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THE 1976 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

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NINETY-FOURTH CONGRESS

SECOND SESSION

PART 1

JANUARY 28 AND 29, FEBRUARY 4 AND 5, 1976

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THE 1976 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 28, 1976

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

The committee met, pursuant to notice, at 10:05 a.m., in room 318, Russell Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey and Proxmire; and Representatives Bolling, Reuss, Moorhead, Long, Brown of Ohio, Brown of Michigan, and Heckler.

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

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. The committee will come to order.

We are very pleased that the Council of Economic Advisers is with us today. We welcome you before the Joint Economic Committee.

As I have said to you, Mr. Greenspan, on a number of occasions, you have been very cooperative with us and we want to express our appreciation for the cooperation which has been extended by the Council and the members of its staff. We welcome Mr. MacAvoy and Mr. Malkiel, members of the Council. I don't believe we have seen you of recent date, Mr. MacAvoy. We remember when you were with us on the first occasion.

The issues to which we might address ourselves this morning are legion: Regulatory reform, energy policy, agriculture, health, and welfare. I hope that we will address each of these issues and others at some point during our hearings. However, we will start off this morning by focusing on the issues which are most essential to the particular mandate of the Joint Economic Committee. These are, of course, the issues of employment and inflation.

The administration has what can only be described as a "do-nothing" position on both of these issues. You will remember that in 1948 we had what the President—President Truman—described as a "do-nothing" Congress. That may have been a dramatic exaggeration but many felt that way. I don't want to travel under false colors, and I don't make these comments at all personally, but in examining the budget message and the Economic Report of the President, gentlemen, I can't help but say we are not attacking the two fundamental issues of inflation and recession which plague the economy today.

The President states in his economic report, "It is often said that we must choose between inflation and unemployment—I reject this view."

I agree with the President that we do not have to choose between inflation and unemployment. The difference between us is this: the President, as best as I can tell, is satisfied to endure both inflation and unemployment for a considerable period of time. I believe that, with proper policies, we can make much more rapid progress against both inflation and unemployment.

I know what the traditional argument has been: That if we move too fast on unemployment, that it generates inflation. I think that is subject to debate. Merely having stated it, doesn't necessarily prove the case.

With regard to unemployment, the President recommends phasing out both public employment programs and income-support programs for the unemployed. This would be fine if the private sector were in a position to absorb the slack thus created. We must recognize, however, that revival in the private sector cannot occur miraculously over night. It will be several years—I think we all agree on that—before the private sector will be in a position to offer enough jobs for all those who are seeking work.

During this period, this transitional period, the Government must continue and indeed enlarge its temporary emergency job programs. I want to speak very candidly. I consider both the administration and the Congress timid, fearful about attacking the problems of employment. We are content to dole out money in a sophisticated welfare program rather than putting people to work.

I would like to have this Council explain to me why with all the things that need to be done in this country, why we aren't able to put people on jobs to get it done and why we go the easy way of running a computer to just turn out checks. That is what is happening. Why aren't we reforesting our forests. We are 15 years behind, Mr. Greenspan, If you don't believe so, you can ask the Secretary of Agriculture. He isn't doing anything about it. I am chairman of the committee and I am the author of the National Resources Planning Act for range land and forests. We are 15 years behind in our reforesting. We have hundreds of thousands of young people who could be out planting those trees under proper supervision. That is looking to the future you know, because that is a renewable resource that we need to do something about.

And I look and see what is happening to our transportation system, to the railroads of this country, and obviously there is something that can be done. But we have gotten this computer now that knows how to write checks faster than the human ever dreamed possible So we have what I call the computer economic policy to just put in the names and run out the checks instead of putting people to work.

My personal view is the work should be mostly in the private sector, but every single recession compels management, of course, to tighten up. After every recession the level of unemployment is just a little higher. It takes a little longer to employ these people. So I'm not going to be content with just a conventional argument and a conventional response that it takes times. People die in time. I know it takes time to turn a private economy around but that is why we have a government. I don't want the Government to take over the private economy because it can't run it; it can't even run the Post Office. But I do think the Government can take over a certain amount of emergency public works and job programs such as public service jobs.

This recession has left in its path a dreadful aftermath. Many people have experienced an economic disaster. I just came back from Rhode Island and I want my colleagues to know this. I went up there to make a speech. In the talk I said: "You know, we have 8.3 percent unemployment." And a fellow jumped up in the audience and said: "What is wrong with you, Senator Humphrey? We have 12-½ percent unemployment in Rhode Island, and the Government knocked off 10 percent of our entire payroll up here with one fell swoop removing the bases. So we have 12-½ percent."

You know I was out in Los Angeles. The Mayor of Los Angeles comes up and testifies. I am reading one of those Government documents we have around here and I said to the Mayor: "Mr. Mayor, I want to read you what the official report of unemployment here is and it is 8.3 percent." Mayor Bradley looked right at me and said: "Senator, don't come out here and talk like that." He said: "We have 11 percent unemployment in Los Angeles."

Now this is the sort of thing that I want us to get at. Frankly when I look at these reports, they don't get at it. I know the administration is worried. I don't try to put any bad motives on any of you. But it doesn't act. As far as I can see, the administration's economic report does not have a single suggestion for dealing with inflation. The only suggestion is hoping that it is going to come down.

Let me be specific. In fact, I think some of the suggestions will raise prices. The recommended social security and unemployment insurance tax increases would be inflationary. There isn't any other way you can interpret it. When you put an additional unemployment insurance tax on a merchant or manufacturer or a social security tax on anybody, that adds to the cost.

Next, the deregulation of natural gas prices will be inflationary. There is a lot of difference between an increased price and total deregulation, which is to let the market work its will regardless of the consequences.

Perhaps these measures are necessary despite their inflationary impact. I'm sure you will make a case for that. I'm not personally at all convinced that they are. But I recognize that there are arguments on both sides.

However, if these inflationary measures are necessary, surely they should be offset by some kind of anti-inflation policy.

It is rather shocking that this administration, which talks so much about inflation; this administration which predicts a 26-percent rise in corporate profits this year; this administration which points out so correctly that 1976 is the heavy year of the collective bargaining cycle has no policy proposals whatsoever for dealing with inflation. I am amazed.

The Council on Wage and Price Stability created by the President at the time of the summit meetings in 1974 is not even mentioned in the Economic Report. It is just like the Council of Wage Price Stability has been eliminated from the face of the earth.

I wish to announce this morning, so that the public will not be in doubt about this, that the Council on Wage and Price Stability has not been eliminated. There is a line item in the budget for it. It does exist. It has offices right here in Washington. I want all of you who are taking these notes to make that clear to the public. The phone is answered if you call them up. They put out some helpful studies. I think they may be trying to do a good job of helping to fight inflation.

