 percent are officially unemployed; that is, individuals who are unemployed as the term is defined by the Government; an individual who is available for work, has been engaged in some job-seeking activity within the past 4 weeks, is waiting to be called back to a job or is waiting to report to a new job within 30 days.

But I must point out that many of our people do not fall under that definition. Typically, when studies have been made it has been found that the unemployment rate of the Mexican-American is grossly understated.

As we travel about the country in our work and particularly when we visit barrios with high concentrations of Chicanos, our observations tend to support those studies.

We suggest therefore, Mr. Chairman, that a more accurate estimate of the unemployment rate among our people is closer to 12 percent. This means that over 250,000 Chicanos are out of work. Allow me to make one further observation with respect to unemployment before going on to the next point.

We take the position that even under the best of economic conditions, that is, even if we had a full employment economy, there would still be a 2½-percent unemployment rate.

For the sake of consistency we have applied this percentage to our people's total number of unemployed individuals. In other words, we have 200,000 Chicanos walking the streets looking for jobs they cannot find.

Now, what does all this mean and what is the Mexican-American community losing?

Last year the average wage for all workers in all industries, except agriculture, was $154 per week or $8,008 per year.

Under full employment conditions 2 million Mexican-Americans would be employed. This means that, at the $8,000 per year wage, our people would be earning $16 billion yearly.

But under the projected or even under the current economic recession, 1,800,000 of our people, employed at median incomes of $4,737—instead of the national median income of $10,000—would earn only $8.5 billion.

Then we add to that figure the loss of another $1 billion of the 200,000 Mexican-Americans who are already unemployed. We did not include in these losses the fringe benefits, such as insurance, vacations, pensions, and other programs.

The difference between the $16 billion they would earn annually under normal economic conditions and their yearly incomes of $7.5

billion under the current economic crisis, Mr. Chairman, is the loss my people would suffer. That loss is $8.5 billion.

I could go into the psychological and demoralizing effects that these conditions can have on a group of people, but I am sure that you will understand.

Thank you very much.

Representative BOLLING. Next, Mr. Ralph W. Borsodi, National Retired Teachers Association.

STATEMENT OF RALPH W. BORSODI, NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. BORSODI. Mr. Chairman, I am Ralph W. Borsodi. I am a retired economist and a member of the American Association of Retired Persons. This association with it's affiliate, the National Retired Teachers Association, represent a combined membership of nearly 8 million older persons.

As advocates for the aged, our associations cannot ignore what is happening in the economy nor what will happen if the administration's energy, tax relief and budgetary programs are implemented.

Let it be understood at the outset—inflation-recession is the most serious threat to our constituency at the present time and is seriously jeopardizing the financial integrity of the income maintenance structure on which millions of them are dependent. Let it also be understood—the extortionately high prices artificially established for oil, both at home and abroad, are responsible for much of this situation.

It is our conclusion that the administration's interrelated programs will destabilize the economy further, will have proportionately greater adverse consequences for the poor and the aged—the very groups who have already suffered the most—and will put the goals of the 1946 Employment Act beyond reach for years to come.

While our organization's statement, which I am submitting for the record of this hearing,[1] deals with all of the administration's programs, I shall abbreviate my comments on energy and tax relief, and concentrate instead on the administration's budget and certain proposals contained therein that are particularly inimical to our people.

THE ENERGY PROGRAM: MORE INFLATION

Our associations are persuaded that the consequences of the implementation of the administration's energy program would be: (1) Accelerated inflation; (2) deepening recession, (3) increased portions of consumer budgets devoted to energy, (4) another massive shift of wealth to the energy industry, and (5) permanent energy prices at levels wholly unjustified by the supply response. The burden of that program would fall heavily on those with the least ability to pay—and most heavily on the aged poor. Since the aged poor, who use less energy than any other group—including the nonaged poor—are already spending a higher proportion of their budgets on fuel, higher prices will mean doing without or cutting expenditures for food or housing.

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[1] See statement, beginning on p. 1169.

As an alternative, our associations support a combination of policies including: (1) "White market" gasoline rationing or a rebatable gasoline tax; (2) an import quota; (3) a graduated excise tax on automobiles—based on weight and horsepower; and (4) a standby fuel allocation system. However, such policies should be gradually phased in to allow stimulative macropolicy time to revive the depressed economy.

TAX RELIEF PROGRAM: HELP FOR THE HIGH INCOME

Contrary to the administration's claims, the tax relief proposal—including the $80 payment—will fail to offset the direct and indirect effects of higher energy prices on the poor and fixed-income aged. Moreover, a disproportionately high proportion of the tax dollars will go, not to the low income who have been hurt the most and are most in need, but to the high income, apparently on the theory that they are more likely to use the tax dollars to purchase new automobiles and revive that depressed industry.

We have criticized the administration's program because it is inadequate and lacks a tax aspect. We prefer H.R. 2166 but have suggested that the minimum rebate for taxable year 1974 be set at $100—rather than the lesser of $100 or 1974 tax liability. If tax relief is to stimulate the economy, the poor and the fixed income aged—the groups most likely to spend whatever they receive—should be given their fair share of this one-time rebate.

The aged who are taxpayers are a small minority even within their own age group. If tax relief is contingent solely on liability, the aged will receive very little.

The administration's energy and tax relief proposals would mean, for the poor and the fixed income aged, higher prices and little relief. For some population groups, the administration's programs would mean a "taking with one hand" and a "giving with the other"; for much of our constituency, they would simply mean a "taking."

THE BUDGET: IN THE CONTEXT OF INFLATION-RECESSION

We believe the administration's budget is inadequate to accomplish the critical objectives at the present time—putting people back to work and getting the economy moving again. While the budget contains a projected $52 billion deficit, it is almost totally a function of the unemployment rate.

Of greater concern to us are the enormous economic losses that result from prolonged recession. High unemployment and low economic growth will mean successive deficits and lost output and that, in turn, means that the pie which we all must share will be much smaller than it might otherwise have been.

Our associations would gladly trade a greater deficit this year, if that would mean higher rates of growth, lower rates of unemployment and lower deficits than those projected by the administration for succeeding years.

While we favor highly stimulative macropolicy to combat the recession, macropolicy must be perfected and implemented by the Council on Wage and Price Stability acting with an expanded mandate if we are to deal effectively with the type of inflation that

results from the unrestrained exercise of market power in certain industries. The continuing trend of market power concentration requires the creation of a countervailing power operating in the public interest. As long as we restrict ourselves to the use of the macroinstruments of monetary and fiscal policy, pretending that they are suitable for all types of inflation, we will be limited to the primitive tactics of stop and go, boom and bust. No economic program that attempts to deal with inflation while ignoring recession or with recession while ignoring inflation will succeed.

SPECIFIC BUDGET PROPOSALS: ARBITRARY LIMITATIONS AND CURTAILMENTS IN FEDERAL PROGRAMS AND THEIR IMPLICATIONS FOR THE POOR AND FIXED-INCOME AGED—GENERAL REMARKS

To facilitate its design of tax relief for the high income and high prices for the energy industry, and still keep the projected budget deficit to a minimum in order to avoid generating aggregate demand inflation, the administration's budget contains certain curtailments in and limitations over expenditures for programs upon which the aged are dependent. In view of the impact of inflation and the estimated impact of the administration's energy program on them and the disproportionately small amount of tax relief that they would receive, these limitations and curtailments are simply callous. Since the food stamp proposal has already been rejected, we shall rescind from commenting on it except to say that there is something extremely wrong when proposals as draconian as this are put forth in seriousness and good faith.

THE 5 PERCENT LIMITATION

Our associations are adamantly opposed to the administration's arbitrary 5 percent limitation on cost-of-living adjustments in social security and other retirement and welfare programs. Over the past 3 years, it has been the aged poor and fixed-income who suffered the greatest loss of purchasing power. They need their full 8.7 percent cost-of-living increase.

The way to control program expenditures and minimize projected budget deficits is not the imposition of an arbitrary ceiling, but the creation and application of an effective micropolicy to restrain exorbitant price increases in noncompetitive markets and coordinate this with a flexible macropolicy to restrain excess aggregate demand inflation in the event it begins to develop.

It must be recognized that the social security system is very sensitive to the performance of the economy. As a result of the conjunction of high rates of inflation, high unemployment and declining fertility rates, additional financing is needed for the system. We have been advised that the difference in projected cost to the system as a result of a 4 rather than 3 percent assumed long-rate term of inflation is in the area of 40 percent, because of the way the system was cost indexed in 1972, increases in the price level centered twice into the computation of future benefit amounts.[1] We would wonder

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[1] Benefit amounts are determined by two major factors: "Average monthly wage" and the benefit table. The table is directly related to CPI. The average monthly wage also tends to rise as prices increase.

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if the rate of inflation, the long-term rate of inflation will not be nearer 6 percent. While the issue of new financing for social security must be considered immediately by the Congress, it may also be possible to desensitize the system somewhat by revising the method of computing future benefits so that a continuation of high rates of inflation will not generate an explosion of future social security benefit levels.

MEDICARE AND MEDICAID CUTBACKS

The administration's proposed curtailments in medicare and medicaid as a means of restraining health care inflation-induced increases in Federal spending under these programs, completely ignores the increasing cost burden on the program beneficiaries that has resulted from this same inflationary trend. Medicare now covers less than 37 percent of the aged's annual health care bill. Inflation-induced increases in expenditures under these programs would best be remedied by restraining inflation in the health care market.

Our associations have urged the administration to reimpose short-term health care controls at least over hospital charges.

The 17 percent inflation rate in health care that followed the end of controls last April was entirely unacceptable, especially in view of our understanding that the controls that were in place were designed to allow a complete passthrough of increased costs. While this rate may have moderated recently, we fully expect a return to the pre-1971 experience when health care inflation annually exceeded inflation for the economy as a whole.

While our associations favor controls over health care, what are urgently needed are fundamental reforms that would make such controls unnecessary in the future. We are convinced that current cost-reimbursement procedures must be abandoned in favor of payment procedure reforms in medicare now and in my program of nation health insurance that may be enacted. Such reforms include prospective approval of institutional providers' annual budgets—with medicare payments made on the basis of those budgets—and schedules of charges prepared according to standard accounting procedures. These procedures for institutional providers should be complimented by negotiated fee schedule procedures for licensed professional practitioners. If, following the termination of controls, such reforms are found to be inadequate, then a more complete restructuring of the delivery of health care services will have to be considered.

Hospitals and other institutional providers are neither competitive nor profit-maximizing entities and have no incentive whatsoever to produce services of a given quality at minimum cost. The only economic restraint on increasing charges is the inability of the patient to pay. Health care inflation is about to leave aged in a position worse than the one that prevailed in 1965. Unless something is done very soon, the only ones to be found to have derived any lasting benefit from medicare and medicaid will be the hospitals, the physicians, and other providers and practitioners.

CONCLUSION

In conclusion, Mr. Chairman, I would like to reiterate, the poor and fixed-income aged have suffered a great deal as a result of the

inflation-recession experience of 1974. Moreover, the income maintenance system upon which they depend for a substantial portion of their income is seriously threatened by a continuation of this combination.

In the giant shell game; that is, the administration's energy, tax relief and budgetary proposals, the poor and fixed-income aged will be very big losers. Our associations have urged the Congress to reject these proposals, to take the initiative in developing a comprehensive economic and energy program that treats all population groups fairly, and to enact that program even over the flurry of executive branch vetoes that must be anticipated. In these efforts, the Congress will have the aid and counsel of our associations and the nearly 8 million persons they represent.

Representative BOLLING. Thank you very much, Mr. Borsodi.

[The statement referred to for the record in Mr. Borsodi's statement follows:]

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS ON THE ADMINISTRATION'S ENERGY-TAX RELIEF AND BUDGETARY PROGRAMS, THEIR IMPACT ON THE POOR AND FIXED-INCOME AGED AND THEIR SUFFICIENCY TO ACHIEVE THE GOALS OF THE EMPLOYMENT ACT OF 1946

I. THE BACKGROUND: INFLATION-RECESSION

The Commerce Department's year-end data[1] on the performance of the economy is conclusive: The United States is experiencing, with the exception of the post-World War II readjustment period, its worst economic recession since the late 1930's and, simultaneously, the highest rate of inflation on record.

As advocates for the aged, our Associations cannot ignore what is happening in the economy nor what can be expected to happen if the Administration's energy, tax relief and budgetary programs are implemented. The interests of the aged cannot be separated from the interests of the population as a whole, nor can the systems upon which the aged are so dependent for a substantial portion of their income security be considered out of the context of the performance of the economy in which they exist.

Let it be understood at the outset—inflation-recession is the most serious threat to the income security of the poor and the fixed-income aged at the present time and is seriously jeopardizing the financial integrity of the income maintenance structure on which millions of them are dependent. Let it also be understood—the extortionately high prices artificially established for oil, both at home and abroad, are responsible for much of this current situation.

It is our conclusion that the Administration's programs (including its tariff,

[1] "Real" GNP, the adjusted value of the economy's total output of goods and services, declined at an adjusted annual rate of 9.1 percent in 1974's final quarter and left real GNP for the year a decisive 2.2 percent below 1973.

Personal consumption expenditures fell $4.5 billion in the fourth quarter to an adjusted annual rate of $896.8 billion—the first such decline since the first quarter of 1960 and the most dramatic since the first quarter of 1951. It reflects a $14.6 billion decline in fourth quarter consumer demand for durable and non-durable goods alike. Further reflection of this decline in demand is the rate of increase in business inventories from an $8.7 billion third quarter annual rate to a $13.4 billion fourth quarter annual rate.

With respect to unemployment, the latest Labor Department statistics indicate an 8.2 percent rate.

The decline in consumer spending and business fixed investments and the increase in personal savings (which accelerated from 6.6 percent of disposable income in the third quarter to 8.5 percent in the fourth quarter) reflect increasing consumer and business anxiety over the deepening recession.

Although consumer demand is way down, the rate of inflation accelerated from an 11.9 percent third quarter annual rate to a 13.7 percent fourth quarter rate. For the year, inflation was 10.2 percent (as measured by the GNP deflator)—almost twice the 5.6 percent 1973 rate.

In January, the government's index of leading economic indicators fell 1.3 percent from 159.4 percent to 157.4 percent of the 1967 average.

The decline matches the September 1957 through February 1958 decrease which was the most prolonged on record. But the current decline is much steeper—12.6 percent (from last July's peak) compared with 9 percent during the 1957 to 1958 period.

excise and windfall profits taxes, "new" natural gas and "old" oil deregulation, tax relief and budgetary cutbacks) will substantially aggravate that situation, will have disproportionately greater adverse consequences for the poor and the aged—the very groups that have already suffered the most, and will leave us far from the goals of high employment, stable prices, a reasonable rate of economic growth, and relative equilibrium in the country's international balance of payments.

II. INFLATION-RECESSION AND THE AGED INDIVIDUAL

For the poor and fixed-income aged, the combination of inflation, recession and unemployment during 1974 was catastrophic. With less purchasing power to begin with, these groups have suffered the most from inflation. While the magnitude of their dollar income decline may not have been as great as that of other groups, the decline was from a level that was, at best, marginally adequate.

A recent study [2] by the staff of the Joint Economic Committee of the Congress indicates that, while the cost of living rose about 14.5 percent for intermediate and higher budget family units because the items which constitute a relatively larger share of these groups' budgets—housing, transportation and taxes [3]—rose faster than other items, the cost of living of the lower budget group rose by 14 percent.[4] Moreover, economic forecasters are predicting that lower budget families are more likely to face 1975 budget cost increases higher than those faced by families at higher income levels (thus repeating the 1973 cost-of-living experience) since food, which constitutes a disproportionately larger share of their budget, is expected to rise faster in price than other items.[5]

We are not suggesting that all the aged are poor. We wish to point out, however, that 45.3 percent of the aged have total money income of under $4,000 per year [6] and older family units now tend to be concentrated more in the lower and less in the upper extreme of the national income distribution.[7] Although recent increases in OASDI benefits have reduced the number of aged in the poverty class to under 3.7 million, the incidence of poverty and low income is still substantial. In 1973, 16 percent of the aged were below the defined level of poverty compared with 11 percent for the total population.[8] Because of the higher rates of inflation with respect to necessaries such as food [9] and housing, on which the poor and fixed-income aged tend to spend far higher portions of their total income,[10] they have, over the last three years,[11] suffered

OASDI benefits, while almost universal among the aged, are wholly insufficient as a source of income. By extrapolating the 1973 Bureau of Labor Statistics' Autumn Budget for a Retired Couple to July of 1974, the Joint Economic Committee of the Congress found that even the $3,951 income for the lower level budget was more than $200 in excess of the average social security payment for retired couples at that time.[12] It must also be kept in mind that for over 50 percent of all OASDI recipients, cash benefits are their principal and in many cases their only source of income.

The impact of the recession and its present 8.2 percent unemployment rate has rendered even more difficult, if not impossible, any moderation of the

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[2] Staff of the Joint Economic Committee, "Inflation and the Consumer in 1974," 94th Cong., 1st Sess. (Feb. 10, 1975) (hereinafter referred to as Joint Eco. Com. Staff Study).