I do have a suggestion. I suggest that the President get on the telephone to the Director of his Council on Wage and Price Stability, Mr. Moskow, and discuss with him that 1976 is a crucial and important collective bargaining year and that rapidly rising prices may invite demands for large wage increases. Industrial prices at this moment are rising far more rapidly that they should during this early stage of recovery. I suggest the President tell Mr. Moskow that he will have full Presidential backing for any efforts the Council undertakes to restrain price increases and to moderate wage increases if they are excessive. I suggest the President tell Mr. Moskow to make full use of his subpena power, which is totally unused. It is brand new as far as they are concerned and hasn't even been taken out of cellophane. It has never been used as if nothing has been happening in this country.

I want to make it clear I'm not an advocate of price and wage controls. I say that, and I mean it. But there is a great deal the Government can do with present legislative authority that would be extremely helpful. Stronger action by the Council on Wage and Price Stability is only one element in the coordinated attack. The year 1976 is going to be a test year, a moment of truth during which we discover whether reductions in the rate of inflation can be achieved or whether we are stuck indefinitely with a continuing inflation rate of 6 or 7 percent.

Frankly, I didn't expect this administration to recommend much in the way of employment policy. When a budget comes down here that cuts manpower programs 27 percent and its total public works program is for Federal prisons and its increase in the budget is 15 percent in the Pentagon, I tell you gentlemen, the priorities are cockeyed. I'm only saying to you what I have said to others because there is no sense to try to travel with two scenarios. It doesn't work. I don't believe that a budget policy that recommends a 20-percent reduction in its manpower policy, $1 billion less in nutrition programs, an 11-percent reduction in education, is a policy that gets at either recession or inflation.

I have spoken very frankly and I expect you to do the same. We are all grownup people. There is nothing personal: It is just a matter of policy. I personally consider that the policies that are being recommended this time are short of the target. In fact. I don't think anybody is even talking of doing something about the problems of unemployment on the one hand—except to wait and see what happens—and inflation on the other hand. Any policy that isn't directed toward those two evils is no policy.

Now, Mr. Greenspan, you have equal time. You can have 50–50.

STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY PAUL W. MacAVOY AND BURTON G. MALKIEL, MEMBERS

Mr. GREENSPAN. That means that I am a loser if I'm only going to get 50–50, Mr. Chairman.

Chairman HUMPHREY. Well that is a good confession.

Mr. GREENSPAN. As always, I appreciate your candor. I must say we will endeavor to do the same. Mr. Chairman, and members of the committee, we are always pleased to appear before the Joint Economic Committee to discuss the annual report of the Council of Economic Advisers.

Instead of a lengthy discussion of the report I would like to make some general remarks on behalf of the Council about current economic conditions and policy, and our expectations for the balance of the year.

As you know, this is the second time that I have appeared before this committee to present an annual report, and the circumstances today are more propitious. Last year at this time the economy was in the late stages of the most severe recession of the postwar period. The very sharpness of the decline made it difficult to gage future developments. Final sales, following the sharp decline of late 1974, bottomed out in the first quarter of last year. Production continued downward until April, as the very heavy overhang of excess inventories which had been built up in 1974 was being knocked off. The economy began to turn around decisively in the second quarter of the year as final sales began to recover. Real final sales rose at a 4.5 percent annual rate in the final three quarters of the year. As the extraordinarily rapid inventory liquidation drew to completion production and employment rose rapidly.

The economy is now in the ninth month of recovery. Production has been rising rapidly since the spring of last year. Real gross national product rose at an 8.6 percent rate in the second half of last year. Industrial production has risen as you know at a 12.0 percent rate since the low point of last April. Total employment in December was up by 1.3 million from the low of last March. Prices, which rose by slightly more than 12 percent between December 1973 and December 1974 rose by 7 percent during comparable months of last year. Increasing employment, lower inflation and the tax reductions have each contributed to significant gains in real disposable incomes.

This recovery started from very low levels of resource utilization. Hence, unemployment will almost surely remain distressingly high this year even though large gains in employment are expected during 1976. Accordingly, we must seek to lower unemployment as rapidly as is consistent with the need to ensure that the reductions will be lasting. Policies that might speed the decline in unemployment in the short run should not be so expansionary as to lead to increased stability and greater social hardships in the long run. Thus policies for 1976 must attempt to sustain the recovery now in progress but at a pace sufficiently moderate to prevent renewed imbalances and a rise in inflation. They must also continue to mitigate the hardships associated with high unemployment. At the same time, our present policies must lay the foundations for a long period of steady growth.

Because we began the present recovery with more slack than in any of the previous postwar cycles, a much longer period of above-average growth will be required for a return to full resource utilization. Even under the best circumstances the return to full employment cannot realistically be accomplished this year or next. To ensure that we return to high levels of resource utilization—as is our objective—the recovery must therefore be a durable one.

Our best estimate is that real gross national product, GNP, will be 6 to 6½ percent higher in 1976 than in 1975. This growth rate is not a goal. Rather, it is a projected outcome of the forces of recovery that were set in motion in 1975, by stimulative fiscal measures and by a return of consumer and business confidence and by external economic factors. With real GNP estimated to grow by 6 to 6½ percent from 1975 to 1976, the unemployment rate should fall by almost a full percentage point during this year. The rate of inflation is expected to continue with little change from late 1975 throughout this year; and hence the GNP deflator, which had risen by 9 percent from 1974 to 1975, should rise by only about 6 percent from 1975 to 1976.

Thus far the recovery has been accelerated by a sharp change in the behavior of inventories, while real final sales have shown fairly steady growth since the first quarter of last year. The sudden cessation of high rates of inventory liquidation in mid-1975 accounted for a substantial part of the growth in real GNP during the last half of that year. The bulk of excess inventories appears to have been worked off, and more normal rates of inventory accumulation should become evident in 1976. Nevertheless, year over year, almost 1½ percentage points of the growth in real GNP is still likely to be due to the inventory swing. Once inventories reach desired levels, the continued strength of the recovery will depend on the vigor of final demand for goods and services.

Mr. Chairman, we have discussions in the prepared statement on various different areas of real GNP that I will skip over, but I felt that I would perhaps insert in the record.

Chairman Humphrey. Yes, we will do that.

Mr. Greenspan. I would just like perhaps to move to some general discussion of economic policy and then——

Chairman Humphrey. Yes, and anything you might have, Mr. Greenspan, on manpower policy, I imagine that fits in your general discussion?

Mr. Greenspan. Yes. Let me just move ahead a few pages.

The availability of much unemployed labor and unused plant capacity requires that economic policy should continue to support an economic expansion at growth rates significantly above the long-term growth of capacity output. But our knowledge of the interdependence between real growth and inflation is not sufficiently precise to permit a direct translation from general goals to specific targets. As a consequence, policies cannot be designed to reach any particular targets with a high degree of confidence.

We believe however, that policies consistent with a moderate but sustained recovery offer a far safer and surer route to full employment than policies which attempt to engineer a very rapid return to full capacity. What we need is a durable recovery—not a boom that carried the seeds of renewed stability in prices, incomes, and employment. This view is based on several considerations.

The difficult inflationary period through which we have come makes is likely that overly expansionary policies, which risk increasing inflationary pressures, will quickly influence consumers' and producers' expectations. High rates of inflation have made price expectations a much more important determinant of consumer and business behavior than they formerly were. It is a harsh fact of economic life that expectations of inflation are built into labor and other contracts in such a way as to be partly self-fulfilling.

Moreover, increased inflationary expectations could restrain both consumption and investment expenditures and thus jeopardize long-term economic goals. High and variable rates of inflation not only create imbalances and sectoral distortions by capriciously changing the real value of existing contracts, but they also raise risk premiums investment decisions and in wage bargains.

The recovery begins with a very high rate of inflation. We expect prices to rise at about a 6-percent rate during the year. Our ability to forecast is at best imperfect and I should like to point out again, as I have on a number of previous appearances before this committee, that economists have not done well over the years in forecasting wage and price trends. A poor understanding of the inflation process is one of the major problems in forecasting and hence in economic policy analysis. We believe that this is the largest area of uncertainty in our forecast and as such, inflation could pose a major threat to the viability of the present recovery.

Policies that are perceived to entail higher inflation risks may not, therefore, affect economic activity and employment in a way that would normally be expected. Even if such policies should succeed in accelerating the recovery in the short run, it would be difficult to decelerate from unusually rapid growth rates to sustainable rates without running the risk of amplifying future fluctuations in economic activities.

There is a lesson to be drawn from past policy mistakes. The history of monetary and fiscal policies demonstrates that we have a great deal to learn about implementing discretionary policy changes. Our ability to forecast is at best imperfect, especially in an increasingly complex and interdependent world, and the difficulties in forecasting grow larger as we extend the period for which the forecast is made. This is a significant problem because of the time lags involved in altering the pace of economic activity through discretionary monetary and fiscal actions. There is a perception lag in diagnosing the problem, a reaction lag in selecting the appripriate response, and an implementation lag in having the policy prescription accepted and put into effect through our political and administrative processes.

We also lack reliable estimates of how long it takes before the economy responds to policies once they are undertaken and how large the response will be. With respect to fiscal policy there is the additional complication that countercyclical increases in Government expenditures are difficult to check during later upswings. Because countercyclical policy changes may be slow to take hold and then difficult to reverse, their effects may extend well beyond the time when they are most needed. Consequently, a significant danger exists that, instead of smoothing economic fluctuations, discretionary changes in policy aimed at demand management may themselves become a source of economic instability.

The proper conclusion is not that we should forswear the use of discretionary policy. Some external shocks to the economic system can and should be offset. Furthermore, provided the growth in Federal outlays becomes more moderate than in the years just past, occasional discretionary adjustments of the income tax schedules are called for in order to prevent excessive growth in Federal taxes. In fact these changes may have to be more frequent if the rate of inflation continues at a somewhat higher average level than at comparable levels of economic activity in the past. But we must be mindful of the great difficulties in successfully executing countercyclical policies.

Over the past year or so we have examined a large number of specific proposals such as public service employment programs, which often advocated to reduce unemployment directly and rapidly. One thing that stands out in our analysis is that public service employment programs have very large displacement effects. There is, therefore, an important distinction to be made between the gross number of jobs paid for or funded under the programs and the net number of new jobs that are created. Public service employment funds tend to be used for financing employment of people who would ordinarily be hired with State and local funds. Even after the first year only 40 percent of the jobs funded represent net new job creation, and after several years the net new job figure declines to about 10 percent. Consequently, a public service employment job funded at $9,000 per year actually costs the Federal Government more than $20,000 per new job at the end of the first year and somewhere in the neighborhood of $90,000 after several years have passed. Moreover, once in place, Public Service Employment programs are difficult to remove, so that they become permanent policies. In our view, therefore the Public Service Employment approach is not a viable solution to our unemployment problem.

What is called for in our judgment is a steadier course in macroeconomic policies broadly consistent with sustainable long-term noninflationary growth.

The severity of the recent recession does call for maintaining stimulative economic policies to accommodate an expansion of real output at a rate above that sustainable in the long run. But departures from the policies that are appropriate in the long run should be moderate. We should try to limit the size and duration of any policy deviations that promise short-term benefits but risk interfering with our long-run goals. If we do not commit ourselves to moderate policies we may increase economic instability and lose our chance for sustainable growth, which we believe offers the safest and surest route to full employment in future years.

Mr. Chairman, I asked that the full text of my prepared statement be inserted in the record.

Chairman HUMPHREY. Of course.

[The prepared statement of Mr. Greenspan follows:]

PREPARED STATEMENT OF HON. ALAN GREENSPAN

We are pleased to appear before the Joint Economic Committee today to discuss the Annual Report of the Council of Economic Advisors. Instead of a lengthy discussion of the Report I would like to make some general remarks on behalf of the Council about current economic conditions and policy, and our expectations for the balance of the year.

As you know this is the second time that I have appeared before this Committee to present an Annual Report, and the circumstances today are much more propitious. Last year at this time the economy was in the late stages of the most severe recession of the postwar period. The very sharpness of the decline made it difficult to gage future developments. Final sales, following the sharp decline of late 1974, bottomed out in the first quarter of last year. Production continued downward until April, as the very heavy overhang of excess inventories which had been built up in 1974 was being worked off. The economy began to turn around decivisely in the second quarter of the year as final sales began to recover. Real final sales rose at a 4.5 percent annual rate in the final three quarters of the year. As the extraordinaryily rapid inventory liquidation drew to completion production and employment rose rapidly.

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Personal consumption expedintures are expected to impart considerable strength to the economy. During 1976 consumption is projected to rise by almost 6 percent in real terms, compared with 3.9 percent during 1975, yielding a year-to-year increase of 5 percent. A close to 6 percent rise during 1976 is consistent with about 5 percent growth in real disposal income, because the average saving rate is projected to fall below the abnormally high 8¼ percent level registered last year. A gradual decline in the saving rate is predicated on year-over-year declines in the rate of increase in consumer prices and in unemployment and layoff rates. Even so, the saving rate for 1976 is expected to remain above its 7 percent average for the previous cycle (1969-73).

Recent experience suggests that consumers react to heightened inflationary expectations by saving more, rather than by advancing their purchases of storable commodoties. Thus we expect a fall in desired saving, or a rise in the propensity to consume, as lower inflation rates are incorporated into consumer expectations. Uncertainties which tend to reduce consumption are also created by high unemployment rates and particularly by high rates of job layoffs. As the unemployment rate and layoff rate continue to recede, we would therefore expect an alleviation of concern about job security to manifest itself in reduced saving and higher consumption in the household sector. Increased consumer confidence and lower saving rates may also result from the partial restoration during 1975 of the real financial assets of households, which had eroded severely in 1973 and 1974.

Nonresidential fixed investment normally lags in economic recoveries, and it is likely to do so again. Nevertheless we expect some strength to develop in business investment in the course of 1976, on the assumption that substantial modernization in plant and facilities will be planned and readily financed. A sustained rise in profits, retained earnings, and cash flow in this year and next should allow the share of business fixed investment in GNP to continue to grow, even as debt-equity ratios are reduced toward desired levels.