[3] The rate of increase in personal income and social security taxes (as a result of inflation) were higher than the rate for all other consumption items in 1974. Real disposable income declined precipitously last year largely as a result of increases in taxes as a percent of total income. Because of inflation, this is the first recession in which the tax burden has actually risen rather than fallen. Joint Eco. Com. Staff Study, at 7 and 20.

[4] *Id.* at 9.

[5] *Id.* at 10.

[6] See Table I in the Appendix.

[7] See Table II in the Appendix.

[8] Applied Management Sciences, "A Study of the Effects of the Energy Crisis on the Low and Moderate Income Elderly," prepared for the FEA, 6.2 (Feb. 5, 1975) (hereinafter referred to as Energy Crisis Study).

[9] The Joint Economic Committee reported that food price inflation in the past 18 months has added twice as much to the cost of living of the poor as to that of the average urban worker. (Joint Economic Committee, "Achieving Price Stability through Economic Growth," H. Rept. No. 93–0000, 93d Cong., 2d Sess.) (Dec. 23, 1974) (hereinafter referred to as J. Eco. Com. Rept.).

[10] See Table III in the Appendix.

[11] See Table IV in the Appendix. (Reproduced from the Joint Eco. Staff Study, at 28).

a relatively greater loss of purchasing power than other groups.

[12] Joint Eco. Com. Rept., at 53.

impact of inflation through increased income from active employment. Even in the best of times, the aged encounter a formidable combination of barriers to employment.[13] With an increasing number of workers competing for a diminishing number of jobs, the employment alternative, as a means of sustaining purchasing power, is for most of the aged, out of the question.

III. INFLATION-RECESSION AND THE INCOME MAINTENANCE SYSTEMS

If our Associations are concerned with the impact of inflation-recession on the aged individual, we are equally concerned about its impact upon the financial viability of the income maintenance programs such as social security upon which the aged are so dependent.[14] With the OASDI trust funds sufficient to continue benefit payments for only nine months in the absence of a continuing influx of payroll and self-employment tax revenues, and with social security cash benefit levels subject to automatic increases that are directly related to the cost of living, the performance of the economy is of critical importance.

Workers who are unemployed are not paying social security taxes. High rates of inflation trigger automatic benefit increases which, in turn, must be financed by contributions from a diminishing number of active workers. Such circumstances cannot fail to aggravate the 3 percent, long-range deficit that is already projected for the system.[15]

Since the projections of the revenue needs for the social security system are based on assumptions that are dynamic with respect to demographic changes and future rates of inflation, we are concerned when we compare the high rates of inflation which the Administration is contemplating and apparently willing to tolerate right through 1980 with the far lower rates used by the social security system to estimate its future financing needs.[16]

We have been advised that the difference in projected cost to the system as a result of a 4 rather than a 3 percent assumed long-term rate of inflation is in the area of 40 percent.[17] The future of the social security system (or of any other primary retirement system) is critically dependent upon the maintenance of a reasonably low rate of inflation and a reasonably high rate of employment.[18]

In view of the sensitivity of the system to economic performance and the number of beneficiaries who are dependent on it (OASDI pays approximately $5 billion each month to 30 million persons) we are not about to remain silent while the Administration proposes and proceeds to implement energy, tax relief and budgetary programs that will combine to destabilize the economy further and aggravate, over the long term, the economic problems of our constituency and the income maintenance structure on which they are dependent.

IV. MACRO AND MICRO EFFECTS OF HIGHER ENERGY PRICES

According to the Joint Economic Committee, soaring energy prices in 1974 resulted in a $30 billion direct redistribution of income from domestic consumers to domestic and foreign energy producers. Over one half of this

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[13] The combination includes: labor union restrictions, mandatory retirement policies and the social security retirement test.

[14] See Table V in the Appendix.

[15] See Table VI in the Appendix.

[16] The Administration projects percent changes in prices, as measured by the CPI of 11.3, 7.8, 6.6, and 4 for 1975, '76, '77, and '80 respectively while the Social Security System estimates, for the same calendar years, maximum rates of 7.1, 5.5, 4.8 and 4.0. See Tables VII and VIII in the Appendix.

[17] An independent panel's report recently submitted to the Senate Finance Committee confirmed the seriousness of the long-range financing problem indicated in the 1974 Trustees' reports. However, the panel's estimate of expenditures as percentages of taxable payrolls even exceeded those in the trustees reports because: (1) the panel assumed that fertility rates will continue a downward trend until 1980; and (2) the panel assumed a long-term inflation rate of 4 percent a year (rather than 3 percent). The panel concluded that the long-range financing difficulties of the OASDI program are attributable jointly to the expectation of an increased ratio of OASDI beneficiaries to the working population and the nature of the benefit formula. The deficit the panel projected was twice that of the trustees' report. See Table IX in the Appendix. (See Report of the Panel on Social Security Financing to the Com. on Finance, 94th Cong., 1st Sess. 2 (Feb., 1975) (hereinafter referred to as Panel Rept.).

[18] Much of the sensitivity of the system to economic performance arises from the way in which the system was cost-indexed. Benefit amounts are determined by 2 major factors: the "average monthly wage" and the benefit table. The table is directly related to in the CPI. The average monthly wage also tends to rise as prices increase. Hence, increases in price level enter twice into the computation of benefit amounts. (See Panel Rept., at 16.).

enormous sum is estimated to have gone to domestic producers and an additional amount has been paid to U.S. companies for imports of foreign oil or oil products.[19] This report concluded that, as a result of this transfer, about one fourth to one third of the 12 percent, 1974 increase in the consumer prices was attributable to higher energy prices.[20]

The Congressional Research Service, in a later report,[21] found that the combined increase in both domestic and foreign energy prices last year cost consumers directly $42 billion.[22] Of this sum, $21.6 billion was attributable to: (1) various legislated and administrated price increases for domestic oil amounting to $10.1 billion; (2) unregulated natural gas price increases in intrastate gas markets, costing users about $5.6 billion; and (3) increased domestic coal prices, costing users $5.9 billion.[23] This report concluded that direct energy price increases accounted for 25 percent of last year's rate of inflation, and when combined with the secondary or "ripple" effects, could have accounted for 35–50 percent.[24]

Certainly our Associations have no doubt that sudden and exorbitant increases in energy prices have resulted in an enormous transfer of purchasing power from consumers to domestic and foreign energy producers and have contributed substantially to the inflation that last year left the domestic consumer with significantly reduced real disposable income.[25] We therefore agree with the general consensus that, in order to reduce our reliance on foreign imported oil and our vulnerability to international trade disruptions, a comprehensive energy policy must be formulated that will reduce demand for energy, promote conservation and stabilization of energy prices, and still provide the incentives necessary to encourage the efficient development of the energy potential of the United States.

With these objectives, the Administration's energy program is supposedly in accord. Our Associations expect, however, that the actual consequences of the proposed program would be: (1) accelerated inflation, (2) continued and deepening recession, (3) increased portions of consumer budgets devoted to energy, (4) another massive shift of wealth from consumers to the energy industry, and (5) permanent energy prices at levels wholly unjustified by the supply response.[26] Moreover, as we shall indicate below, we feel the Administration's program is founded upon premises at variance with the evidence with respect to the oil-natural gas industries.

The Administration estimates a direct, annual cost of $30 billion for its program.[27] The direct and ripple effects of its proposed energy program on average family expenditures range from $275–$345. The increased fuel expenditure impacts of the program in terms of dollars and percentages of total income for the poor, the lower and upper middle, and high income groups are estimated to be $82 (3.3 percent), $129 (1.6 percent), $189 (1.3 percent), and $225 (.9 percent) respectively. The program is expected to produce a 2 percent increase in the Consumer Price Index over what would have otherwise obtained.

The Congressional Research Service, on the other hand, estimates that the Administration's program would have direct cost consequences to consumers of $50.3 billion in 1975. Average family expenditures for energy would increase $720, including both direct and ripple effects. Its estimates of the increased energy cost for the poor, the lower and upper-middle, and high income groups

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[19] Joint Eco. Com. Rept. at 104.

[20] *Id.*

[21] See Lawrence Kumins, Cong. Research Service, Library of Congress, "Administration's Energy Tax Proposals and Related Measures," (Jan. 23, 1975) (hereinafter referred to as CRS Rept.).

[22] According to the Bureau of Mines, U.S. energy costs increased by over $33 billion in 1974: $17 billion for imported oil, $11 billion for domestic oil, $1 billion for domestic natural gas, and $4 billion for domestic coal. See Staff of the Com. on Interior and Insular Affairs, "Economic Analysis of President Ford's Energy Program", 94th Cong., 1st Sess., Serial No. 94–4 (92–94) at p. 7, (1975) (hereinafter referred to as S. Interior and Insular Affairs Com. Staff Rept.).

[23] CRS Rept., at 1–2.

[24] *Id.* at 2.

[25] See Table X in the Appendix.

[26] The Senate-House Democratic Task Force's Report states: "Adding at least $30 billion in taxes and costs on domestic oil and gas consumption proposed by the Administration, would further burden the economy with such weighty impediments that any effort at economic recovery would be hopelessly foredoomed. (See "Congressional Program of Economic Recovery and Energy Sufficiency," 2 (February 1975)).

[27] This figure does not take into account the ripple effects according to the S. Interior and Insular Affairs Com. Staff Rept., at 1.

are $341, $530, $694, and $1,017 respectively. The Service concluded that the program could increase the 1975 estimated rate of inflation of 6-7 percent to 9-10 percent—even before considering the ripple effects.[28] If these latter effects are included, double-digit inflation is likely to continue.

The analysis of the Administration's program prepared by the staff of the Senate Committee on Interior and Insular Affairs, concluded that energy-related costs to U.S. consumers would increase by approximately $43 billion in 1975 and ultimately by $50 billion annually (not including ripple effects) as fuel supply contracts expire or are renegotiated to reflect higher prices.[29] The energy bill for an average family of four would increase by over $800.[30] The estimates, contained in that report, of the effects of increased energy prices on the poor, the lower and upper-middle, and high income groups are $336, $505, $748, $944 respectively [31]—figures that do not differ substantially from those found by the Congressional Research Service (although the latter's estimates included ripple effects that the former's apparently did not).

In criticizing the Administration's $250 energy cost increase per average family, the Committee staff report states:

"[T]his estimate is a clear misrepresentation of the real impact of the program on the American household. * * * [This] $250 [amount] is only a third of the real cost of the program to an average American family.

"The difference is that the estimate includes only direct purchases of fuels and electricity by households. The additional impact of energy costs because of their pass-through in the price of all goods and services dependent on energy, is nearly three times as large as the direct purchases of fuels and electricity by households. These costs all reach the consumers; no one else pays them. Indirect energy costs arise from the increased prices for every item which must be transported before it is sold: food, clothing, construction materials, manufactured goods. Indirect energy costs arise from increases in the price of basic materials which are produced with a large energy input: glass, steel, cement, aluminum, petrochemicals." [32]

By examining Table XI in the Appendix the disproportion between added energy costs and ability to pay is clear. The poor must find extra cash to pay for a third as much energy as the high income even though their income is only one tenth as large. Moreover, since the aged poor, who consume less energy than any other age group—including the non-aged poor—are already spending a higher proportion of their budget on energy costs,[33] higher energy prices will mean even less fuel consumption or smaller budget portions available for other necessaries such as food and housing.

Our Associations, having examined evidence such as this, cannot but conclude that the burden of the Administration's energy program to achieve a reduction in energy use through higher prices will devolve heavily on those with the least ability to pay—and most heavily on the aged poor.

V. RATIONALE FOR THE ADMINISTRATION'S ENERGY PROPOSAL

The theory of the Administration's program is that high energy prices will discourage consumption and simultaneously attract the investment necessary to increase the supply of domestic fuel. Not only are our Associations opposed to the structure of the program, but we are unpersuaded by both aspects of its rationale.

Testimony given recently before the Senate Committee on Interior and Insular affairs seriously questions the justifiability of the degree of decrease in energy demand that the Administration assumes will result from a surge in energy prices.[34] That Committee's Staff Analysis indicates that, in response to the 1974 price increases, fossil fuel demand dropped only 2.4 percent from 1973 levels. It may be that the reduction that did occur may have been less a direct consequence of high prices and more the result of gasoline shortages, voluntary conservation, the inflation that those high prices generated and consequences of inflation such as higher taxes, reduced disposable income

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[28] CRS Rept., at 5.
[29] S. Interior and Insular Affairs Com. Staff Rept., at 5.
[30] *Id.* at 6–7.
[31] See Table XI in the Appendix.
[32] S. Interior and Insular Affairs Com. Staff Rept. at 11.
[33] See "Energy Crisis Study", 6.1.
[34] S. Interior and Insular Affairs Staff Rept. at 17.

and the current recession. In any event, the reduction in demand that was achieved last year hardly seems worth the shock to the domestic economy that the doubling and quadrupling of domestic and foreign crude oil prices produced.[35]

Not only is the validity of the energy demand elasticity assumption upon which the Administration's program is predicated questionable, but in view of the current recession, the inflation that the program would generate, and the additional shock to the economy that would occur, this is hardly the appropriate time to test the validity of the theory of reasonable negative energy demand elasticity.

Furthermore, a reasonable domestic supply response to higher prices is also questionable. While our Associations believe that it is important to provide the price and profit incentives necessary to expand domestic production of oil and gas, we also believe that excessive concentrations of market power in these interrelated industries may produce high prices and profits without any reasonable supply response in the absence of policies designed to restore workable competition to these industries.

With imported, "new" domestic and "old" domestic oil selling in the marketplace at $12, $11 and $5.25 per barrel, respectively, with federal income tax subsidies to mineral producers totalling nearly $3 billion per year, and with oil industry prices and profits at record levels, we do not believe that immediate higher prices are justified or necessary as a stimulus to increased domestic production. Moreover, with constraints in the capital goods markets, higher prices for domestic oil will add nothing to the supply incentives but will add inflationary pressure within the economy.

VI. REASONABLE POLICIES TO REDUCE ENERGY DEMAND AND STIMULATE DOMESTIC ENERGY PRODUCTION

In order to decrease the domestic demand for foreign oil, the prices for which are administered (set without reference to world supply and demand), by the OPEC nations, our Associations have concluded that a reasonable policy response to achieve a gradual reduction in energy demand without generating adverse inflationary effects should include: (1) a "white market" gasoline rationing system or a rebatable gasoline tax; (2) an import quota with respect to foreign oil; (3) a phased-in, gradual excise tax (at time of purchase) on new and used automobiles and pleasure-craft (based on vehicle weight and horsepower); and (4) a stand-by mandatory fuel allocation system.

The automobile accounts for 50 percent of fuel consumption in the transportation sector, which itself consumes 25 percent of all energy; a reduction in gasoline consumption therefore, would do more to reduce petroleum consumption and would do it with less consumer and economic hardship, than reduction in the consumption of any other petroleum product. Since the aged poor spend significantly higher portions of their budgets on heating fuel and utilities than higher income households, but lower portions on transportation, a reduction in gasoline use would impact the least the group that has already reduced its energy consumption to the minimum.[36] Consequently, our Associations could support either a "white market" gasoline rationing system or a rebatable gasoline tax, both of which can be made to be equally equitable. However, in order to assure that any reduction in energy demand is realized in terms of decreased imports rather than decreased domestic production, an import quota, phased in over a period of years in conjunction with the rationing system or gasoline tax should be used.

With respect to the automobile, a steeply graduated excise tax based on weight and horsepower in excess of minimum prescribed levels should be phased in. In addition, vehicle engine efficiency must be monitored and mileage standards must be prescribed for new automobiles until they reach, by 1980, the required minimum average of 25 miles per gallon on the range of automobiles offered for sale by a manufacturer. If the choice is between less size, comfort and "extras" in the automobile, or less heat in the home, our Associations prefer the former. The longer a shift to fuel-efficient automobiles is delayed, the more difficult will be the task of managing future fuel shortages.

[35] *Id.* at 9.
[36] "Energy Crisis Study," at 6.3.

In order to meet any emergency shortage of petroleum, a standby, mandatory fuel allocation program must always be available and ready for immediate implementation. The goal of such a system should be to distribute resources geographically among various sectors of the economy in order to insure that all share the shortage in a reasonably equitable manner.

In selecting a combination of options to reduce energy demand, the Congress must, of course, take into account a number of moderating factors. First, in considering a desired level of reduction in imports of foreign petroleum and derivative products, the impact of any such reduction on the available supply of fuel and the rates of inflation or unemployment must be taken into account. Second, the impacts of any excise tax on automobiles and any rationing system or rebatable gasoline tax on the depressed condition of the automotive industry must also be considered. It seems to us desirable to phase in demand reduction policies over a period of time to allow stimulative fiscal and monetary policies a reasonable opportunity to take effect and revive the economy.

As a means of stimulating domestic production, our Associations do not believe that another dramatic increase in prices is the best answer. Instead, we believe that efforts should be made to promote competition and facilitate entry into the oil and gas markets. We have heretofore expressed support for legislation to break up the vertical integration existing in these industries and to prevent control over multiple-energy sources by individual companies. Concomitantly, we have urged the establishment of an independent, public corporation to explore for and develop oil and natural gas reserves in the federal domain to stimulate competition and to provide a much needed yardstick with which to measure profits, costs, and production techniques. Furthermore, we believe it necessary for the Department of Interior to substitute a "royalty bidding" policy for its present "bonus leasing" procedures which tend to preclude entry into the federal off-shore production areas by small producers. Finally, the Congress must prohibit the practice of extending off-shore leases beyond five years after lease sales without requiring production and must assure that forfeiture is strictly enforced.