According to a recent survey conducted by the Department of Commerce, businesses plan to increase capital spending by 5½ percent from 1975 to 1976. Assuming that prices of capital goods rise by about 6 to 7 percent per annum, this implies a decline in planned real business fixed investment which is inconsistent with past behavior during comparable stages of recovery. During the early stages of recoveries, businesses usually underestimate the strength of final sales. Even though the present recovery started from a lower measured rate of capacity utilization than previous recoveries, businesses are likely to spend more on new plant and equipment in 1976 than they expected at the start of this year, and the year-to-year rise could be as high as 5 to 6 percent in real terms, or approximately 8 percent from the second half of 1975 to the second half of 1976.

Housing starts in the fourth quarter of 1975 were at a 1.4 million unit annual rate, 37 percent above the depressed year-earlier rate. In the past, changes in the supply of mortgage credit rather than changes in demand have frequently dominated short-run movements in housing starts. In 1975, however, demand factors, not the unavailability of mortgage credit, hampered the recovery in housing. There were large savings inflows into the thrift institutions in 1975 and their liquidity is expected to remain high in 1976. Nevertheless, the high stock of unsold new single-family homes and rapid cost increases, particularly in the land and materials components of home prices, suggest that there is likely to moderate the rise in single-family starts. On the other hand, the recovery of multifamily starts from the extremely depressed levels of

1975 should begin to accelerate in 1976, spurred in part by the $3 billion in mortgage commitment funds at 7½ percent interest released by the Government National Mortgage Association in January 1976. Thus total housing starts should reach a level of about 1¾ million units by year-end, and the real value of residential construction is expected to rise by about 30 percent from 1975 to 1976, on the strength of an almost 40 percent rise in housing starts.

The extraordinary reduction in inventories in the first half of last year, together with the faster growth in final sales which began in the second quarter, restored inventories to more normal levels. By the end of 1975 the ratio of real business inventories to final sales was the same as the average for 1969-73 and lower than the ratio for 1974, when large inventory accumulations had occurred. The ratio of inventories to sales is expected to decline a little more in early 1976. We estimate that the stock of inventories will brow at about the same rate as final sales after the middle of 1976.

The availability of much unemployed labor and unused plant capacity requires that economic policy should continue to support an economic expansion at growth rates significantly above the long-term growth of capacity output. But our knowledge of the interdependence between real growth and inflation is not sufficiently precise to permit a direct translation from general goals to specific targets. As a consequence, policies cannot be designed to reach any particular targets with a high degree of confidence. We believe, however, that policies consistent with a moderate but sustained recovery offer a far safer and surer route to full employment than policies which attempt to engineer a very rapid return to full capacity. What we need is a durable recovery—not a boom that carried the seeds of renewed instability in prices, incomes, and employment. This view is based on several considerations.

The difficult inflationary period through which we have come makes it likely that overly expansionary policies, which risk increasing inflationary pressures, will quickly influence consumers' and producers' expectations. High rates of inflation have made price expectations a much more important determinant of consumer and business behavior than they formerly were. It is a harsh fact of economic life that expectations of inflation are built into labor and other contracts in such a way as to be partly self-fulfilling. Moreover, increased inflationary expectations could restrain both consumption and investment expenditures and thus jeopardize long-term economic goals. High and variable rates of inflation not only create imbalances and sectoral distortions by capriciously changing the real value of existing contracts, but they also raise risk premiums in investment decisions and in wage bargains.

The recovery begins with a very righ rate of inflation. We expect prices to rise at about a 6 percent rate during the year. Our ability to forecast is at best imperfect and I should like to point out again, as I have on a number of previous appearances before this Committee, that economists have not done well over the years in forecasting wage and price trends. A poor understanding of the inflation process is one of the major problems in forecasting and hence in economic policy analysis. We believe that this is the largest area of uncertainty in our forecast and as such, inflation could pose a major threat to the viability of the present recovery.

Policies that we perceived to entail higher inflation risks may not, therefore, affect economic activity and employment in a way that would normally be expected. Even if such policies should succeed in accelerating the recovery in the short run, it would be difficult to decelerate from unusually rapid growth rates to sustainable rates without running the risk of amplifying future fluctuations in economic activities.

There is a lesson to be drawn from past policy mistakes. The history of monetary and fiscal policies demonstrates that we have a great deal to learn about implementing discretionary policy changes. Our ability to forecast is at best imperfect, especially in an increasing complex and interdependent world, and the difficulties in forecasting grow larger as we extend the period for which the forecast is made. This is a significant problem because of the time lags involved in altering the pace of economic activity through discretionary monetary and fiscal actions. There is a perception lag in diagnosing the problem, a reaction lag in selecting the appropriate response, and an implementation lag in having the policy prescription accepted and put into effect through our political and administrative processes.

We also lack relable estimates of how long it takes before the economy responds to policies once they are undertaken and how large the response will be. With respect to fiscal policy there is the additional complication that countercyclical increases in Government expenditures are difficult to check during later upswings. Because counter cyclical policy hanges may be slow to take hold and then difficult to reverse, their effects may extend well beyond the time when they are most needed. Consequently a significant danger exists that instead of smoothing economic fluctuations, discretionary changes in policy aimed at demand management may themselves become a source of economic instability.

The proper conclusion is not that we should forswear the use of discretionary policy. Some external shocks to the economic system can and should be offset. Furthermore, provided the growth in Federal outlays becomes more moderate than in the years just past, occasional discretionary adjustments of the income tax schedules are called for in order to prevent excessive growth in Federal taxes. In fact these changes may have to be more frequent if the rate of inflation continues at a somewhat higher average level than at comparable levels of economic activity in the past. But we must be mindful of the great diffculties in successfully executing countercyclical policies.

Over the past year or so we have examined a larger number of specific proposals as public service employment programs, which are often advocated to reduce unemployment directly and rapidly. One thing that stands out in our analysis is that public service employment programs have very large displacement effects. There is, therefore, an important distinction to be made between the gross number of jobs paid for or funded under the programs and the net number of new jobs that are created. Public service employment funds tend to be used for financing employment of people who would ordinarily be hired with State and local funds. Estimates based on previous experience suggests that after the first year only about 40 percent of the jobs funded represent net new job creation, and after one or two years more the net new job figure declines to as low as 10 percent. Consequently, a public service employment job funded at $9,000 per year for example actually costs the federal government somewhere in the neighborhood of $90,000 per job eventually.

What is called for in our judgment is a steadier course in macroeconomic policies than has been followed in the past. We should set policies broadly consistent with sustainable long-term noninflationary growth and try to limit the size and durating of any policy deviations that promise short-term benefits but risk interfering with our long-run goals. The severity of the recent recession does call for maintaining stimulative economic policies to accommodate an expansion of real output at a rate above that sustainable in the long run. But departures from the policies that are appropriate in the long run should be moderate. If we do not commit ourselves to moderate policies we may increase economic instability and lose our chance for sustainable growth. which we believe the safest and surest route to full employment in future years.

Chairman HUMPHREY. Mr. Greenspan, would your associates like to participate at this time and make any comments or I gather you are speaking for the whole Council?

Mr. GREENSPAN. In my opening remarks I am speaking for the whole Council but I suspect they will be more than willing to participate in the question and answer period.

Chairman HUMPHREY. In the discussion?

Mr. GREENSPAN. Yes.

Chairman HUMPHREY. Yes. We will operate under the 10-minute rule here for each of us so that we can all have a chance to participate.

Mr. Greenspan, very quickly I want to get at the unemployment problem. You predicted continuing high rates of unemployment. Of course, you made it very clear that you don't solve the unemployment problem over night. I think we all agree with that. You referred to the high rates of unemployment as distressingly high.

We recognize that to get the private economy to absorb all the unemployed, to get the unemployment to 4 percent, much less 3 percent, that that is quite a task. I mean, it would require an incredibly large increase in real GNP, yet the administration recommends the phasing out of public jobs programs; it recommends reducing the coverage and duration of unemployment benefits; and it recommends the reduction of the summer youth program. Perhaps this is a naive question, but could you explain to me what you expect the unemployed to do if they don't have any benefits, if there are fewer public service or public works jobs? And just what do you expect these young people to do in these cities where they are roaming the streets?

The rate of crime among youth, which is attributable in large measure to joblessness, is incredible; just plain incredible.

What do you expect them to do? Where are they supposed to go? I notice Mr. Reagan said they could always vote with their feet and go someplace else but what do you expect them to do?

Mr. GREENSPAN. First of all, Mr. Chairman, I believe the phase-out is well into 1977 and will come at a time when the unemployment rate will be dropping quite rapidly.

Chairman HUMPHREY. To what levels do you expect it in 1977?

Mr. GREENSPAN. Well, I think we expect it to be in the area of 6 percent or so and falling.

Chairman HUMPHREY. You do?

Mr. GREENSPAN. By the end of 1977.

Chairman HUMPHREY. By 1977?

Mr. GREENSPAN. Well, it would be in that area.

Chairman HUMPHREY. You expect it to be about 7.7 in 1976?

Mr. GREENSPAN. On the average, that is correct.

Chairman HUMPHREY. Yes, on the average. Now you are telling us that your forecast for 1977 is 6.9?

Mr. GREENSPAN. That is correct.

Chairman HUMPHREY. That is about 7 percent, of course. Well, what do you expect to do with the 7 percent? And many of them are kids. Many of them minorities, Mr. Greenspan, and young people. What do you expect to do?

Mr. GREENSPAN. Well, Mr. Chairman, we expect the unemployment rate to be falling and the ability to get jobs to be increasing at that time. The point at issue is that we are not by any means eliminating unemployment insurance. We are merely recommending a phasing-down of some of the temporary programs and extensions which were put in place during the period of exceptionally high unemployment.

Chairman HUMPHREY. You have approximately 3 million people that are long-term unemployed. If you start taking out these emergency unemployment compensation benefits, well, they have to do something. What they are going to do, obviously, is to go an welfare and then on the dole. I just want to know what kind of work we you planning? Am I old fashioned? Have I forgotten there is something else besides this damn computer? Isn't there something people can do? Can't the Government of the United States figure out something for people to do instead of sitting on their backsides and drawing a check?

Mr. GREENSPAN. Mr. Chairman, our view, and I think everybody agrees with this, is that we have allowed our basic economic situation to worsen to such an extent in recent years that we must put all of our resources into the effort to restore the vitality of our economy as quickly as we conceivably can. And as far as we are concerned, it is urgent that we facilitate the creation of jobs by the private economy in a way which will be lasting and productive as quickly as possible.

Chairman HUMPHREY. Right. I don't disagree with that, Mr. Greenspan, and I will go along with you on that. But in the meantime—and you know in the long run we are all dead but it is what is happening in the short run. In the meantime what do we do with these people? What about these people that have no unemployment compensation benefits because they have no work? They never had a job. What about the young people that you are phasing out of their summer youth program?

Mr. GREENSPAN. I wasn't aware that the summer youth program was being phased out.

Chairman HUMPHREY. Sir.

Mr. GREENSPAN. As I recall, there are fairly substantial commitments for this time.

Chairman HUMPHREY. There is a drop of 170,000 jobs in the President's budget.

Mr. GREENSPAN. It is not being phased out; it is being reduced.

Chairman HUMPHREY. If you drop 170,000 jobs in the summer youth program, I would call that quite a reduction.

You know, I don't disagree with you and your long-term projections. I'm not arguing about that. I think we have had a modest recovery—a very fragile recovery—but we have had one and we have had it in profits and in production. We have had it in inventory liquidation.

Now, obviously some industries are showing it like the auto industry. The housing industry, of course, is still dead as a doorknob and you know that.

Last year we appropriated funds around here for 400,000 homes and they built 1,500 under that appropriation. The administration's program got out 1,500.

So you see we watch these things, Mr. Greenspan. I live with this problem all the time and I just don't think there is the proper response here for a certain segment of our economy.

Now you are looking at what you call the recovery in the long term. I'm not arguing with you that there are not good indications, even though there are some difficulties in capital investment. I would like to ask your comment: The Commerce Department seems to feel that capital investment by industry will be down. I would like your comment on that. I believe, according to what I read in your report, Mr. Greenspan, that you feel that it will be up.

Mr. GREENSPAN. That is correct.

Chairman HUMPHREY. The latest Commerce Department survey of business investment plans indicates investment will decline in real terms in 1976. You predicted a 4 to 5 percent increase. I know sometimes business people underestimate at this phase of the cycle, but do they underestimate as much as 6 and 7 percent? Do you have a historical pattern that shows that?

Mr. GREENSPAN. I think this is a period in which the underestimation of the increase in business investment is likely to be very significant. From what we can judge and the external signs of development in the capital goods markets, I think we are going to experience a more rapid increase in investment than indicated by any of the surveys of business intentions.

Chairman HUMPHREY. Is that a wish?

Mr. GREENSPAN. No, I think that is based on a number of events falling into place, which typically precede a significant capital accumulation. Now I'm not saying that there is not a lot of uncertainty on this matter; there ordinarily is. But I would say it is extremely unlikely that the type of plans and investment intentions that were being registered in the surveys in the late fall will be close to where actual investment will come out.

Mr. Chairman, may I just go back to a very broad question which we have to confront? I think we all agree with respect to the long term goals, Mr. Chairman, and also as to the basic problems we have. And nobody denies that this tragic recession and its vast consequences we got have meant some very significant hardships for the American people.

But I think it is encumbent upon us to make sure that it does not occur again.

And it is often appealing to look at short term solutions; and understandably there are some and there is no question but that there should be. I think we should be sure, however, that in the process of confronting the immediate problems, we do not lose sight of where we have to go. That means some very difficult choices. And I don't think anybody who says he knows exactly where the answers are, knows what he is talking about. Everyone must make these choices.