With respect to natural gas, our Associations have already expressed their support for the Natural Gas Production and Conservation Act. We feel that it will provide adequate price incentives to elicit the natural gas supply increments necessary to eliminate the current shortage while simultaneously continuing price ceiling regulation to prevent oligopolistic pricing practices.

The failure of higher prices for domestic oil and gas to elicit a reasonable supply response in the past, indicates to us an absence of workable competition and excessive market power in the hands of a few corporate entities. In a market dominated by a few producers, where cooperation rather than competition prevails, the principles that operate in competitive markets do not apply. It is precisely the absence of workable competition that undermines the Administration's high price-increased supply rationale for its energy program.

In an oil-gas oligopoly, higher prices for gas are likely to be used to justify even higher prices for oil, coal and other energy products—thus accelerating the current inflation and generating disastrous consequences for the poor and fixed-income aged.

Producers and the Administration seem to agree that the artificial prices established for OPEC oil should be used as the basis for "new" domestic gas and "old" domestic oil prices. It is ironic that, while the Administration is opposed to artificial pricing practices in the international market, it is willing to tolerate these same practices in the domestic market.

It is the cost of finding, developing and producing gas and oil that should be determinative of field prices (and would be if the markets were competitive). The ability of the domestic oil and gas industry to boost the prices for that portion of oil and gas that is not under price ceiling regulation to the artificial levels established by the OPEC cartel is further indication of industry non-competitiveness.

VII. THE IMPACT OF THE ADMINISTRATION'S TAX RELIEF PROPOSALS ON THE POOR AND FIXED-INCOME AGED

While we have commented separately with respect to the Administration's energy proposals, our Associations recognize that the Administration's tax relief (including the $80 payment) proposal in its fiscal 1976 budget is an

integral part of the same package and is intended to offset higher energy costs and stimulate the economy. According to Administration estimates,[37] the tax rebate will offset the average increase in direct costs of the poor and of the upper-middle income families and significantly offset the costs of the lower middle-income group.

Our Associations believe that these conclusions, especially with respect to the poor, are erroneous. First, there is good reason to believe that the Administration's estimates of increased energy costs for family units at different income levels are substantially understated. Second, since the tax relief program lacks a negative income tax aspect (availability of the intended tax relief is conditioned solely upon the presence of income tax liability), the poor and the non-poor living on non-taxable income can expect to receive only the $80 payment and little or no tax relief.

Since only 4.5 of the 6.8 million returns filed by the aged in 1971 (the last year for which our Associations have comprehensive IRS statistics) were taxable returns, only about 5.8 million persons (66 2/3 of 8.7 million) had some federal tax liability.[38] It should be clear that the aged who are taxpayers are a distinct minority within their own age group; they can therefore expect to receive a disproportionately small share of the intended tax relief.

In evaluating the merits of any proposed tax relief mechanism, our Associations must object to a mechanism that conditions the availability of relief solely on tax liability. We must also object to any mechanism which disproportionately benefits those in higher income tax brackets.

With respect to our first criterion, we fully appreciate the policy significance of a tax relief mechanism that is in the nature of a negative income tax. However, it is the poor and the fixed-income aged who have suffered the most from inflation and who could expect to suffer even more as a result of the Administration's energy program. Moreover, since the purpose of tax relief is to stimulate demand and create jobs, the relief dollars should be placed in the hands of those most likely to spend them—the poor and the aged. This could not readily and efficiently be done in the absence of such negative tax devices.[39]

With respect to our second criterion, we wish to point out that the tax benefit distribution of the Administration's tax rebate proposal would probably benefit more those in higher income tax brackets[40] and could not therefore have our support.[41]

Considering both the energy and tax relief aspects of the Administration's package, we believe that the results will be, with respect to the poor and

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[37] See Tables XII, XIII, and XIV in the Appendix.

[38] Derived from Tables XV and XVI in the Appendix.

[39] Certainly it would be possible to channel increased income to some of the poor and fixed income aged to have no federal tax liability through existing programs such as Aid to Families with Dependent Children and Supplemental Security Income. But these programs do not reach all of the poor nor do they reach all of the aged who are not poor but have no tax liability. Indeed, the Supplemental Security Income program is, according to the Joint Economic Committee, presently providing benefits to less than one-fourth of the estimated 1.2 million potentially eligible individuals.

Although our Associations have consistently urged welfare reform (taking into account what has already been done with respect to the substitution of the SSI program for the former federal-state adult assistance programs), we cannot realistically expect comprehensive welfare reform, despite the need therefore, to be achieved in time to enable the aged and non-aged poor to benefit from the proposed tax relief. Since these groups cannot be fully reached if relief is contingent solely upon liability, we recommend a mechanism to provide both permanent tax relief to taxpayers who have, in the absence of such relief, federal income tax liability, and temporary relief to persons who would have no liability. The temporary period should be sufficient to provide the Congress ample time within which to determine upon the comprehensive program of welfare reform that would coordinate the "needs" programs with the federal income tax system and with the primary retirement systems such as OASDI, railroad retirement and civil service.

[40] See Col. 5 of Table XVII in the Appendix. The refunded amounts for different income categories projected as percentages of "adjusted gross income" tend to support the disproportionate distribution we expect.

[41] Our Associations have expressed support for H.R. 2166, the $21.3 billion Tax Reduction Act of 1975. But our support is not without qualification: 63.6 percent of the $8.1 billion rebate with respect to 1974 taxes is intended for the benefit of taxpayers with AGI between $7,000 and $20,000. While this group was confronted by the largest percentage increase in taxes last year, the absence of a negative tax aspect to the rebate (eligibility is contingent upon actual tax liability) will mean that the poor and non-poor aged living on nontaxable income will not share to any extent in the intended relief. Even the Administration's proposal would have provided an $80 payment for these groups.

Our Associations are aware that the $8 billion individual income tax reductions of title II of the bill (which includes an increase in the low income allowance and the percent standard deduction, and a refundable earned income credit) would reduce the federal income tax burden with respect to aged taxpayers and remove many of them from the tax rolls. In view of the relatively small number of aged individuals who are

the fixed-income aged, higher prices and little relief. While for some population groups, the Administration's energy-tax relief program would mean a "taking with one hand" and a "giving with the other", for much of our constituency, the program would simply mean a "taking".

VIII. THE BUDGET: IN THE CONTEXT OF INFLATION-RECESSION

The current combination of 12 percent inflation (caused to a large degree, by higher energy and food prices and by "administered" [42] pricing practices in non-competitive markets), high rates of increase in federal income and social security taxes (resulting from wage and salary increases achieved by workers as they attempt to keep up with inflation), and declining real disposable income have contributed substantially to the current recession. With the rate of unemployment at 8.2 percent (and rising) more than 7.5 million workers cannot find jobs. Instead of working and paying taxes, these workers are unemployed and receiving unemployment compensation or perhaps welfare.

Substantial underutilization of the capacity of the economy to produce goods and services would seem to require a shift from the restrictive macroeconomic policies (including the monetary aspect thereof) which were being pursued to control inflation (without great success) to stimulate policies designed to put people back to work.

Although inflation seems to be abating somewhat, the rate is still unacceptably high and will certainly be accelerated if the Administration's energy program is implemented. The Administration has conceded as much and projects a rate of inflation (as measured by the CPI) for calendar year 1975 of 11.3 percent.[43] With repeated expressions of concern over inflation and the size of recent budget deficits emanating from the Administration, the fiscal 1976 budget should not have been expected to be a highly stimulative one. It certainly is not, despite the $52 billion deficit it contains. Indeed, the budget seems to reflect a deliberate attempt to avoid overly stimulative fiscal policy that might, at some point in the future, produce the type of inflation that results from excess aggregate demand within the economy.[44]

With so many members of the work force unemployed, paying little or no income (or social security) tax, and receiving unemployment compensation, the effect on the budget is a projected deficit of $52 billion—an enormous figure that is of obvious concern to the Administration. In view of the continuing high rate of inflation (that has substantially eroded individual purchasing power), the higher energy costs (and their inflationary impact) that the Administration's program entails, and the rapid rates of increase in social security and income taxes (which helped to offset the higher wages and salaries received by workers attempting to keep up with inflation), a reduction in federal taxes was certainly indicated, if only to replace income purchasing power lost during the past year. The budget provides for such a tax reduction. At the same time, however, the budget reflects a conscious effort to restrain total federal expenditures by, among other things, imposing arbitrary ceilings on existing programs, thus minimizing the projected deficit.

Our Associations have have examined the budget. We do not believe it is sufficiently stimulative to accomplish what are the most critical objectives at the present time—putting people back to work and restoring a healthy rate of growth in real economic output. The rates of unemployment which the Administration's budget is apparently willing to tolerate right through 1980 [45] are, to us, unacceptable. Moreover, these unemployment rates are some indication of the net stimulative effect of the tax reduction for which the budget provides. We think it quite likely that the additional dollars that will be left in the

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taxpayers, the tax reduction which the aged can expect to receive under H.R. 2166 will be disproportionately small.

Our Associations have, therefore, recommended for consideration by the Finance Committee the following amendment:

A negative aspect to the rebate intended to be provided with respect to 1974 taxes should be incorporated. The minimum rebate should be set at $100 instead of the "lesser of $100 or the taxpayer's 1974 tax liability" for which the bill presently provides.

[42] Certain industries possess the market power to boost prices (or maintain them at levels not justified by market conditions) even while demand for their products or services is declining.

[43] See Table VIII in the Appendix. Reproduced from Office of Management and Budget, "The United States Budget, In Brief: Fiscal Year 1976," 14 (January 1976).

[44] Inflation that results from excess consumer demand in relation to supply when the economy is producing at full, or nearly full, capacity.

[45] 8.1, 7.9, and 7.5 percent in 1975, '76, and '77 respectively, declining gradually thereafter to 5.5 percent in 1980. See Table VIII in the Appendix.

hands of consumers as a result of this reduction will fail to offset the losses that consumers have already suffered (in terms of inflation and higher taxes) or will suffer (as a result of higher energy prices, their inflationary consequences, and another round of higher taxes). The net stimulus of the proposed tax reduction may be zero or even negative.

Our Associations recognize that the budget contains a deficit of $52 billion. Moreover, it projects succeeding defiicits through fiscal 1978.[46] On the other hand, we also recognize that, if the economy were operating at "full"[47] employment, this budget would not produce a $52 billion deficit but a $12 billion surplus.

Certainly deficits of this magnitude are a cause for serious concern. But the far greater economic losses that result from a prolonged recession are even more serious. High rates of unemployment mean successive budget deficits and lost output. This latter consequence means that the pie which we all must share will be smaller than it might othewise have been. A loss such as this is never really retrieved.

Our Associations would prefer an even greater deficit this year, if incurring such a deficit would mean a more rapid return to a full employment economy. We are convinced that highly stimulative macroeconomic policies must be pursued for the purpose of restoring and sustaining a rate of growth in real economic output in excess of the low rates which the Administration's budget contemplates for this and succeeding fiscal years (roughly 5 to 6 per annum.)[48] We would be willing to trade an even greater deficit this year for deficits lower than those projected by the Administration for succeeding years.

Our Associations are fully aware that if highly stimulative macroeconomic policies were successful in revitalizing the economy, the type of inflation that results from excess aggregate demand would again become a problem. While there may be no "trade-off"[49] in the short run, as the volume of idle resources is being reduced, shortages will emerge in particular sectors and create inflationary pressures long before full employment is reached. At that point, adjustments in macro-policy will have to be made. But considering the excess capacity within the economy at the present time, this type of inflation is not likely to be the type with which we will be immediately confronted. Instead, we must contend with the type that results from excessive concentrations of market power in particular markets.

It must be recognized that the price setting power of certain industries comprises an inflationary force within the economy largely independent of market conditions and macroeconomic policy. Despite a substantial volume of unutilized resources within the economy, noncompetitive industries have the power to command excessive price increases even in the face of falling demand for their products and services. Macroeconomic policy ("tight" money and restrictive budget) as a means of dealing with this type of inflation, is not very effective[50] and is very costly.

IX. NEW TOOLS TO CONTROL INFLATION

While our Associations favor highly stimulative macro-policy to combat the current recession, we believe that a micro-policy (and a mechanism to imple-

[46] See Table VIII in the Appendix.

[47] "Full" employment has generally been considered to contemplate a rate of unemployment not in excess of 4 percent although that assumption is increasingly criticized as too low.

[48] See Table VIII in the Appendix.

[49] The Report of the Joint Economic Committee asserts that: "For 1975 and 1976, there will be no 'trade-off' between the goal of reducing unemployment and the goal of containing inflation. The rapid growth necessary to reduce unemployment is also essential to achieve the productivity gains needed to hold down costs and prices. In subsequent years, however, as the volume of idle resources is reduced, shortages may emerge in particular sectors and create inflationary pressures long before overall full employment is reached. Sectorial pressures should not divert attention from the goal of full employment. However, as the economy approaches full employment, it is important that policies be directed to avoiding both excessively rapid rates of overall economic growth and sudden large increases in demands on particular sectors. See Joint Eco. Com. Rept. at 12–13.

[50] The experience in the automobile industry is a good illustration. Although it experienced its worst sales record in over a decade in model years 1974–75, prices were raised faster than ever before. Despite sluggish sales, large inventory and production cutbacks, prices were marked up sharply. With market powers so excessively concentrated, the automobile industry was at liberty to raise prices at will despite the highly restrictive macroeconomic policies (both monetary and fiscal) that were being pursued to restrain inflation and that were producing declining consumer demand for goods and services. It has taken a virtual depression in the automobile industry to break the administered pricing practices there. See Joint Eco. Com. Rept. at 30.

ment it) must be perfected to deal with the type of inflation that results from excessive concentrations of market power in the hands of many of our basic industries. No economic program that attempts to deal with inflation while ignoring recession or with recession while ignoring inflation will be successful.

Our Associations agree that prices have a special role over and above indicating how much income is to be given out for a particular good or service. The pricing system serves as an allocator of resources between competing demands, "signaling" producers to expand production of some goods or services and to contract the production of others. We know that the pricing system, reflecting a change in consumer preferences, sets in motion a chain of events which automatically increases the production of the goods necessary to satisfy this increased demand. This process does not require government fiat for the expansion of output or the reduction of alternative outputs. It is accomplished strictly on the basis of free and voluntary exchange between economic agents without the need for government intervention. When prices are not free to rise, the result is permanent shortages. Yet our Associations see a very definite rationale for government intervention with respect to specific markets.

The above chain of events is that which occurs in competitive markets. If, however, new firms did not (or were not able to) enter an industry, over the long run, prices would not be driven back down because of restrictions on market entry. Extra high profits would continue and would not justify the increase in supply that may be forthcoming. This is the situation which occurs when markets are something other than competitive, and is a situation many economists believe to be the rule rather than the exception in the United States economy.

There are numerous industries in our economy, such as automobiles, steel, aluminum, chemicals, oil and cement where new entry does not occur (for a variety of reasons including enormous capital requirements) regardless of high rates of profit. These sectors are generally immune to the competitive pressures of the marketplace.

Because there is little, if any, new entry into these industries to expand supply, only aggregate demand policies can mitigate against price increases. But here, the government finds itself short of tools with which to confront the problem. Driving up interest rates to slow investment demand is muted by the retained earnings that excessive prices generate. Reducing demand directly by reducing government expenditures is also muted because these reductions directly impact primarily upon specific sectors—which may or may not be the appropriate ones.

In order to have an impact on noncompetitive markets, it is necessary to engineer a prolonged recession, driving unemployment to very high levels so as to reduce demand. Yet, driving up unemployment in order to break the pricing power of noncompetitive industries is politically unfeasible. This is the solution that the Administration was (and perhaps still is) pursuing to control our current inflation. The result has been a dramatic and, from the point of view of the individual citizen, a frightening experience. The other solution on which we have relied is antitrust action. Historically, this tool has been very ineffective.

In summary, then, our Associations do not believe that sufficient competition prevails to permit each market to control prices. The direct and indirect effects of fiscal and monetary policy are weak and require a good deal of time as well as unemployment cost. Finally, antitrust has not worked.

To us, some form of controls over noncompetitive markets is absolutely essential. If antitrust and other remedies aimed at restoring a viable degree of competition over controlled markets ultimately work, then such controls need not be a permanent device or would not have to apply to as large a number of markets as they do at the outset. Microeconomic policy should be viewed simply as another tool to stabilize the economy.

Certainly, there are ways and means of establishing the existance of noncompetition to the satisfaction of any reasonable man. When it can be demonstrated that excessive market power is preventing price declines in the face of falling consumer demand, when it is clear that the unemployment cost required to make the prices in these industries respond to these demand conditions is too high, when it is clear that antitrust action will take too long, clearly some government control is called for. To refuse to do so is to permit these industries large and continuing excess profits—profits which could not be justified on the basis of cost and fair rates of return—at the direct expense of society, other more competitive industries and consumers alike.