The President in his particular approach has said, and I believe very cogently, that we must not deviate from the types of policies which will cure this malaise that we have overhanging us, and cure it as quickly as is feasible.

These are going to be very difficult choices for all of us. I don't think any of us here would deny that we have great problems.

Chairman HUMPHREY. I think we can agree with that.

May I say most respectfully, Mr. Greenspan, you are constantly reminding me of the price of the prescription and I'm trying to remind you of the cost of the disease. I am an old pharmacist, you know, and I know a lot of people who believe antibiotics are costly, but they do get at the infection. You can just tell them to take aspirin and tell them to drink water and have an occasional bottle of Coca-Cola and get their sleep and in due time, if they don't die, they will recover. Well, that is true. Your doctors of this Administration never tell anybody what the cost of the diseases, of inflation, is. I maintain we are staying sick too long and there is a better way, and there is a better prescription.

I'm not one who believes that you just run willy-nilly and pump money into the economy just to throw money at everything. But I am upset to see a full year go by with really no working programs. Unemployment compensation was never designed for long term unemployment. Most of the people that are administering it today weren't for it in the beginning.

You know, I looked back at the historical picture of who voted for social security and unemployment compensation, and I realize that. I might say that the descendants of those who were in power at that time and who are now currently in power—that is, those in the Congress that were called upon to vote for this—our Republican friends didn't vote for one of these programs.

Now we have everybody convinced as to their worth. It is kind of a new religion that says that all you need to do is keep pumping that computer out and writing those checks and everything is going to be jolly. I don't agree with that. I am a humanitarian as are you, but I think young people today need something to do. I think there is work to be done in this country. I believe the Administration has failed to come up here with anything except the easiest answer of all; namely, to pay people off. It is exactly what has gone wrong worldwide and with families in America and everywhere else. If anybody gets in trouble, they don't sit down and try to work it out, but just give them a check. Just say "here son, go on out and get yourself a car," or "here daughter, have a good time and take a trip to Europe." That is what we have been doing. Maybe once in a while we ought to just sit down and say: "Well, listen, what are we going to do?"

I do not buy from this Administration that there is nothing we can do in this country except line up and give them food stamps and line up and given them unemployment compensation. No one will take second place to me on that opinion because I am the author of the food stamp program, Mr. Greenspan. I have been at this 26 years in this body, and I do believe that there is a job to be done in America instead of just continuing this high level of unemployment. Even with your own figures, Mr. Greenspan, in 1977 we are going to have 6.9 percent unemployment and that means at least 2.5, 3 million people who ought to be getting something to do instead of just waiting for something to do, but who will not. Now what are you going to do with them after you cut the benefits off and have done all of this stuff?

I know they call this the old kind of politics and all that nonsense, but I want to tell you that when you haven't got a job, you are going to do something that you ought not to be doing. Families break up, burglaries and murders and robbery and alcoholism and drug addiction all increase. The figures are so staggering and horrendous that it ought to shake the living daylights out of all of us. I just don't see anything in the program except that hopefully we are going to get a nice recovery.

We are getting some kind of recovery now. I'm doing all right, and you are doing all right, and I realize that. We are both comfortable, But what about the other ones? But what about the 20 percent or 25 percent of unused plant capacity? When do we get that used? That is not in this report which is supposed to be a projection for this Government as to what we are going to do.

Now what about this money supply? I notice mention of this 2.3 percent rate of money supply growth in the third and fourth quarters of last year. I thought we had that Federal Reserve Board up here and had finally got them on the team, but instead of that they have gone up to the bleachers.

You indicate an acquiescence in this 5 to 7.5 percent money growth target. Then in the next chapter you say that you have to have a more expansive monetary supply or policy. Now which are you for?

Mr. GREENSPAN. Well, let me just go back first to the question of general policy and then let me ask one of my colleagues to try to answer your second question.

Starting early last year we went through a long series of analyses of various different job programs that everybody was beginning to recommend. And we concluded—and I will be glad to go into detail if you like, Mr. Chairman—that these programs, or at least the ones that have been recommended, were not the solutions to the unemployment problem. If we thought they were, we would be recommending them.

But it is very easy to come out with a big program and a lot of numbers and promise a great deal. Our analysis indicates—and we would be glad to supply that—that not only does it not amount to anything in terms of solving the problems, but that there are many problems involved or indeed created along the way. All you do, Mr. Chairman, is divert the problem in one way or another and really do not fundamentally come to grips with it.

I think it is inaccurate to assume that these particular types of programs actually work in the way that they are said to work.

And if we adopt a series of programs which, if they fail, have no cost, then there may be no great future cost involved. But the question is not only one of "do they work," but what happens if they fail.

This is the type of analysis which I think is essential because we have had so many programs introduced which have not worked. And I think this has caused a great deal of problems that have confronted this economy in recent years.

Chairman HUMPHREY. We will come back to that. I want you to take a look at our midyear report and see if you analyzed that on jobs. Nobody ever said public service jobs and emergency public works programs is a solution. I just tell you it is better than the dole. Mr. Greenspan, anything is better than the dole. That is my judgment. And that is why I'm not asking for a total solution through emergency public works; but I am just simply saying is it better than the kind of stuff you have been giving us? I think it is a choice.

Congressman Bolling.

Representative BOLLING. Mr. Greenspan, I would like to endorse everything the Chairman said in his opening statement and what he said in his followup. I have been here about the same length of time he has and I am often asked what the difference is between Republicans and Democrats. And it is a terrible generalization for a person, who is relatively sophisticated, but I think the difference really falls as to who looks hardest at what happens to people.

I was a critic, an early critic of some of the programs passed in the early Johnson period, the ones that are being blamed for having been expensive and not having worked—and I recognize that they weren't very well drawn—but we had some programs a long time ago that did work and did put people to work, and the benefits of those programs are still around. And politically the opponents were not able to disregard them. They were programs that put people to work.

There was a program known as the CCC and so forth. And the notion that today we have to put up, Mr. Greenspan, over another 2 or 3 years not with 7 or 8 percent, but in crucial areas that we have to put up with 12, 13 percent unemployment among the young, and among the minorities is to me an absolute proof that the fundamental difference between Republicans and Democrats is there; is not in one's humanitarian view but in one's immediate view of how long human beings can last in a society where most people do have jobs and they don't.

And you know their fathers lose their jobs and don't get them back, and this is a serious problem no one can ignore.

And then on the next page there is a good example of the fathers that lose their jobs and don't get them back. Long-term unemployed in 1975, the unemployed 27 weeks and over, went from 632,000 to 1,667,000. And if you look at the other long-term unemployed, the figures are not a whole lot better; the ones with shorter long-term unemployment. And the figures on both sexes, both sexes ages 16 to 19 years, show remarkably little change. And the figures on Negro and other races show an increase from January to December.

Now I don't know whether anybody in the administration looks at what is happening in the society. The Government is not respected, much less admired. The crime rate escalates. The inability to get people to attend and stay in school worsens. And there is just a constant crisis in all the areas where the young people are involved.

Now I think the cost of not finding a solution in human terms is a worse cost than inflation. And I am one of the earliest Democrats to have recognized that inflation was the cruelest tax. I have been talking about it for a long, long time in terms that are considered very conservative by many of my Democratic colleagues. But I say the human tragedies in here are lost: The human tragedies in this document are lost.

I wonder if anybody knows anybody that is poor or anybody who is Black? And that is a thing that disturbs me.

Now what are we going to do about this? Are we just going to ride it out?

Mr. GREENSPAN. Congressman Bolling, first of all, it is just not true that nobody looks at the detailed data, or that nobody is fully aware of what the hardships of this period for vast numbers of Americans.

Representative BOLLING. I hope not.

Mr. GREENSPAN. As I said at the beginning of this session I think it is absolutely essential that we try to eliminate the causes of this extraordinary imbalance in our economy. It is very easy to come up with the whole series of projects and programs which give the appearance that we are coming to grips with the problem. But I think it is urgent that we come to grips with some of the very fundamental, long-term problems which are causing these problems.

Representative BOLLING. Well, I don't have any disagreement with that hope, but I think you missed the point. I guess I was wasting my time in what I tried to say. Those people are destroyed and never recover. What happens in the ghetto in this society is they never come back. They are gone. They are lost. They won't stay in school because they have no hope for a job. They don't recover from the drug addiction. They don't recover at all. They get shot by the policeman. They are just gone.

Now I don't see any of that kind of understanding in this approach, in this document. I credit every single person, either Republican or Democrat or what have you, with some sense of humanitarianism. But I'm not clear that this administration understands what happens to people when this continues as long as it has. Most of us at this stage of the game haven't had an experience with the last situation where there was a long period of unemployment for a lot of people. This has been the most acute recession since the depression. And most people who are dealing with this most acute recession since the depression, Mr. Greenspan, don't know how many people were destroyed by the depression.

And I hate to come back to this again. And I know everybody is decent who makes up these documents. And I know the President is decent. I testified for him at his request when he was before the Senate for confirmation to be Vice President. I know he is decent. But I am not clear when I read this and then read that, when I read the front part of the document, I am not clear that anybody does see what is happening to these people.

Now these figures: 19.6 for 16 to 19-year-olds; 13.8 for Negro and other races; long-term unemployed of 1,667,000—and you have to add to that something near 1 million of discouraged workers, of part-time workers about 3 million, and a full-time equivalent of 1.5 million—well, I don't know how many of these people are going to be permanently destroyed by this experience. But I think we ought to be more worried about it than we seem to be; I say more since we are all worried.

Mr. Malkiel. Congressman Bolling, if I could just make a remark?

Believe me, I hate unemployment. I hate waste as much I am sure as you do. And if I can continue Senator Humphrey's analogy, the patient is clearly sick. There is no doubt about it. And I think I would also agree with him that in the long run the only way to get out of this is to create productive jobs in the private sector. And we have been well aware of this and have tried to write a report recognizing that our objective is to get to full employment in as short and quick a way as we possibly can.

The problem is, if I may go back to your analogy, that with the sick patient, I think realistically what we have to say now is that one needs a gradual convalescence. We all know the case of taking the sick patient and trying to get him back at top speed right away. And all that happens is you get a relapse. And the relapse that we are talking about is precisely the instability, the inflation, the greater unemployment, and it is precisely the difficulties we have now.

Representative Bolling. I don't want to be rude and interrupt but we are not talking about the same thing. You are treating a society of whatever number it is today, of 215 million people as if it were an entity, as if one person could be traded off against the other. What I am trying to say is that we have to look at that, is we have to look at the long-term health of the society and the economy as a whole; but in doing that, we have to remember that the sick ones are individuals who may be destroyed in the process of the society recovering.

And I as one person, who is not a professional economist but have been in on this committee for a very long time, am not prepared to admit that the mind of the American politician can't devise a technique whereby we restrain the dangers of inflation—perhaps with an income policy; I don't know—and at the same time see to it that we do not destroy hundreds of thousands of individual Americans.

I just happen to believe that there has to be a better answer than to treat the whole society as one sick patient.

I think we have to look at every individual in that society who doesn't have an opportunity to work and who wants to work, look at him as a sick patient. So I agree with you and I also disagree with you.

Mr. Chairman, I am through for the moment. I am getting too mad.

Chairman HUMPHREY. That is good.

Mr. MACAVOY. Perhaps I can adrress your concern.

I am the microeconomist on the council. And together with the CEA staff I have spent considerable time in the last 6 months on attempting to determine ways that we might reach a 17-year-old in St. Louis or Chicago or Indianapolis. We have asked how the Federal Government puts a 17-year-old to work. The process that has developed over the years is to have a program application generated by some local group through a city government and a State Government to an agency in a department of the Federal Government.

That is then responded to with a very complicated feedback system going the other way. The response generally is to evaluate that job opportunity for that 17-year-old within a very broad frame of reference of a number of congressional bills or programs that have been in operation for a number of years. The process is similar to filling a very large 12-gallon can with money and out of the other end there is a small hole from which drops a quarter. The process is roughly speaking one of generating $50,000 or more of Federal grants to put one 17-year-old to work at $7,000 or $8,000 or $9,000 per year.

And we have not been able to break through that process to anything that looks like success. We have not been able to offer ways of redesigning these programs to get the layers of Government out of the way between the 17-year-old and your aspiration and my aspiration, Congressman Bolling. And until we do, we can't honestly put forth programs we think would be more effective than those that are being described in this report.

Chairman HUMPHREY. I will write you one this afternoon.

Mr. MACAVOY. I would be delighted to start again.

Chairman HUMPHREY. Let's set aside all these analyses and just hire people. I come from Minneapolis, and we have work out there to do. We have snow that needs to be removed. We don't need any psychoanalysis. We can forget about that. We have garbage that needs to be collected. We have parks that need to be built.

Mr. MacAvoy. If we were to hire that 17-year-old to shovel snow in Minneapilis, he would replace a 35-year-old that is already doing it.

Chairman Humphrey. Oh, no, he wouldn't if it were a supplemental program.

Mr. MacAvoy. We find the replacement rate is at least two out of three. For every three jobs two of them are replacement. And then we have to hire two Federal employees to watch the city government to make sure that they do not replace that third job opportunity with someone else.

Chairman Humphrey. We will come back to you on that.

Mr. MacAvoy. It is a very difficult problem.

Representative Bolling. It is a very difficult problem, correct.

Mr. MacAvoy. It has failed, Congressman Bolling, in the past to work the way you wish.

Representative Bolling. No, I agree. And I think you can be very critical of the function of——

Mr. MacAvoy. No, disappointed but not critical.