Our Associations' position is not to be construed as an endorsement of blanket economic controls such as those used during the economic stabilization period. What we are endorsing is the development of a flexible policy pursuant to which an agency of the federal government would have a broad mandate to intervene in particular sectors of the economy to prevent the untrammelled exercise of market power that has been a major contributor to recent inflation. To achieve this end, we think the Congress should delegate to the Council on Wage and Price Stability the authority: (1) to subpoena pertinent information on wages, prices, sales, costs and profits in industries where market power is concentrated; and (2) to delay for a limited period, actions which threaten to undermine progress towards price stability and which are unjustified by existing market conditions.

The continuing concentration of power and the proliferation of conglomerates and multinational corporations as the recent embodiments of that power, requires the creation of a countervailing power operating in the public interest. As long as we restrict ourselves to the use of the macro-instruments of monetary and fiscal policy, pretending that they are suitable for the treatment of all types of inflation, we will be limited to the primitive economic tactics of stop-and-go, boom-and-bust.

X. ARBITRARY CURTAILMENTS IN FEDERAL PROGRAMS: INCREASED BURDEN FOR THE POOR AND FIXED-INCOME AGED

1. General remarks

In order to facilitate the tax relief aspect of the budget, keep the projected deficit to a minimum and hopefully, restrain inflation, the fiscal 1976 budget contains a number of curtailments in expenditures for programs upon which the poor and fixed-income aged are highly dependent. In view of the impact of inflation over the past three years, the estimated impact of the Administration's energy program and the disproportionately small amount of tax relief that would be made available to these groups, these program curtailments are simply callous. Since the Administration's proposal to increase the cost of food stamps to recipients has been rendered moot by timely action by the Congress, our Associations will recind from commenting on this issue except to say that, in view of the extraordinary rates of increase in food prices and the impact these have had on the budget of the poor and fixed-income aged, and the high rates of unemployment, we cannot understand how this proposal coulld have been thought to be in the public interest.[51]

2. The 5-percent limitation

With respect to the Administration's proposal to impose an absolute 5 percent limitation for one year on cost-of-living increases in the cost-indexed, primary retirement and welfare programs, we wish to reiterate what we said at the White House Inflation Summit last autumn:

"We will vigorously oppose any reduction in benefit payments from, or any delays in scheduled cost-of-living increases under, income maintenance programs such as OASDI and SSI."

We appreciate the Administrations' concern with respect to the rate of growth of federal spending for income security programs. Perhaps there is also a feeling that the aged, who have been the chief beneficiaries of this increased spending, have gotten their fair share. Our Associations would point out, however, that as of 1966, one-third of the aged were living below the poverty level.[52] Even as recently as 1973, the median income of aged family units was only $4,441.[53] In view of the Joint Economic Committee finding that, for the past three years, the aged have suffered a relatively greater loss of

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[51] The Joint Eco. Com. Rept. at 52–53 states with respect to the food stamp proposal, the following: "[H]ouseholds with one or two persons would be hurt the most. Of these, 50 percent are over 60 years of age. An elderly individual receiving the current Supplemental Security Income (SSI) payment of $146 a month now pays $30 to receive $46 in food stamps, a $16 bonus. The President's amendment would increase the purchase price to $43.80, reducing the bonus to $2.20, a virtually negligible amount. Among food stamp recipients of all ages, those with the lowest incomes will experience the greatest percentage increases in purchase prices. The ultimate effect, therefore, will be a strong inducement for many to drop from the program. . . . "Food price increases have been harsh for most elderly, but absolutely devastating for some. A retired couple simply cannot spend 30 to 40 percent of their budget for food when rent or a mortgage may consume another 40 to 50 percent of their income."

[52] See Task Force of the Senate Special Committee on Aging, "Economics of Aging: Toward a Full Share in Abundance", 91st Cong., 1st Sess., p. vii (March 1969).

[53] See Table I in the Appendix.

purchasing power than higher income groups, this proposal is particularly ill-advised.[54]

Our Associations recognize that high rates of inflation trigger automatic benefit increases in social security, and other cost-indexed primary retirement and welfare systems, thereby increasing federal expenditures and the extent of the projected federal deficit. But the appropriate way to control increasing expenditures under these programs is not the imposition of an arbitrary ceiling, but the creation of appropriate machinery to restrain the exorbitant and unjustified price increases in noncompetitive markets that have contributed (along with food shortages and artificial petroleum pricing practices in the international market) to recent inflation.

3. Curtailments in medicare and medicaid

The consequences of continuing inflation in the health care industry have been these: on the one hand, the portion of the aged's health care bill that is paid for by Medicare has been declining to the point where the program now covers less than 37 percent of that bill; on the other hand, the program costs to the federal government have increased dramatically. In response, the Administration has proposed curtailments in the Medicare and Medicaid program.[65]

Our Associations suggest that inflation-induced increases in expenditures under these programs on which the aged are so heavily dependent for their health care protection, would best be remedied not by changes designed simply to decrease federal expenditures, but by remedies designed to restrain inflation in the health care market.

The Economic Stabilization Program was reasonably effective in suppressing the rate of inflation in health care charges. In the absence of controls, we have observed a surge in the rate of inflation in this particular market even higher than that which prevailed prior to the imposition of controls in 1971.

From the advent of Medicare until the imposition of the 1971 wage and price freeze, the annual rate of inflation in health care was approximately 11-13 percent. As the economy was gradually decontrolled after the 1971 wage and price freeze, we were provided with some evidence of what would happen if controls were retained over a limited number of sectors (including health care) while the remainder of the economy was under no controls. Inflation in health care during 1973 was about 10 percent. This we regarded as an improvement over the pre-1971 experience.

The 17 percent rate of inflation in health care that followed the expiration of controls was entirely unacceptable, especially in view of our understanding that the controls that were in place were designed to allow a complete pass-through of increasing costs. While this 17 percent rate may have moderated in the last few months, our Associations fully expect a return to the pre-1971 experience where inflation in health care annually exceeded inflation for the economy as a whole.

We do not consider it unreasonable to recommend that controls be imposed immediately over this sector which, by its very nature, is noncompetitive. If costs for hospitals (such as those for laundry services, food, wages, etc.) increase, the provider should be required to come in and justify to the Council on Wage and Price Stability the increased charges necessary to cover those costs.

While our Associations favor an immediate return to controls over the health industry, we also recognize the need to develop and implement fundamental reforms that would have such controls unnecessary in the future. We are convinced that current cost-reimbursement procedures, used not only by Medicare but by private insurers as well, must be abandoned in favor of payment procedure reforms in Medicare and any program of national health insurance that may be enacted. Such reform should require prospective approval of institutional providers' annual budgets and schedules of charges prepared according to standard accounting procedures. This should be complemented with a prospective payment procedure based on the institutional providers' budget. With respect to licensed professional practitioners, nego-

[54] Joint Eco. Com. Staff Study, at 4.

[65] The Administration has proposed increasing the cost-sharing under the Hospital Insurance program through the introduction of a 10 percent coinsurance rate after the $92 deductible. With respect to Supplementary Medical Insurance program, the Administration has proposed that the fixed $60 deductible be subject to automatic increases concomitant with percentage increases in social security cash benefits. However, as a partial offset, a maximum cost-sharing limit of $750 per year would be introduced into each program. With respect to Medicaid, a reduction in federal matching payments from 50 to 40 percent has been advanced.

tiated fee schedule procedures should be used. If, following the termination of controls, such reforms are found to be inadequate, then a more complete restructuring of the delivery of health care services may have to be considered.

Hospitals and other institutional providers are neither competitive nor profit-maximizing entities and have no incentive whatsoever to produce services of a given quality at a minimum cost. The only economic restraint on increases in their charges is the inability of a patient to pay. Although Medicare and private health insurance initially eliminated this crude restraint (and in the process, contributed to spiraling hospital charges), the aged are once again finding their access to needed health care blocked by their complete inability to pay. Health care inflation and Medicare's contribution thereto are about to leave the aged in a position worse than the one that prevailed in 1965. Unless something is done very soon, the only ones who will be found to have derived any lasting benefit from Medicare will be the hospitals, the physicians, and other providers and practitioners.

The Administration's proposed curtailments in the Medicare programs are apparently predicated on the "over-utilization" theory of health care inflation. While we concede that increased financial barriers to needed health services will restrain demand, they will do nothing to remedy the structural and procedural perfections which we believe to be the real causes of inflation in the health care market. Although demand reduction policies may have desirable effects in certain circumstances, we believes that such policies are wholly inappropriate in cases where inflation in a particular market is not the result of excess demand but the result of the market's structural imperfections.

XI. CONCLUSION

The poor and fixed-income aged suffered a great deal as a result of the inflation-recession experience of 1974. The income maintenance system upon which they depend for a substantial portion of their income is threatened by this combination. The Administration's programs will aggravate their economic situation.

In the giant shell game that is the Administration's energy tax-relief and budgetary proposals, the poor and the fixed-income aged will be very big losers. Our Associations therefore, have urged the Congress to reject these proposals, to take the initiative in developing a comprehensive economic and energy program that is fair to all population groups, and to enact that program, even over the flurry of Executive Branch vetoes that must be anticipated. In these efforts, the Congress will have the aid and counsel of our Associations and the nearly 8 million persons they represent.

APPENDIX

TABLE I.—1973 ANNUAL INCOME BY AGE[1] PERCENT OF POPULATION[2] BY INCOME LEVELS

Current total money income	Age 65 and over			Age 25 to 64		
	All consumer units	Families	Nonfamily persons	All consumer units	Families	Nonfamily persons
Under $1,000	2.8	0.8	5.3	1.9	1.0	6.2
$1,000 to $1,499	4.9	1.1	9.7	1.1	.5	4.2
$1,500 to $1,999	6.9	2.0	13.0	1.5	.8	5.0
$2,000 to $2,499	8.9	3.1	16.1	1.7	.9	4.9
$2,500 to $2,999	8.6	4.9	13.2	1.5	1.1	3.4
$3,000 to $3,499	7.1	5.5	9.0	1.7	1.3	4.0
$3,500 to $3,999	6.1	5.8	6.5	1.6	1.3	3.5
$4,000 to $4,999	10.8	12.4	8.9	3.9	2.9	8.5
$5,000 to $5,999	8.3	10.6	5.3	4.0	3.2	7.7
$6,000 to $6,999	6.3	8.8	3.2	4.2	3.6	6.7
$7,000 to $7,999	4.4	6.5	1.8	4.7	4.3	6.9
$8,000 to $8,999	4.0	5.7	1.8	5.1	4.7	6.8
$9,000 to $9,999	3.0	4.2	1.4	4.9	4.8	5.5
$10,000 to $11,999	4.5	6.7	1.8	10.9	11.4	8.8
$12,000 to $14,999	4.8	7.6	1.2	15.1	16.4	8.8
$15,000 to $24,999	6.0	9.9	1.3	26.8	30.8	7.4
$25,000 to $49,999	2.0	3.4	.4	8.4	9.9	1.2
$50,000 and over	.6	1.0	.1	1.0	1.1	0.5
Midpoint (median)	$4,441	$6,426	$2,725	$12,243	$13,500	$7,367
Arithmetic average (mean)	$6,696	$9,029	$3,772	$13,681	$14,965	$7,533
Percent under $4,000	45.3	23.0	62.2	11.0	6.9	31.2
Percent over $12,000	13.4	21.9	3.0	51.3	58.2	17.9

[1] Tabulation developed from table 25, Consumer Income Current Population Reports, P-60, No. 97.
[2] Age population based ol March 1974 Current Population Reports estimate.

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TABLE II.—FIFTHS OF FAMILIES RANKED BY SIZE OF MONEY, INCOME BY AGE, 1952, 1962, AND 1972—FAMILY INCOME

Age of head in years	Total			Lowest fifth			Second fifth			Third fifth			Fourth fifth			Highest fifth			Top 5 percent		
	1952	1962	1972	1952	1962	1972	1952	1962	1972	1952	1962	1972	1952	1962	1972	1952	1962	1972	1952	1962	1972
14 to 24	5.2	5.5	7.7	7.1	8.4	13.2	8.0	8.5	12.4	6.0	6.0	7.5	3.7	3.4	3.8	1.3	0.9	1.6	0.3	0.2	0.5
25 to 34	23.6	19.3	22.0	13.8	13.5	17.1	26.1	21.9	23.7	29.5	26.8	27.7	28.7	22.4	24.5	19.7	12.7	16.8	9.2	7.3	9.4
35 to 44	23.8	24.4	19.7	15.7	14.8	11.7	22.2	20.8	16.0	25.2	26.0	21.0	28.4	30.8	24.3	27.7	29.3	25.6	24.8	26.7	24.5
45 to 54	19.8	20.8	20.7	16.1	14.1	11.7	17.0	17.3	14.9	18.6	18.9	19.4	21.0	22.8	25.8	26.5	30.9	31.7	29.7	33.1	36.3
55 to 64	14.6	15.6	15.9	17.2	14.9	13.5	14.0	14.4	15.3	12.9	14.7	16.4	11.9	14.7	16.0	17.0	19.0	18.4	25.2	22.4	22.6
65 years and over	13.0	14.5	14.0	30.1	34.3	32.8	12.7	17.1	17.6	7.8	8.0	7.9	6.4	5.9	5.6	7.9	7.2	5.9	10.9	10.2	6.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: U.S. Bureau of the Census ,Current Population Reports, Series P-60, No. 90, "Money Income in 1972 of Families and Persons in the United States," U.S. Government Printing Office, Washington, D.C., 1973, p. 40.

The Consumer Price Index makes no distinction among subgroups, assuming that all consumers, rich and poor, consume the same market basket of goods and services. This is obviously not the case, for the rich by choice spend a higher proportion of their income on luxuries, while the poor have no choice but to spend a higher proportion of their income on such necessities as food and shelter. In order to assess the impact of inflation on such dissimilar groups of consumers, it is necessary to develop price indices based on the different market baskets that are consumed.

Such market baskets were developed in R. G. Hollister and J. L. Palmer's analysis of "The Impact of Inflation on the Poor." They created market baskets for both rich and poor families from the 1960–61 Survey of Consumer Expenditures, which in turn were used to fashion both a Poor-Person's Price Index (PPI), and a Rich-Person's Price Index (RPI), that approximate the true price indices for these different groups. These market baskets are split into eight major categories, with the importance of each category to the rich and poor consumers identified in the following Table.

TABLE III.—WEIGHTS OF MAJOR CATEGORY EXPENDITURES

Item	Poor person's index	Rich person's index
Food	0.349	0.219
Housing	.356	.278
Apparel	.078	.118
Transportation	.051	.160
Medical care [1]	.058	.062
Personal care	.033	.027
Recreation	.034	.077
Other	.041	.059

[1] For the aged, the weight for medical care would generally be higher.

Source: Joint Economic Committee, "Inflation and the Consumer in 1973," 93d Cong., 2d Sess. 34–35 (1974).

According to the recent staff study of the Joint Economic Committee "Inflation and the Consumer in 1974," [94th Cong. 1st Sess., 27–28 (1975)], prices have risen more for the low-income consumer in the last three years than for the high income individual. From October 1971 to October 1974, the poor person's index rose 27.8 percent while the rich person's index increased 24.6 percent—a difference of three percentage points.

The following table is reproduced from that recent staff study.

TABLE IV.—COMPARATIVE PRICE INDEXES (AUGUST 1971=100)

	Poor person's index	Rich person's index
1971: October	100.13	100.31
1972:		
April	102.04	101.76
October	103.91	103.62
1973:		
April	108.36	106.93
October	114.07	111.49
1974:		
April	120.52	117.49
October	127.94	125.02
	Percent changes	
1972	3.8	3.3
1973	9.8	7.6
1974	12.2	12.1
1971–74	27.8	24.6

Source: Consumer Price Index and Prof. Thad Mirer.

TABLE V.—SHARES OF AGGREGATE INCOME

Income	Social security	Earnings	Private pensions	Public pensions	Asset income	Other
	Married men and their wives, 1970					
$500 to 1,499	82	8	1	1	4	3
$1,500 to $2,499	69	16	2	2	6	5
$2,500 to $3,499	57	21	7	3	8	4
$3,500 to $4,499	48	22	12	6	9	4
$4,500 to $5,499	40	25	14	6	10	4
$5,500 to $6,499	34	27	17	6	12	5
$6,500 to $7,499	29	27	18	8	13	4
$7,500 to $8,499	25	31	17	10	13	4
$8,500 to $9,499	23	33	18	8	14	4
$9,500 to $12,499	17	39	15	7	16	5
	Nonmarried men, 1970					
$500 to $1,499	77	8	0.005	1	4	10
$1,500 to $2,499	62	15	3	3	6	12
$2,500 to $3,499	46	19	10	6	9	11
$3,500 to $4,499	37	18	19	8	9	8
$4,500 to $5,499	29	18	26	9	12	6
	Nonmarried women, 1970					
$500 to $1,499	77	9	1	1	4	7
$1,500 to $2,499	62	16	4	3	8	8
$2,500 to $3,499	45	23	9	5	8	8
$3,500 to $4,499	35	25	14	7	13	6
$4,500 to $5,499	29	23	14	11	17	6
$5,500 to $6,499	23	24	12	14	23	5

Source: Social Security Administration, Office of Research and Statistics, Preliminary Findings From the Survey of New Beneficiaries, Report No. 10 (June 1973).

TABLE VI.—ESTIMATED ACTUARIAL BALANCE[1] OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL,[2] DYNAMIC ASSUMPTIONS[3]

Item	OASI	DI	Total
Average cost of system	11.97	1.92	13.89
Average rate in present tax schedule	9.39	1.52	10.91
Actuarial balance	−2.58	−.40	−2.98

[1] As measured over the 75-year period, 1974–2048.
[2] Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.
[3] See text for a description of the assumptions.

Source: 1974 Trustee Report on OASDI, H.R. Doc. No. 313, 93d Cong., 2d Sess. 35 (1975).

Because of the uncertainty of future economic developments and because of the very high degree of sensitivity of future levels of benefit expenditures to assumed changes in the CPI, two alternative sets of estimates based on different economic assumptions are presented in this section. The alternatives differ with respect to the assumed future path of the CPI and to assumed future increases in average wages.

TABLE VII

[In percent]

Calendar year	Alternative I		Alternative II	
	Increase in wages	Increase in CPI	Increase in wages	Increase in CPI
1974	7.9	9.1	8.3	9.7
1975	8.5	5.7	9.3	7.1
1976	8.0	4.5	8.6	5.5
1977	7.6	3.2	8.4	4.8
1978	5.5	3.0	7.5	4.3
1979	5.5	3.0	6.0	4.0
1980	5.5	3.0	6.0	4.0

Source: 1974 Trustee Report on OASDI Trust Funds, H.R. Doc. No. 313, 93d Cong., 2d Sess. 18 (1974).

TABLE VIII.—ECONOMIC ASSUMPTIONS

[Calendar years, dollar amounts in billions]

Item	1973 actual	1974 actual	Assumed for purposes of budget estimates			
			1975	1976	1977	1978
Gross national product:						
Current dollars	$1,295	$1,397	$1,498	$1,686	$1,896	$2,606
Constant (1958) dollars:						
Amount	$839	$821	$794	$832	$879	$1,061
Percent change	5.9	−2.2	−3.3	−4.8	5.6	6.5
Prices (percent change):						
GNP deflator	5.6	10.2	10.8	7.5	6.5	4.0
Consumer price index	6.2	11.0	11.3	7.8	6.6	4.0
Unemployment rage (percent)	4.9	5.6	8.1	7.9	7.5	5.5

Source: Office of Management and Budget, "The United States Budget In Brief, Fiscal Year 1976," 14 (January 1975).

Following is a brief comparison, for selected years, of payroll tax rates scheduled under preesnt law, and projected expenditures expressed as percentage of taxable payrolls from the 1974 Trustees' Report and from this Panel's analysis:

TABLE IX

[In percent]

Calendar year	Combined payroll tax rate	Expenditures as a percentage of taxable payroll	
		1974 trustees' report	This panel
1975	9.9	10.2	10.2
1990	9.9	11.0	11.5
2010	9.9	12.7	14.6
2030	11.9	17 6	23.3
2050	11.9	17.2	23.9
Average	10.9	13.9	16.9
Average deficit		3.0	6.0

Source: Report of the Panel on Social Security Financing to the Committee on Finance, U.S. Senate, pursuant to S. Res. 350 (February 1975) 94th Cong., 1st sess. p. 2.

As the following table shows, the decline in real disposable income during the current recession is almost twice as large as that which occurred during any other post-war recession.

TABLE X.—CHANGES IN INCOME AND TAX BURDENS DURING POST-WAR RECESSIONS

Recession years	Percent decline in real disposal income[1]	Taxes as a percent of personal income: Including Government transfer payments		Excluding Government transfer payments	
		Peak	Trough	Peak	Trough
1948–49	−1.9	10.4	9.5	11.0	10.1
1953–54	−.7	14.2	13.2	14.9	14.0
1957–58	−1.3	13.8	13.4	14.7	14.4
1960–61	−.7	14.6	14.5	15.7	15.8
1969–70	−.8	18.1	16.9	19.8	18.8
1973–74	−3.1	17.8	18.4	19.9	20.8

[1] Percent changes based on those quarters during which peak and trough months occurred, as defined by the National Bureau of Economic Research.

Source: Bureau of Economic Analysis, Department of Commerce.

TABLE XI.—INCREASED ENERGY COSTS FOR HOUSEHOLDS BY INCOME: DIRECT AND INDIRECT ENERGY PURCHASES

Category	Income [1] (1974 dollars)	Cost increase for direct energy purchases [2]	Cost increase for indirect energy purchases [3]	Total increase
Poor	$3,050	$124	$212	$336
Lower middle income	9,770	176	329	505
Upper middle income	17,000	242	506	748
Well off	29,900	287	657	944

[1] Income adjusted by the ratio of consumer price ndexes: December 1971/December 1972=1.221.
[2] Purchases of fuels and electricity for households; energy costs assumed to increase by 60 cents/MMBtu.
[3] Purchases of all products (food, automobiles, housing appliances, petrochemicals services) dependent on energy; dollar-for-dollar passthrough of 60 cents/MMBtu is assumed without any increase due to "ripple" effect.

Source: Staff, Senate Committee on Interior and Insular Affairs, "Economic Analysis of President Ford's Energy Program, 94th Cong., 1st sess., Serial No. 94-4 (92-94) at 12 (1975).

TABLE XII.—CURRENT ENERGY COSTS WITHOUT THE PRESIDENT'S PROGRAM

	Poor average $2,500	Lower middle average $8,000	Upper middle average $14,000	Well-off average $24,500
Gasoline	$140	$349	$627	$736
Heating oil	66	66	66	83
Natural gas	91	108	117	140
Electricity	160	203	259	319
Coal	16	16	16	16
Total	473	742	1,085	1,294
Percent of average income	18.9	9.3	7.8	5.3

Source: WCMS Survey for 1972-73, adjusted for price increases to September 1974.

TABLE XIII.—ENERGY COSTS WITH PRESIDENT'S PROGRAM

	Poor	Lower middle	Upper middle	Well-off
Gasoline	$166	$415	$746	$876
Heating oil	83	83	83	105
Natural gas	120	142	154	184
Electricity	170	215	275	338
Coal	16	16	16	16
Total	555	871	1,274	1,519
Percent of average income	22.2	10.9	9.1	6.2

TABLE XIV.—NET ENERGY COSTS OF PRESIDENT'S PROGRAM

	Poor	Lower middle	Upper middle	Well-off
Average increase in energy costs	$82	$129	$189	$225
Average rebate	97	311	253	183
Net energy cost	458	560	1,021	1,336
Percent of average income	18.3	7.0	7.3	5.5

TABLE XV.—RETURNS WITH AT LEAST 1 TAXPAYER AGE 65 OR OVER: ADJUSTED GROSS INCOME, TOTAL DEDUCTIONS, EXEMPTIONS, TAXABLE INCOME, AND TAX ITEMS BY MARITAL STATUS, SEX, AND AGE

[All figures are estimates based on samples—data are in thousands]

Marital status, age exemptions by sex of taxpayer	(1) Number of returns	(2) Adjusted gross income
All returns, total	6,761	55,265,581
Joint returns of husbands and wives, total	3,847	37,731,364
Both 65 or over	1,909	18,629,417
Man 65 or over; woman under 65	1,647	16,178,292
Woman 65 or over; man under 65	291	2,923,656
Separate returns of husbands and wives, total	125	657,216
Men	77	408,191
Women	47	249,025
Returns of heads of households, total	125	949,635
Men	47	373,726
Women	78	575,909
Returns of surviving spouses, total	22	101,234
Men	7	60,173
Women	14	41,061
Returns of single persons, total	2,643	15,826,131
Men	670	4,397,537
Women	1,973	11,428,594

Source: Department of Treasury (I.R.S.), "Individual Income Tax Returns," 185 (Pub. 79 (12-73)).

TABLE XVI.—ALL RETURNS AND RETURNS OF TAXPAYERS AGE 65 OR OVER, 1969, 1970, AND 1971

[All figures are estimates based on samples—data are in thousands]

Item	(1) 1969	(2) Percent change 1969 to 1970	(3) 1970	(4) Percent change 1970 to 1971	(5) 1971
All returns, total	75,834	−2.0	74,280	+0.4	74,576
Taxable	63,721	−6.9	59,317	+1.0	59,916
Nontaxable	12,113	+23.5	14,962	−2.0	14,680
Returns of taxpaeyrs age 65 or over, total	7,181	−3.7	6,913	−2.2	6,761
Taxable	4,637	−4.0	4,452	+1.2	4,507
Nontaxable	2,544	−3.3	2,461	−8.4	2,254

Source: Department of Treasury (I.R.S.), "Individual Income Tax Returns," 186 (Pub. 79 (12-73)).

TABLE XVII.—EFFECT OF THE TAX REFUND—ILLUSTRATED FOR A FAMILY OF 4

Adjusted gross income	Present tax	Proposed refund	Percent saving	Percent of adjusted gross income
$5,000	$98	$12	—12.0	—0.24
7,000	402	48	—12.0	—.68
10,000	867	104	—12.0	—1.04
12,500	1,261	151	—12.0	—1.21
15,000	1,699	204	—12.0	—1.36
20,000	2,660	319	—12.0	—1.60
40,000	7,958	955	—12.0	—2.39
50,000	11,465	1,000	—8.7	—2.00
60,000	15,460	1,000	—6.5	—1.67
100,000	33,340	1,000	—3.0	—1.00
200,000	85,620	1,000	—1.2	—.50

Representative BOLLING. Senator Javits.

Senator JAVITS. Thank you very much for your appearance. It has been very helpful in pinpointing where you find the greatest difficulties in the President's budget and also in its representational quality, as you all speak for a very large constituency.

I hope very much that you will encourage your members to express themselves to their legislators. Our reach is considerable. We report, debate our reports on the floor of the House and Senate. But the sentiment back home is equal to it. So I would hope very much—and Nelson Cruikshank is an old friend of mine, and Mr. Borsodi—will activate their constituents along the lines of your statement.

I think certatin of the fears answered in these statements are answered, that we will not reduce the cost of living or cut down the cost of food stamps. We have already refused certain decisions in the health field in the House and I am sure we will follow that in the Senate.

In addition, we will not refrain from starting new programs, notwithstanding the President's feelings.

But the President himself is a human being, is rather outgoing and has very constantly said that he wishes to work out a suitable compromise with the Congress by way of partnership. We would take him at his word. There is no need for anyone being beligerent if there is no occasion for it. I am convinced of that. As one Senator, that is my judgment.

Representative BOLLING. I think that is a very good judgment.

Senator JAVITS. Now, I have just a few questions of my very old friend, former Secretary, Wilbur Cohen.

I notice the preference you express for the Bentsen bill insofar as medical care for the unemployed is concerned, over and above, I assume, the Kennedy-Javits bill, which by the way will be marked up in the Labor Committee this afternoon.

One of the things which emerged from our hearings is that the Department has violently objected to our bill on the grounds that it is impossible to administer within a reasonable period of time, and the thing that troubles me about medicare is twofold.

One of their arguments is that it is a much more difficult operation, but you will implement at least 3 million unemployed in to the medicare system. They talk about complexity and that would be even more complex.

The second thing is whether or not it would result in a very serious dislocation of the ongoing programs when you introduce such a very large new constituency into it. The Kennedy-Javits bill has the advantage of not changing or dealing with an ongoing program. It is really a payment proposition, who sends the check and to whom.

I just raise that question, Mr. Cohen, because that is what will be troubling us. I wonder what would be your view?

Mr. COHEN. Yes, Senator, I have considered that issue very carefully in my recommendation to the Senate Finance Comittee and the House Ways and Means Committee in favor of the Corman-Bentsen bill, and I have to admit that having been an administrator myself, I am indeed conscious of that problem.

However, I believe if I were still the administrator of it that we could handle that problem reasonably satisfactorily and efficiently by simply having the bills for hospitalization, and if you extended it to physicians services in part B, paid by the hospital and directed to the hospital and paid by them on what I would call an ad hoc basis, that is paying for the bills submitted. Obviously, not all of the unemployed are going to have to go to a hospital or go to a physician during this 12-month period that is being considered. Therefore, I think that it would not be desirable to enroll them in the medicare program, and if you read the Corman bill, H.R. 3208, there is a specific clause on page 2, line 9, which says: "They shall be entitled, without the necessity of any preenrollment." Now, I would agree if the intention was to enroll all of the unemployed people in medicare, that would be a very difficult administrative job.

However, Senator, I want to say this. There are two big issues. One is this administrative problem, and I recognize some of the merits to that. But to me the equity question is much more pertinent. I do not see how, indeed I cannot recommend that the Federal taxpayer spend $1¼ billion—I don't know what the exact estimate is, but it is in that order of magnitude—to finance private health insurance of a differential amount to each employee and their family, depending on the happenstance of what the employer unilaterally, or the employer in the collective bargainingwise, happened to provide the individual employee and his family.

It would seem to me that spending that amount of money out of general revenues in a discriminatory, differential, unequitable way is a very important point to me.

Finally, I believe that in good conscience I have to say this.

I think that the policy decision was made on the part of the administration to oppose the pending legislation on this subject. That administrative point is one I think could be overcome. That is my personal view.

Senator JAVITS. You speak of the subsidy of the private insurer, and isn't it a fact that whatever may be profit margins for stock companies, et cetera, but when no subsidy is involved, you are paying for services, aren't you? You are going to get some service if you pay the premiums?

Mr. COHEN. It depends on what your bill provides, and I don't know what you are marking up. Does it provide you with what will merely pay the net cost of the hospital and physician services plus a reasonable managerial fee or all the acquisition costs that are normally inherent in the private insurance mechanism? I don't know what is in your bill, so I can't comment.

Put it this way, if you are going to do that, then I think the reimbursement should be on a net basis, not for these other, what I would call costs that are not primarily related to paying for the service that you are paying for.

Senator JAVITS. I assume what you are talking about is front-end costs?

Mr. COHEN. Costs of acquisition, sales costs, and costs attributable to the sale of insurance but not attributable to that part of the insurance that was never intended to be financed when the insurance was sold.

Senator JAVITS. I think our disposition would be to allow the Department of Labor to regulate that, in other words, determine what part of a premium should be paid in order to carry on the insurance.

We do have a little difficulty in that there is a certain privy of credit which is involved. You can't make this or give the service in return of the payment. There is no right of domain to make people give you service, so it would be a matter of negotiation without any question.

I believe self-interest on the part of the carriers, certainly that would be true, Blue Cross and Blue Shield, which is probably the biggest carrier, and that is why I take exception to your statement about subsidy. It is a fact that many of these, probably most of these are nonprofit.

Mr. COHEN. I didn't mean it was a majority.

Senator JAVITS. That isn't true both in service and the fact that many are nonprofit enterprises.

Mr. COHEN. Perhaps I should revise my terminology in the light of this colloquy to say that I am not in favor of paying any costs that are not directly related to this particular extension of the benefit. That is perhaps a more precise way of saying it.

Senator JAVITS. Mr. Cruikshank, have you had an opportunity in your organization to look into this question of implementing the very large number of unemployed workers into the medicare system? I am not too impressed with the idea that the worker won't have to register. I doubt very much that institutions, like hospitals, and supplies, and medical services, are going to just take any unemployed man, who walks off the street and shows his card, and give him service. There are many reasons why he is eligible.

But have you people examined that as to the impact of the medicare system, of the immediate introduction into that system of billions of unemployed workers?

Mr. CRUIKSHANK. We haven't gone into it in depth, honestly, Senator. We have some broad views about it, but I am not sure they would be relevant and I would not really pose as an expert on that part of the program.

Senator JAVITS. I think, gentlemen, if we may call on you to do so, I would like to have you, on the behalf of the voluntary agencies or entities that you represent, file with the committee—I would hope say 10 days or 2 weeks, whatever you prefer would be a very useful time—any observations you have on that plan. Perhaps if you would be kind enough to send Mr. Cohen a copy, he could comment. I think it would be very illuminating to all of us if we knew this, especially from you, Mr. Cruikshank, having been a specialist in this field.

I have no preconceptions about it. I could just as enthusiastically be for the Bentsen bill, it is just a question of which one will have the most sympathy here, and two, where do we start from the operation? I think in the pension fund huge parts of the Finance Committee approach were accepted.

Thank you, Congressman Bolling.

Representative BOLLING. Congressman Rousselot.

Representative ROUSSELOT. Thank you, Congresman Bolling, Senator Javits. The question may have already been answered.

In your statement, Mr. Cohen, you mention the Congress should provide promptly for the payment of hospital and physician bills for unemployed individuals whose health has been terminated. In other words, you adopt this kind of approach. What is your estimate of the cost?

Mr. COHEN. I don't have an independent estimate that I have made. It is my understanding, and I would stand corrected if the administration has presented different ones, but it is my understanding that it is in the nature of $1 billion to $1¼ billion for a 12-month period.

Senator JAVITS. $1½ billion is about the tab for both, I gather.

Mr. COHEN. It is in that order.

Senator JAVITS. That is the cost estimate?

Mr. COHEN. It is in that range.

I gather the various proposals provide that the cost be paid out of general revenues. That is a real concern to me. If the general taxpayer out of general revenues, is going to pay the cost, what is the equity of that incidence of that cost? That is why, in my response, I didn't deal primarily with the administrative question that Senator Javits asked me but with the equity situation.

I think if you are going to pay out of general revenues you are entering on a very complex policy question in the health insurance area which will come to haunt the Congress in the future.

I would recommend very serious study of this policy issue. Maybe I am wrong on that, but it does offend my sensibilities about the use of Federal funds in such a discriminatory manner.

Representative ROUSSELOT. How would you recommend we finance it, then, since we are running into substantial deficits now, just further deficit financing?

Mr. COHEN. If you follow the version of the bill that Senator Javits and Senator Kennedy have introduced, I know of no other way to do it than general revenues.

Representative ROUSSELOT. Which means additional revenues?

Mr. COHEN. You mean an increased deficit?

Representative ROUSSELOT. Which doesn't bother you?

Mr. COHEN. Well, it bothers me, but I don't have a better answer.

But I do say this, that if you are going to do it, then I favor doing it in an equitable way which provides what Federal cost would be such that each individual would get the same protection. That is the value of using the medicare approach, everybody would be treated equitably in the sense of financing in terms of the same benefit.

Senator Javits, we didn't really have a complete discussion of this important matter. I see it as a far-reaching policy issue in connection with national health insurance.

If Congress takes the position now that you are in favor, and I recognize you are going to say it is an emergency, it is a very rush situation, we have to do something for the unemployed, I recognize all that, but if you take that position that you are going to use general revenue payments to finance payments through private health insurance that are differential, I think Congress has taken a very large step in making a decision which will come to haunt us later. I feel that is a very dangerous position to take at this juncture.

Senator JAVITS. If we take the stand, passing tthe bill, paying insurance carriers, it will lead to what?

Mr. COHEN. Well, it is a precedent.

Senator JAVITS. Precedent to do what?

Mr. COHEN. It is a precedent for doing the same for the coverage of general benefits for other people, all people, when you come to the issue of how you are going to reconcile the various health insurance measures.

Representative BOLLING. Are you talking about different payments for the same service?

Mr. COHEN. I am talking about the use of Federal general revenue funds to provide private health insurance benefits in the health area when we come to the broader issue of national health insurance coverage.

Senator JAVITS. Mr. Cohen, you just as reasonably argue that, by giving up unemployment compensation, we will supplement in the future lower general revenue funds in order to keep people from being below the poverty level in their earnings. It is an emergency and it is a unique situation, and it is only a precedent if we make it one, which I haven't the remotest intention of doing. I believe the national health insurance has to be financed by an increase in the social security tax or by a separate tax, because we always have.

Mr. COHEN. Knowing your views on that matter, I did not attribute any implications to your personal feeling. But I am very doubtful as to whether that would be the same view that other Members of Congress might take. At least I am fearful about it.

Senator JAVITS. In my judgment, you don't appear at all fearful. We don't finance a multibillion dollar national health insurance. We are talking about $60 billion for national revenue.

Mr. COHEN. The Advisory Council on Social Security recommended, by a majority vote, that medicare be financed out of the general revenues. Now, I am opposed to that. As you know, my view has been that the worker and the employer ought to contribute to this to maintain a contributory right. Now, when an advisory council for the first time in American history has recommended that the total cost of medicare, a program which you made a very significant contribution to the ultimate legislative decision—now recommends that we finance it entirely by general revenues. I think you will have to admit I have a little bit of cause for concern when those people were in addition some businessmen and others.

So I think we are at a point where the whole question of how to finance social security and national health insurance is changing very rapidly, and all I am saying is before we throw the baby out with the bath I want to be very sure that the contributory system, with its statutory rights to benefits, is maintained.

Senator JAVITS. I thoroughly agree with you on that. I am not as worried about it as you are.

Mr. COHEN. I think your record and your position on that is one which is so close to mine that I find it difficult to argue with you.

Senator JAVITS. I don't think there is much of a chance in Congress, but you are right to call on us.

Representative BOLLING. Congressman Rousselot.

Representative ROUSSELOT. Mr. Cruikshank.

Mr. CRUIKSHANK. I am not sure I am reflecting Dean Cohen's concern, but possibly so, and the one that concerns me on this differential

of benefits is if we simply, out of general revenues or any source, pay the premiums minus certain overhead costs, acquisitions and the rest that goes into this insurance, we are buying all different kinds of insurance because in negotiated plans there are various deductibles, exclusions, coverage of dependents, noncoverages. Blue Cross has almost 77 plans, and almost every unit that has negotiated a pattern—thereby probably well over 1,000 of these different things that cover a whole range of risks and also exclusion on the other side. I don't know whether this is what concerns Dean Cohen or not, but it would be financing on a general tax basis a rather capricious chosen set of benefits. They depend on the strength of the union negotiating, they depend on the economic condition of the employer who negotiates. Sometimes an employer is in a position to provide coverage, sometimes a marginal employer does the best he can, but he pays only a cash amount, 10 or 15 days for each hospitalization or something like that. So you would be financing on a broad case a very wide range of benefits. You would just be simply underwriting the existing program. This is where the inequity would arise.

Representative ROUSSELOT. You subscribe going to the general treasury to finance those who are unemployed?

Mr. CRUIKSHANK. I don't think there is any other source.

Representative ROUSSELOT. How does your membership feel with deficit financing or would they rather have increased taxes?

Mr. CRUIKSHANK. On the social security?

Representative ROUSSELOT. On this point the doctor makes——

Mr. CRUIKSHANK. We haven't had a convention recently or a resolution on this particular matter of the unemployed, that is why I did hesitate at first to say something about it.

Representative ROUSSELOT. No; on the general thesis of either deficit financing or new taxes in order to finance this add-on cost, how do they feel about that?

Mr. CRUIKSHANK. Oh, with this you should not have an additional social security tax burden on the payroll tax to pay for this. We feel eventually, and we have had very strong positions on this, that further broadening of the social insurance program, whether for health insurance—not just broad health insurance, but——

Representative ROUSSELOT. So we shouldn't pay for it by deficit financing?

Mr. CRUIKSHANK. Yes; it is.

Representative ROUSSELOT. Have you polled your membership to this subject?

Mr. CRUIKSHANK. We haven't polled them, but resolutions come up out of 3,000 local clubs that come in to an annual convention.

Representative ROUSSELOT. You represent a very important segment of our community and our society. I think it would be helpful to know how they feel about deficit financing.

Mr. CRUIKSHANK. We do know how they feel about it.

Representative ROUSSELOT. Do they like it?

Mr. CRUIKSHANK. They don't object to it to meet these objectives. They object more to further regressive payroll taxes.

Representative ROUSSELOT. I understand they don't approve of a tax increase, that I understand. You have made that clear.

I find that—and I meet with the senior citizen groups purposely in my district, and I have a very substantial advisory committee, as a matter of fact a little over 100 from all segments of the senior citizen groups. They were very strong about their deficit financing, the impact they think that has.

I would be interested to know if you get a chance to pole your membershsip sometime——

Mr. CRUIKSHANK. More sophisticated or less sophisticated?

Representative ROUSSELOT. Maybe so. But you have never polled them? I know you represent them like we do in our constituency at home. I assume that you would give them a chance to participate in the policies you enunciate here?

Mr. CRUIKSHANK. Yes, sir.

Representative ROUSSELOT. I would be very much interested if you have a chance to see how they feel about add-on deficit financing by the Federal Government.

Mr. COHEN. Could I add one more point?

Representative ROUSSELOT. Sure.

Mr. COHEN. I would like to make it in relation to the discussion with Senator Javits.

Just to return to your question, Senator Javits, on the administrative problem, which I recognize as a serious one, while I have to admit that there would be some complications of handling it under the medicare program, I would like to urge you to reconsider and think very carefully about what the impact of this responsibility under the bill that you and Senator Kennedy have introduced which puts the burden on the State unemployment compensation. Now, those State agencies are already overwhelmed with the payment of the unemployment claims at the present time in what is the most serious and highest rates of unemployment since the unemployment insurance system was started in 1937.

Now, if I understand your bill—to make it effective, to do what you said, to see that the eligibility is determined and the bills properly paid—you would do that primarily through the State unemployment insurance agencies of the Labor Department. I am talking about the paperwork. I feel that a very careful consideration ought to be given as to whether this wouldn't weigh down the State unemployment insurance agencies more than it would weigh down, let's say, the medicare program.

Senator JAVITS. I have one comment as to the inequity of different types of coverage, the fact that the same equity exists in unemployment compensation. Not every worker gets the same unemployment compensation. It depends on two factors, what he has earned and by the State ceiling, depending on what State—and by different States. So you can't be uniform, including the medicare system. It is very illuminating.

Mr. COHEN. Well, I find it very embarrassing, say for the first time in my life, to be on the opposite side of not only Senator Javits, but Senator Kennedy, two friends of mine. But I must say I do feel strongly about it, perhaps somewhat emotional about it, because I think we are taking a very important step with inadequate consideration of the implications.

Senator JAVITS. I yield.

Representative BOLLING. Congressman Rousselot, go ahead.

Representative ROUSSELOT. Congressman Bolling, I am overwhelmed by the emotions.

Representative BOLLING. For those who are not used to my friend, he occasionally comes up with a remark like that.

I am interested in pursuing briefly with two members of the panel and the others, if they chose to get involved with it, not a technical question, but I would like a little guidance.

I am taking over the Fiscal Policy Subcommittee chaired by former Congresswoman Griffiths in which quite an extraordinary study was done on income maintenance. I think my friend from California is a member of that subcommittee also. One of the things that I hope we will be able to do, perhaps initially through staff rather than through hearings, is to begin to broaden the base of information obtained through that substantive study to include other forms of information and perhaps finally get to the point where a relatively comprehensive study is done on all income maintenance from the kinds of things that Mrs. Griffiths and her group dealt with to things as far away from that as military retirement, civil service retirement, and so on and so on.

I would be interested in getting the view of the panel as to the wisdom of undertaking a project of that sort so that perhaps we might develop some hard information, not necessarily along the same lines of Mrs. Griffiths' study, in attempting to obtain information, but we would have some baseline in making policy, finding out where the gaps are and the abuses are, and the needs in terms of some kind of an equitable approach to income maintenance in all the different circumstances—aside from unemployment and age, probably include some other things.

I wonder if you gentlemen would have a view as to whether that would be a worthwhile long-range undertaking?

Mr. CRUIKSHANK. Yes, Congressman Bolling, I think it would. There are, of course, a lot of studies and a lot of material around and the various advisory councils, which have always had a unique role in the development of our social security systems. But it is piecemeal. There are bits and pieces.

I think to suggest to start with a staff review would be useful, first to pull together in some kind of comprehensive form the bits and pieces that exist.

But there hasn't been, recently, to my knowledge at least, an overall synthesis of this in terms of that policy. I think of one aspect of this; for example, there has been a tremendous amount of criticism of the social security system, which oddly enough is based on the projections of certain economic factors and demographic factors and pointing out that there will be x number of retirees in the year 2020 as against x minus something of people actually working.

Well, if this is true or not isn't to the point right now. But the point I am making is that these criticisms have been written as if social security caused these problems. If we are going to have many more nonworking people, whether it is older people, sick people, young mothers with children at home, or children or people staying

in college longer, or even in the armed services for that matter, in relation to the productive workers; that is going to be a problem. Some of these critics have written it, if you did away with the social security system you would do away with the problem. Well, that is only illustrative of a lack of an overall comprehensive kind of policy or philosophy about the question as to how social processes take care of the nonproductive people in the population as against the productive people and how that burden should be shared. I put it that way because it isn't just the aged; there is a policy question about how long people should continue in educational activity. They are nonproductive workers, too.

The question of the relation of women, the production of housewives and how you reward them and underwrite their security, is one which has been raised and hasn't been answered satisfactorily.

There is the question of the shorter work week, the longer vacation, and the sabatical years for people in midlife. All of those are a part of the picture of the nonproductive population against the productive.

So I would like to see the whole retirement problem and that put into an overall pattern of a policy regarding the maintenance of income and the distribution of income and the appropriate and the most equitable distribution of the burden of taking care of the nonproductive worker. I think it would be useful.

Representative BOLLING. Mr. Cohen.

Mr. COHEN. I am in the unfortunate situation in that I teach a graduate course on income maintenance at the University of Michigan and we have used Mrs. Griffiths' materials extensively. I have had the advantage of assigning them to my students, reading them, and reporting on them.

So I guess my answer to your question is that I see quite a number of things to do that yet remain to be done. I think I would have a little difficulty in separating out in my mind what I would recommend for you to do first. But I will make two or three suggestions on this.

First, following Mr. Cruikshank's comments, I do think that it is extremely important, particularly for the Joint Economic Committee, to deal with those factors in our total income maintenance programs that are pervasive across all of our programs and begin to focus on those programs that will produce significant changes over the next 25 years in the role of Federal financing. He mentioned a couple. Let me comment on them.

The change in fertility rates, the number of children, the impact of zero economic growth; over the next 25 to 75 years you will probably have the biggest factor in changing the Federal Government's responsibility. I think you ought to look at that across all of the programs and see what implications they have for the future.

Are you familiar with the Senate Committee on Finance's report on the social security system, which takes these various factors that Mr. Cruikshank has mentioned and goes through social security increases? You ought to take those same factors and look at the civil service retirement system and the veterans programs and the food stamp and everything——

Mr. CRUIKSHANK. And private pension.

Mr. COHEN. Very important. Private pension plans are going to be affected by exactly the same demographic adverse factors, and there is already——

Representative BOLLING. In effect what really is the case in modern times, is that there has never been an attempt to look at this in a chunk.

Mr. COHEN. There was some 20 years ago when the programs were so small and could be encompassed reasonably. But if you look at it today, plus looking at what it will be in the year 2000, based on extrapolation of present trends, the situation is completely different than anything that has ever been done.

Representative BOLLING. Perhaps this is a late time, but certainly time to take a late view.

Mr. COHEN. Never too late, because these programs have built-in costs due to the aging of the population.

I want to mention, particularly if you read the actuarial report to the Senate Finance Committee on the interaction between the price level and the wage level resulting in the differences in what they call the real wage increase, vitally affects every program.

Representative BOLLING. Which leads us to general economics rather rapidly——

Mr. COHEN. There is a big difference which people don't realize produced here. Even though real wages increases by the same percentage, which in this report is 2 percent, as has been pointed out, if money wages go up 6 percent and prices go up 4 percent as compared with 5 percent and 3 percent, even though the net result appears to be the same, it makes a big difference to pension plans if prices go up faster, even though the residual productivity is the same. That is a point I think which has very little been realized in this situation, and I would therefore urge very serious consideration of these common elements, Congressman Bolling, which I think have never been studied across the board.

There is one other factor which I would hope you would take into account: What the difference would be in the income maintenance programs, depending on what the proportion of poor people are in our society. If in 1959, 22 percent of the population were poor and now, there are 11 percent poor, you have a different impact. If you assume for 1985 it will be 5 percent or some other figure, your analysis and conclusions may be radically different. So I think the poverty incidence, the fertility incidence, prices, wages, economic growth and demographic changes and all of these factors ought to be looked at across the board.

Representative BOLLING. Thank you.

Mr. Terrones, do you feel this might be useful?

Mr. TERRONES. I think it might. We haven't looked into this, but let me go back to my office and look into this matter and then make a point.

Representative BOLLING. I wish you would.

Mr. Borsodi.

Mr. BORSODI. We have looked at the whole income maintenance problem. We will study it and give you our own views on it. We are

particularly concerned about it because at the present it consists of bits and pieces, and it is highly vulnerable to inflation.

Representative BOLLING. Right.

Thank you very much.

Do you have anything further, Congressman Rousselot?

Representative ROUSSELOT. No, I just want to make one further comment. We are aware social security didn't cause the problem, but it is part of the problem.

Mr. CRUIKSHANK. It is the answer to the problem.

Representative ROUSSELOT. Just because people make criticism, it doesn't mean they want to do away with it. I think that is an unfair assumption, because people look at it critically just as they look at Members of Congress critically, they don't want to necessarily do away with all of us. They may just want to contribute to a solution. I don't think that one assumption should stand on the record itself.

Mr. CRUIKSHANK. No, I don't mean all are critical. I am critical of it in many ways myself. But there are some of the scary head writers that have been infesting the press recently that seemed to imply if you did away with the social security system you would do away with the problem.

Representative ROUSSELOT. The Committee on Ways and Means in the House has become very concerned about it as you began to project out for the next few years, we had better be concerned or there will be some real problems.

Mr. COHEN. I just want to say that the short-run problem for the next 3 or 4 years for social security is quite different than the long-run problems. I think you can handle these short-run problems rather easily, but I do admit that the longer run problems, fertility rate and growth rate and prices represent something Congress will have to work on much more diligently. That is a much more difficult question.

Representative BOLLING. Thank you gentlemen. We appreciate your coming and we appreciate your wisdom and we are grateful to you.

Mr. COHEN. Thank you.

Mr. CRUIKSHANK. Thank you.

Representative BOLLING. Mr. Peterson we are delighted to welcome you here and we will hear from you and proceed as you wish.

STATEMENT OF JAMES R. PETERSON, PRESIDENT, THE PILLSBURY CO.

Mr. PETERSON. Thank you. My name is James R. Peterson, president of the Pillsbury Co.

Gentlemen of the committee, on behalf of the Pillsbury Co. I welcome this opportunity to present Pillsbury's response to high food prices, a subject we consider a very sensitive and critical issue to the American consumer. I will describe briefly the circumstances that have led us to take a significant step—a substantial reduction in a number of our consumer food prices.

Pillsbury is a broadly based, diversified company competing in many areas of the food business.

56-887—75——17

Since 1972 the food industry has been sharply affected by increases in costs in all areas, but particularly, and most dramatically, by the increase in agricultural commodity and raw material costs.

Productivity improvement programs at Pillsbury have been given top priority to offset as much as possible the impact of these cost pressures. These productivity programs have been particularly effective in meeting the impact of certain major costs of doing business such as a 37-percent increase for energy in 1974; a 40-percent increase for packaging costs since 1972; a 17-percent increase for labor the last 2 years; and a 30-percent increase in transportation costs since 1972.

The charts attached to this statement illustrate what has taken place in recent months in the costs of wheat, shortening, sugar and eggs, major agricultural commodities.

From the first quarter of 1972 to the third quarter of 1974, the wheat price quarterly average went from $1.58 a bushel to about $5.50 a bushel, reaching as high as $6 on some days. But because of expectations for a very promising U.S. wheat crop, and a slackening of world demand, the price has lowered to the $3.65 level on March 10, Monday of this week.

Shortening prices increased from about 11 cents a pound in mid-1971 to 42 cents a pound in the third quarter of 1974. Soybean oil has been dropping steadily this year and this week is in the 28 cents a pound range.

Sugar increased from 9 cents a pound in the first quarter of 1971 to 46 cents in the last quarter of 1974, and actually reached a high of 77 cents a pound during its climb. Today sugar has receded to the 30 cents a pound range.

Eggs went from 30 cents a dozen in the second quarter of 1972 to 69 cents a dozen in the third quarter of 1973 and today are in the 59 cents a dozen range.

Wheat, shortening, sugar and eggs are the major ingredients in refrigerated foods. These ingredients constitute about 55 percent of the total cost of production or the total cost of sales.

In summary, from January, 1972, to October, 1974, a period of less than 3 years, the aggregate cost of these ingredients increased 258 percent.

In response to the recent weakening in these commodities, Pillsbury began to reduce its prices some weeks ago. Pillsbury's BEST flour, sold to consumers, was reduced 6 percent in January, and bakery mix prices to industrial users have been lowered three times since mid-December by a total of 17 percent. We have taken this week an additional and broader step—one of major importance to consumers.

Effective Monday, March 10, Pillsbury lowered the wholesale price of Pillsbury buttermilk biscuits and 26 other refrigerated food products by an average of 10 percent, a double-digit decline. The products are all in the refrigerated, fresh dough biscuit and dinner roll categories, and annually represent 630 million packages of sales or 73 percent of our refrigerated foods unit volume.

We have taken this action with the expectation and hope that these price reductions will be passed on to the consumer by retailers.

We would expect that these lower prices would appear at retail stores within the next 2 to 5 weeks. I was informed this morning some retailers have taken advantage of these lower prices and have reduced prices to consumers.

Because the agricultural commodities we use in Pillsbury's products are also in a majority of the other products in the supermarket, other food producers may find it possible to follow suit and, thus, relieve pressure on the American consumer's food budget.

It is our conviction that the market mechanism for establishing prices, which is being demonstrated in the action we are taking, is infinitely better than price controls in any form.

We feel our mutual experiences with price controls demonstrate their adverse effects. I would like to further state that the administration's assurance that price controls are not in the offing has given us the confidence to execute the price reductions.

Our price reductions are on products used most heavily by consumers who have been hurt the most by inflation.

Our consumer research shows that about one-third of the users of basic biscuits, our most economical item, earn less than $7,000 a year, but they consume almost half of the basic biscuits purchased. These are basic bread-type products.

People who live on farms and in communities with less than 2,500 people represent about 18 percent of the Nation's population, but they buy about one-third of the basic biscuits sold.

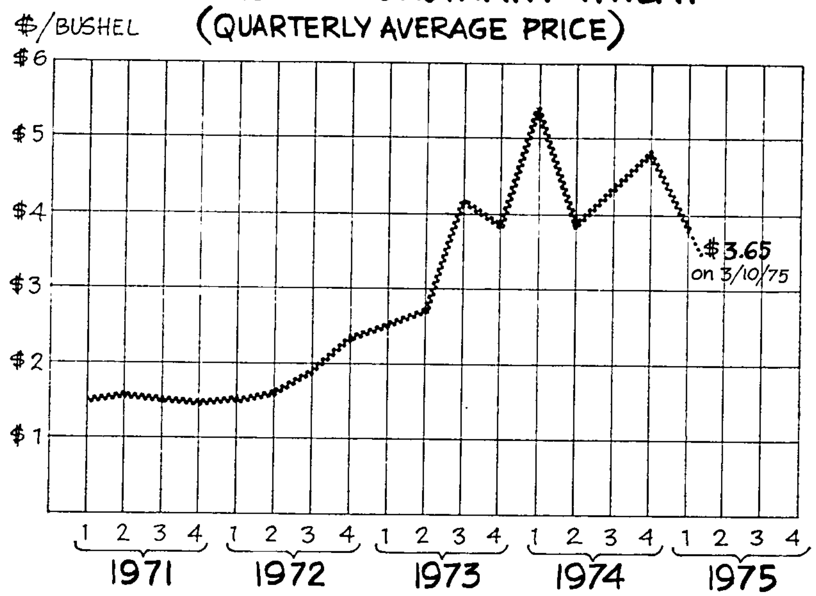
We are hopeful but cautious about the future of food prices in 1975. With a return to normal weather conditions this year, commodity prices could continue to lead to additional price reductions.

I would like to add that during the past 2 years, in the face of dramatically increasing prices, consumers have demonstrated their ability to substitute one food for another to minimize the impact of inflation. This has been especially true in the broad spectrum of consumer products affected by grain prices. Such products include nearly everything in the food store except fruits and vegetables. Since refrigerated fresh dough products compete with thousands of items, Pillsbury's price decreases should aid consumers in lowering their food costs dramatically.

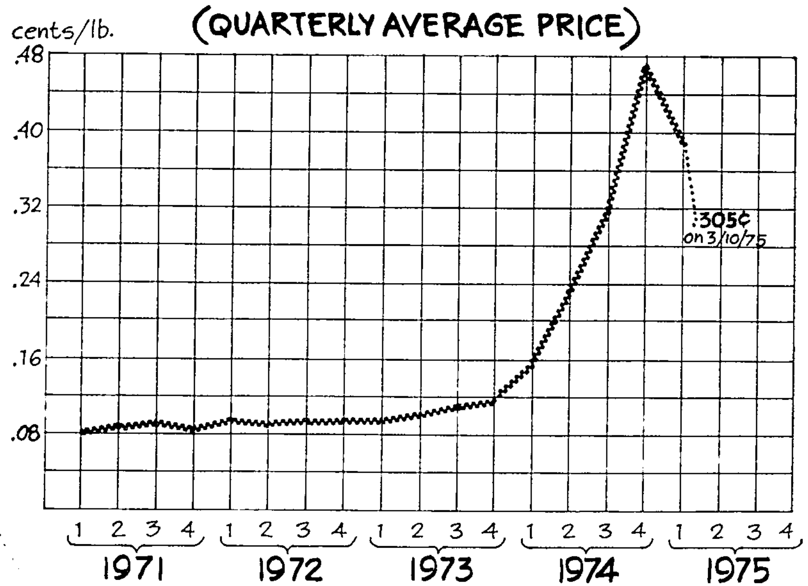
We would like to thank you for the opportunity to appear here today, and point out that in the free market system, companies such as Pillsbury can and do respond to changing conditions rapidly. We believe this type of action is particularly important in the largest and most basic industry in the Nation—the American food industry. I would be very happy to answer your questions.

Chairman HUMPHREY [presiding]. Mr. Peterson, I thank you.

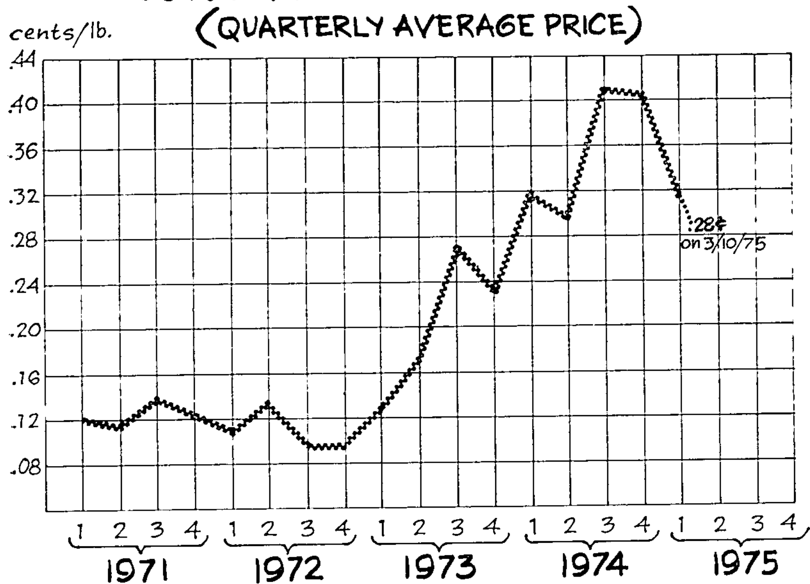
[The charts attached to Mr. Peterson's statement follow:]

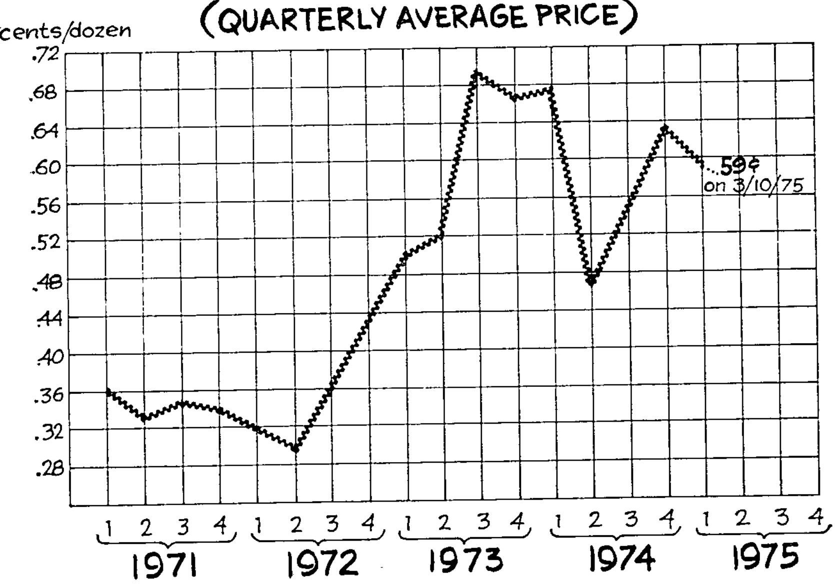


KANSAS CITY ORDINARY WHEAT
(QUARTERLY AVERAGE PRICE)
$/BUSHEL
$6
$5
$4
$3
$2
$1
$3.65
on 3/10/75
1 2 3 4
1971
1 2 3 4
1972
1 2 3 4
1973
1 2 3 4
1974
1 2 3 4
1975



NEW YORK DOMESTIC SUGAR
(QUARTERLY AVERAGE PRICE)
cents/lb.
.48
.40
.32
.24
.16
.08
.305¢
on 3/10/75
1 2 3 4
1971
1 2 3 4
1972
1 2 3 4
1973
1 2 3 4
1974
1 2 3 4
1975


SOYBEAN OIL: CRUDE DECATUR
(QUARTERLY AVERAGE PRICE)
cents/lb.
.44
.40
.36
.32
.28
.24
.20
.16
.12
.08
28¢
on 3/10/75
1 2 3 4
1971
1 2 3 4
1972
1 2 3 4
1973
1 2 3 4
1974
1 2 3 4
1975


SHELL EGG PRICES: N.Y., LARGE WHITE, GRADE A
(QUARTERLY AVERAGE PRICE)
cents/dozen
.72
.68
.64
.60
.56
.52
.48
.44
.40
.36
.32
.28
59¢
on 3/10/75
1 2 3 4
1971
1 2 3 4
1972
1 2 3 4
1973
1 2 3 4
1974
1 2 3 4
1975

Chairman HUMPHREY. I apologize for my absence. It is just impossible for me to cover all the bases this morning. I had to appear before the Appropriations Committee to see if we could get an appropriation for this committee and also a majority caucus where the majority leader asked each of us to be present.

We had a chance, as you know, to look at your statement prior to your coming here, and there are some questions I want to raise with you, and our other colleagues here, also.

One of the questions that constantly comes up is the relationship of a basic commodity to your costs. Let me just put the question to you: How important are commodities to your costs?

Mr. PETERSON. The majority of products that are produced by the Pillsbury Co. are very highly effected by commodities, and they make up a majority of the cost of sales in most of these items. The four basic commodities that I covered this morning, wheat, shortening, sugar and eggs, make up about 55 percent of the cost of sales of the items that we were talking about in the refrigerated line. This would be fairly typical of most of the products that Pillsbury produces.

Chairman HUMPHREY. So what you are saying is that in every instance the basic commodities are 50 percent or more of the cost of your product. Is that correct?

Mr. PETERSON. That is correct.

Chairman HUMPHREY. Is not that a rather high ratio?

Mr. PETERSON. I believe it would be high for some food products that are processed or have a great deal of convenience built in them, but I believe it would be representative of the food industry. It is higher than maybe average.

Chairman HUMPHREY. I know there are charts, and obviously you used these charts in your testimony. Could you get to that sugar chart. You have tremendous increased costs in sugar. It was pretty level all the way except in 1972, and it started to really go up in the third and fourth quarter of 1973 in June, on up to very high rates of 43 cents a pound. Is that what it is costing you?

Mr. PETERSON. That is representative of what we paid. That is a quarterly average. You can reduce the impact of that somewhat if you are a skillful buyer for your company.

Chairman HUMPHREY. I see that costs have come down. Did you anticipate anything like that?

Mr. PETERSON. Well, we believe that sugar would not stay at those levels. I think one thing you learn in the commodity markets, about the time you think they will go up forever they turn around and go the other way, or about the time you think they will go down forever they turn around and go the other way.

Chairman HUMPHREY. One of the questions that is always asked is why food prices are not falling as quickly as farm prices. We know they are not and we do not expect that they are going to be automatic. But there seems to be such a sticky necessity between the price levels, the farmers prices have been going down in many products and food costs have not fallen even percentagewise very much. This is particularly true, of course, in the product you do not handle; namely, the meat products. We have lots of stickiness in meat prices.

But you might help us—you are a respected businessman from a very large company—in explaining why food prices are not falling as quickly as farm prices.

Mr. PETERSON. Well, I think there are two basic reasons. One, usually a company has some coverage for its basic ingredients so the price that is paid and has an inventory which would extend beyond the price the farmer has received for a commodity.

The second issue is one of the impact of labor costs, energy costs and other costs that go in to the manufacturing process that are much heavier in the retailing and the manufacturing end of the food business than they are for the farmer. Those costs have continued to increase.

As I have stated, our company, as I believe many others in the food industry have, had productivity programs which have attempted to minimize those costs, and I could enumerate some of the types of programs that our company has carried.

Chairman HUMPHREY. What have you been doing as a company to mitigate these cost rises or, in other words, even to bring these costs down, which you are indicating today in your testimony?

Mr. PETERSON. I mentioned earlier in my testimony that our energy costs have increased 37 percent. That is a unique figure for our company and would be a little lower than the food industry where that has been in the 50 percent range. We have had a program of conservation reducing the use of energy by 10 percent during the past year.

In other areas we have had a 36 percent reduction in the metal ends of cans over the last 10 years with a program to continue to reduce the amount of metal that is being used. This has two affects, that has lowered our costs, of course, and has had an impact on our environment.

Chairman HUMPHREY. How do you do that?

Mr. PETERSON. By working with technical people in the packaging area we have developed new types of metal, new designs, and new applications that can use a much lighter metal in the can itself.

Chairman HUMPHREY. And still protect the product inside, right?

Mr. PETERSON. In some cases it affords more protection than before. There is a double benefit.

We have moved very aggressively to the bulk handling of flour to bakeries, and this program has saved about 11 million pounds of multiwallpaper bags that were previously used in the distribution of flour to the bakeries.

We have a process in Grand Forks, N. Dak., where we convert about 50 tons of potatoes, a process that peels the potato flakes into feed for turkeys, some of which go to California, and for chickens.

Chairman HUMPHREY. Are those the peels?

Mr. PETERSON. We take the peels and make little pellets that turkeys consume. So we have saved the ecology, the use of the peel and—they used to say you get everything from the pig except the squeal, well we get everything from the potato, including the peel.

Chairman HUMPHREY. And you make those into little feed pellets?

Mr. PETERSON. Yes, into feed pellets, feed for chickens and turkeys.

Chairman HUMPHREY. You have potato peels?

Mr. PETERSON. We have for the farms.

In our Burger King restaurants we have replaced paper bags and containers with trays for those people that consume products on the premises. That has saved about 30 percent of the total cardboard in the total restaurant chain.

Chairman HUMPHREY. One of your competitors in the hamburger business has these cartons, and I wonder why in the world they continue to use these expensive cartons. I, by the way stopped into the Burger King not long ago when I was home on highway No. 12. But I stopped in at this other place, where they have this fellow Ronald and I noticed for takeout orders they have a very highly processed carton as well as the wrapping of the sandwich and the hamburger; and I would think that would be a very heavy cost item.

Mr. PETERSON. We are working very directly on that particular issue for two reasons, the ecology, obviously, and to continue to offset the increase in costs for labor and energy and other ingredients.

I might add, one other project we have in the State of Pennsylvania where we are attempting to convert our solid waste and sewage sludge into fuel for a furnace will supply the steam and some of electricity from that plant.

Chairman HUMPHREY. These are very interesting observations you are making for us, about what is happening out in industry. We do not always hear about what is really happening. We read and get a good deal of esoteric conversation around here.

Are other industries doing this sort of thing that you are talking about, under the crunch of the energy price rise—I was going to say shortage, but there is no shortage? It is mainly price we are talking about. Are other industries making these moves? You are obviously in a competitive situation, so your competitors must be looking at what you are doing. You bring around these tin cans and show us what you are doing and now you are telling us what you are doing in the use of sewage. Is that a practice in the industry?

Mr. PETERSON. I believe every well-run company has a program of this type. It is also my belief that the American food industry is probably the most competitive industry in the country, and each company is competing in the cost arena. The American consumer, in my view, is a connoisseur who has a keen view of what is valuable and what they need. The steps we are taking to reduce the price of these products is in response to that belief, and we believe it is good for the consumer and it will be good for our company because the consumer will see the added price value of these products and will respond by greater purchasing.

These products compete with a product range with bakery-type and bread-type products.

Chairman HUMPHREY. You mentioned this competition, and that brings to mind something about the preliminary study on the food-retailing industry, which reveals a striking degree of simularity of prices; 75 percent of the prices in retail stores were identical. Now, at your level, the processing level, the manufacturing level, there may be a good deal of competition. I do not think I have seen any studies that would indicate to the contrary. But at the retail level, and I repeat, it is a preliminary study but it was rather extensive,

about 75 percent of the prices in the retail stores are identical. To what do you attribute that?

Mr. PETERSON. Well, I am not an expert on the retail industry, and I would not pretend to speak for them, but I would go back and say that I can remember when all gum was a nickel, and I did not think that was an unusual thing that that particular commodity would be priced at the same price. I think today——

Chairman HUMPHREY. Well it was not always that way, because I remember we used to sell three packages for a dime on what I would call these teaser sales, the low-cost items to bring the folks into the store. Do not misunderstand me. I am sure there is considerable competition in the processing areas, because you make different products, too, I mean products that are not identical. You have a particular line of products that are unusual to your company. But there are competing products that may not be identical. So that people do get some choices, but insignificantly enough, many of the stores, and we go to A. & P. and Safeway and many of the stores, and we find strange similarity in price structure for comparable products, not the same brand name. Suppose that Heinz catsup, for example, in a number of stores might be different. I think you would most likely find it somewhat different. But you are not in the retail business, are you?

Mr. PETERSON. No, I am not, but I do believe most food products are quite sensitive to price and any deviation from what the consumer might consider to be the true value of that product would have a material effect on the volume that might be generated by the sale.

Chairman HUMPHREY. Let me move quickly to another pricing element. With farm prices falling, and I surely do not rejoice in that statement, I can assure you, because I think our farmers are going to be in very serious trouble this year with the high cost of products and high interest rates on their loans. I get no comfort out of hearing farm prices are falling. I want this record to be very clear. I think it is a major problem.

As you know, coming from Minnesota, we are having a small uprising out there among our farmers. I have been summoned to a meeting at Windom, Minn., this Saturday where they have said there will be over 2,500 farmers who do not just want to talk to me but work me over. There is another one at Alexandria, Minn., and Wheaton, Minn. These are farmers who will decide whether they are going to plow under their crops to cut production and increase prices.

But having said that, apparently farm prices are receding. If these trends continue, in light of your earlier reply to the relationship of basic commodities to cost, would you be able to cut your prices again?

Mr. PETERSON. Well, we would hope that with a return of normal weather this summer that we would see materially increased crop yields, and that this would enable the food business to reverse the trend of rising food costs.

We believe this is one of the first evidences that in the food industry and we are very delighted to be able to take this action which we believe deals with the most pressing part of inflation as far as the consumer is concerned, that is food, which is the most basic of all things they have to buy.

Chairman HUMPHREY. The Secretary of Agriculture said he thought food prices would go up this year. Do you think so?

Mr. PETERSON. He has been changing his estimate, I believe. In December his estimate or the Department's estimate was about 15 percent. That came down, I think, in February to about 7½ percent and in this morning's paper, I believe, he did forecast lower prices, at least in the second half of this year. We are in tune with that trend.

We have been watching these commodity prices for about a year, and in December we told people publicly that we thought we would be able to reduce prices in the first half of 1975 and that has come true. I hope the trend will continue.

Chairman HUMPHREY. Congressman Rousselot.

Representative ROUSSELOT. Thank you, Senator.

Mr. Peterson, we appreciate your testimony and especially the good news about lower pricing, especially at your level. Do you find that other food processors are experiencing the same thing; your competition shows some signs of lower price levels?

Mr. PETERSON. I do not think there have been any broad reductions in food prices as yet.

Representative ROUSSELOT. Processors?

Mr. PETERSON. I mentioned flour, Pillsbury's Best flour, and that was across that broad sector of the food business. To my knowledge, this was the first broad reduction by any major manufacturer.

Representative ROUSSELOT. Well, you certainly bring very good tidings today to the consumer and the housewife.

Is there a timelag that a processor or producer reduces his price from the time it is sold at the retail level?

Mr. PETERSON. Yes; I commented earlier we estimated on this particular line of products it would take somewhere between 2 and 5 weeks for prices to be broadly reduced. I did comment that I have had reports that some retailers have already dropped the price and are——

Representative ROUSSELOT. Normally it is 2 to 5 weeks?

Mr. PETERSON. It would take that amount of time to find its way through the distribution system.

Representative ROUSSELOT. So if the pattern you have indicated here today is true for other producers, then the housewife can on these kinds of items that you have mentioned expect reductions on the consumer level, the retail level, within 2 to 5 weeks.

Mr. PETERSON. That is true of our products; yes.

Representative ROUSSELOT. Is that normally the case of other producers, too? Is it a reasonable period of time, 2 to 5 weeks?

Mr. PETERSON. I would say so. It would depend on the turnover in the item. If it is a slow moving item——

Representative ROUSSELOT. If you are overstocked it might not come down so quickly?

Mr. PETERSON. I would like to correct one statement. I said this line represented 300 million—it is 630 million packages a year.

Chairman HUMPHREY. Is that your total line of packages?

Mr. PETERSON. Just the price we have reduced price on.

Representative ROUSSELOT. 630,000?

Mr. PETERSON. 630 million.

Representative ROUSSELOT. That ought to be interesting to the housewife, especially if your other fellow producers do the same thing.

I am delighted to have your testimony on wage and price controls, at least price controls, because I think Congress has finally gotten the message, too, that they do not work too well, and I am delighted to have your comments that you do not think that would necessarily enhance the market place for the consumer.

Do you find that you have to do much of your financing in the general money market? Are you required to go to the money market much these days to finance new equipment, whatever?

Mr. PETERSON. We have been spending about twice our cash flow over the last 2 years. We have had a major expansion program in our restaurant operation, and we have also had productivity projected broadly throughout the company. Yes, we have used——

Representative ROUSSELOT. How do you find that deficit financing on our part here in the Congress, that is unwillingness to live within our means or what we have affects your ability to get money in the marketplace?

Mr. PETERSON. Well, I do not think I am really competent to make a broad——

Representative ROUSSELOT. If that is too much of a hard question I would be glad to have it in writing for the committee, because we are contemplating anywhere from $50 to $70 billion deficit this year, next year around $100 billion, what the projections of your finance people are is to how it will affect your ability to gain financing.

Mr. PETERSON. Let me make one observation. As the demand for money increases the interest rate has had a direct affect on the equity market. There has in effect been no equity market for many months, as you probably know. The common stock issue has been very rare things. Hopefully, if interest rates can continue to go down, and they probably will not if there is a large deficit, but if they were to continue to go down we feel that the equity market will return. So there is a very direct relationship between——

Representative ROUSSELOT. It can effect your ability to finance what you need to do to produce products at a lower rate. Is that correct?

Mr. PETERSON. Very directly.

Representative ROUSSELOT. So it does indirectly affect the consumer in your ability to produce low-priced products for the consumer. Is that correct?

Mr. PETERSON. That is correct.

Representative ROUSSELOT. I appreciate your comments.

I was interested in your thoughts about the consumer demonstrating their ability to substitute one food product for another. In other words, the consumer or the housewife, and she is one of our biggest shoppers, does adjust, if one product, eggs goes up to much she adjusts to a lower priced product, so she does shop around?

Mr. PETERSON. That is correct.

Representative ROUSSELOT. A little more intelligent than we sometimes give her credit for.

Mr. PETERSON. She is a very intelligent shopper.

Representative ROUSSELOT. Thank you.

Chairman HUMPHREY. Mr. Peterson, just a matter that may be beyond your range of wanting to comment, but there is some discussion of exporting management regulations. In other words, when we draw on domestic supplies and they seem to be getting very scarce, there have been suggestions that at least there ought to be a very close monitoring of supports, and I have made the suggestion, for example, that no importer ought to be able to import more than 120 percent of their baseline; in other words, so that you did not have Saudi Arabia jumping in here buying up our crop stocks and the Soviet Union buying more than it ordinarily would purchase. My thinking is you ought to take care of your regular customers and give sympathetic treatment to your regular customers and let no one come in and sort of grab the market. What is your view as to some kind of regulations without having what you call supporting embargoes?

Mr. PETERSON. I would agree with your comment on embargoes. We are on a one world system in food or one world market. I think it would be both amoral and sacrilegious for the American public to deny the world sharing of food. The United States exports about 50 percent of the total grain in the world and has a responsibility to see that those ingredients and commodities move freely.

I would say, and I am a free-market man, because I think that is where the incentive in the system gets the greatest amount of productivity available, I would say, though, that a free knowledge of what is going on in that market is very necessary for the market to operate. I think the fact that in 1972 broad quantities of grain were purchased at very low prices was due to the fact that there was not knowledge of supply and demand, and there must be very adequate information for both buyer and seller for the free market system to work properly. I think that is fundamental, and I think that is something that must be addressed frequently and thoroughly to make sure that it is operating properly.

Representative ROUSSELOT. Senator, I have to go vote, but I want to compliment you on such an intelligent constituent.

Chairman HUMPHREY. Thank you very much. It is kind of nice to have somebody come in here and announce that price reductions are taking place when people have such unbelievable troubles over inflation.

We want to thank you very much. We do not want to let you out of here yet.

Thank you, Congressman.

Let me just say in reference to the matter on supporting management, and I put it in the form of management, not in the form of controls or embargoes. I have long proposed that we have a strategic food reserve of basic commodities in the country, and hopefully insulated sufficiently from the market so as not to have a price depressing effect on the farmer but to have some price stabilizing effect in case suppliers are so terribly short that they go sky high and get totally out of sight. Also it would be a reserve that would make it possible for us to be a reliable supporter, because of support trade is very, very important to us, particularly in a time when we have

to buy high-priced energy. Finally, a reserve would be a means of being able to sop up at times excess production as we have in the coming year, thereby holding a fairly reasonable price structure for the farm producer.

Do you have any thoughts on reserves?

Mr. PETERSON. I do not propose to be an expert, but I do have a personal opinion. I believe that the world's supply and demand of food is in very tight balance, and with the impact of weather as it was this past year in the United States it would be a very rational move to provide some reserve funds of grains for our users, both domestically and in the world.

I have heard estimates that some million metric-tons would probably be very adequate for that purpose. I do not propose to have ideas on how that should be funded or managed. I think those are mainly political issues beyond my particular expertise.

But I would join you in thinking that that would be a very proper position for this country to take.

Chairman HUMPHREY. Well, there is always this argument that the cost of the reserves is very high, and I just wanted to state for the record again, the only time you would accumulate reserves is when the price of the basic commodity, the raw material is low. That is when the Government would buy in. The only time that you could sell the reserves under the proposal I have would be at 150 percent of target price, for example. Let's say wheat. We have a reserve and a target price being contemplated now at about $3.25 or $3.50 per bushel of wheat. That is what the floor price is. Anything between the floor price and the market price under our present legislation would be made up by the Government. Fortunately market prices have been above floor prices, so the Government has had no expenditures, but as a way of sharing the risk with the farmer, when the Government asks for all-out production we have said they will assure you, Mr. Farmer, the floor price, and if the market price goes below that floor price the Government will make up the difference to you. I repeat, as of recent years the market price has been way above the floor price.

Now, my reserve program would simply say, if you had a floor price on wheat of $3 per bushel, you could not sell out of the reserve for less than $4.50. But at least you would have some reserve, and it would not mean if the supply got tight it would run up to $7 a bushel, which would be highly inflationary. It would not help the farmer, who is a large consumer of his own product, or the urban dweller who is a consumer. So this is what we are talking about.

Finally, you mentioned something about accurate information. It not only has to be accurate but timely?

Mr. PETERSON. Yes.

Chairman HUMPHREY. Very important in this business of food production and food processing. It is very important for you as a processor to note the latest trends in production, in distribution, in pricing, no matter where they are, because we are all tied into a world system, and I have been working to have this Congress in a major effort expand, modernize, and up-date using the latest tech-

nologies to bring in a better information system on everything that relates to agriculture and agribusiness. We have this presently underway in the Office of Technology Assessment. We have brought in experts from all over the United States. We have a panel of experts working on it, plus people in the scientific and technological community working on it to improve our own information system in the Department of Agriculture, and to improve it on a worldwide basis. Even though we may have the best of information here about our own production, our own plantings, our own intention of plantings, which by the way has a lot to do with the futures markets, we may have all of that information, but if we do not know what is going on in Eastern Europe, in Western Europe, or in West Africa, or the Middle East, or the Soviet Union or China, we are still in a situation where the information is less than adequate and inaccurate, and someone said a man's judgment is no better than his information.

One of the problems we have had on marketing and prices is that our information has been scanty. That has been less than adequate, to put it in the most modest terms. We have never quite known what the Russians intended to buy. We have never quite known what their plantings were, what their market situation was. I have told the Russians, and I am going to be there again in another few weeks, I have sat down with the chairman of the Council of Ministers, Minister of Agriculture, and said if you want the United States to be a reliable supporter of your needs you have got to give us better information as to what those needs will be. Otherwise you, sir, as a processor in the United States are never really in control because it can be modified by the Soviet Union overnight.

According to your testimony, the commodities that you buy represent about 50 percent of the cost of the product that you process. Is that correct?

Mr. PETERSON. That is correct.

Chairman HUMPHREY. Therefore, I think the consumer needs to know in America that you are not always in control of the price of this product. In fact, you are really never in control, but you are in less control if we do not have accurate information as to supports and as to what the possibilities are in supports. You must have forward buying in your business?

Mr. PETERSON. That is right.

Chairman HUMPHREY. These are matters that make this agribusiness situation so complicated, and this has a real effect on the retail price down the line, because people do not understand these retail prices are always hedged a bit.

Has a portion of your price charge covering processing increased significantly in the past couple of years?

Mr. PETERSON. I do not believe so. The last year, particularly, our margins were reduced by the increase in commodity prices in our consumer area.

Chairman HUMPHREY. So that your processing, the actual managing department would not substantially increase?

Mr. PETERSON. Would not go up as much.

Chairman HUMPHREY. Would not go up as much?

Mr. PETERSON. Right. On the ingredients mentioned we had a 258 percent increase over a 2-plus year period in these particularly com-

modities, and that is far in excess of any other cost increase that we experienced.

Chairman HUMPHREY. Now, you have reduced these prices, which of course is some of the best news, and I want to compliment you. I have heard there was the possibility of a company like yours doing this. I was very happy to invite you to testify, because I think this has a rippling effect throughout the economy. I believe other companies will sense something is happening. You have been a leader. We are really very grateful to you and I hope that the response on a national basis will be rather significant, and I think it can be.

The need of some reassurance in this economy to the consumer is of paramount importance. Your testimony today, I believe, signifies that there is a determined effort being made in the food industry to cut costs and bring products down closer to the purchasing power of American people.

I will not keep you any longer, Mr. Peterson. I just want to thank you very much and appreciate you taking your time to come down.

Mr. PETERSON. Senator, I want to thank you very much for allowing us to participate in your committee.

Thank you very much.

Chairman HUMPHREY. The committee stands adjourned.

[Whereupon, at 12:40 p.m., the committee adjourned, subject to the call of the Chair.]

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