Representative Bolling. Well, I think critical. I think you can be very critical of the function of the Congress and of the executive that has been in power, without any regard to personalities, for quite a long time. I happen, and many know it, to have worked a long time on reorganization in the Congress. I would suggest that if the situation is as bad as you say, that one of the first priorities of the administration ought to be what I have come to believe is essential and that is the reorganization of the whole executive as well as the Congress.

Now if it is that bad and you condemn it strenuously, that should be a very stimulating thing to the President to undertake a major reorganization of the executive at the same time as he tells us to return to the kind of program that he supported in terms of reorganizing the House of Representatives and I presume the Senate. But what you are describing is the failure of Government——

Representative Brown of Ohio. Will the gentlemen yield?

Those programs were made 4 years ago and were met with all the enthusiasm in the world in the Congress and——

Representative Bolling. I would deny the proposals made by the administration for reorganization came within 100 miles of the kind of proposal that was made by an objective commission called the Hoover Commission quite a long time ago. But my time has long since expired.

Chairman Humphrey. Congressman Brown wants to yield to you. You may go ahead, Congressman Long.

Representative Long. Yes, thank you, Mr. Chairman.

I would like to associate myself with the remarks of you, Mr. Chairman, and my colleague Congressman Bolling. And rather than pursue that again, I would like to add perhaps one dimension.

I served the first year of the Office of Economic Opportunity as the Assistant Director of that. And the difficulty of dealing with these is a very, very real problem. I objected at the time as to the direction that it took. I thought it was supposed to be experimental and I looked at it and I thought it built up a great many false expectations. And some of the programs, it took a long time to see that they would not work rather than a short period of time. And if they had been done on a pilot basis, it could have been shown immediately that they were not going to work. Some of them turned out to be very good programs though and economical programs and they have been continued by both Democratic and Republican administrations.

I think there is another element here that really relates to the overall economic problem and that is that, as the chairman said and as Congressman Bolling said very articulately, that is the whole question of the people who are lost. It is not only that it is a very serious question that you have this 300,000 or 400,000 or 1 million, or whatever it is that gets lost during this period and their lives become meaningless because they lose or do not develop work habits and they lose the motivation that is required in order to develop a work ethic, but more than that what happens is that they then in turn compound your overall problem because they are a constant drag on your long-range recovery and therefore deter your ability to have a long-term solution to the problem.

And it seems to me that while the human element is an important one, it has got to be treated as we move toward a long-range solution to the problem. We have got to recognize that not only the human element is involved there but the long-range economic element is involved there too because they are there destroying what is the economic asset that we have to help us recover long range from the economic doldrums in which we find ourselves. And it is nearly a self-defeating type of situation; it is an incessant relationship that continues to exist and continues to compound the problem as we go along.

But that has been pursued perhaps enough, unless someone has a comment with respect to that particular comment on my part.

Mr. MacAvoy. I would only add that in our endeavors to develop these programs, Congressman, we aren't writing anybody off. We are making comparisons between different ways of saving them. If we have to generate extraordinary federal grants, five to ten times the salary of the 17-year-old in order to get just one new public sector job, then we have to ask the question as to whether that fiscal grant could not better be replaced by monetary and fiscal policies which would generate more than one private job.

We have to ask whether that will both help us in the long run and in the short run with less inflation, with less disruption to the operation of the economy as a system.

Now that is the kind of question that we are asking. We are not writing anybody off.

Representative Long. Well, two additional points in that regard. One is that it is difficult to deal with these and dealing with them individually and dealing with the programs of people who are in that economic level and in that educational level, and I recognize that is an extremely difficult problem. It is much easier to go, as Senator Humphrey was talking about, to just printing checks and giving them money than it is to do this. And all I would say is I would ask you not to be deterred in doing this because it is difficult.

Mr. MacAvoy. But I come from a very small town in Massachusetts and this town recently added six public sector jobs and it fired six long-term city employees so they could take the money and put 17-year-olds to work. Now that was a net gain of no jobs. And unless he had read the newspaper, no Federal employee would have known that the net gain is zero. We haven't found a way of getting around that yet.

Chairman HUMPHREY. Well, I know a way to do it. Just say you don't——

Mr. MACAVOY. Yes; just send me to that small town so I can watch them.

Chairman HUMPHREY. No; just simply say you don't get the job. you don't get the money if you fire other people.

Mr. MACAVOY. But somebody has to watch them to make sure they don't do it.

Chairman HUMPHREY. That is what we have people in this Government for. We have more watchers than workers anyway.

Mr. MACAVOY. And we will get even more.

Representative LONG. That may be true, but it is just an argument for counter-cyclical financing. I mean the very case you are making is just that argument.

But anyway, let me tell you one thing that happened to me once. I talked to a man who had been both the collector of revenue and the commissioner of welfare for the State of Oklahoma. He was an elderly gentleman and I had great respect for him. And just to show the difficulty of the problem—and I recognize it is a difficult problem —he said that it was much easier to collect than it was to give it away and see that is was done honestly. And I think this is a very good point. And I do think it is difficult.

Mr. Greenspan, if I may explore with you for a moment this whole question of inflation and the danger there? How much effect on this inflation do some things have? I don't see that mentioned in your statement but we see, those of us who represent basically rural areas, we see the prices go up. Beef is a classic example. It goes up in the supermarkets while the price on the farm goes up, and then we see the beef farmers' price go back down but the price in the supermarket remains exactly the same. It doesn't really move.

In fact, it is even continuing to rise a bit. There was a modest decline, using my example, but it still continues to go up.

How much of that is caused, now moving from the specific to the general, how much is caused by such things as a lack of a stringent and aggressive enforcement of the antitrust laws and any effective control over the multinational corporations and the oil cartel? Do you all attempt to bring that into your formula here when you, rightfully I think, say that economists have not done well over the years in forecasting wage and price trends and that the poor understanding of the inflation process is probably the principal or one of the principal reasons for this misunderstanding or lack of understanding?

Mr. GREENSPAN. Yes, Congressman Long, we have looked at all various elements which affect the price levels. And specifically as to the case you are referring to, there are a number of factors involved which cause changes in distribution margins in the food industry and which makes it extremely difficult to generalize in any simple way.

My colleague, who has worked on this area, may like to respond.

Representative LONG. Relate that specifically, if you would, to the fact that demand goes down and yet price doesn't go down, Mr. MacAvoy. Now this looks to me like—well let's take the case of aluminum. The fact of the lack of aggressive enforcement of the antitrust laws might be a major factor that is involved in that.

Mr. MACAVOY. Congressman Long, Mr. Greenspan has suggested that economists do not forecast quarter-to-quarter movements in margins and price changes very well.

The Council in the preparation of its report did a great deal of work in three areas; first, in trying to anticipate a passthrough of important wage changes to the industrial sector and higher industrial prices; second, in trying to forecast four quarters ahead changes in the meat and food components of the Consumer Price Index; and third, in trying to forecast the impact of the recent energy bill on prices of energy at wholesale and consumer levels.

The situation in each is quite different. We have spent a great deal of time on the so-called administered price part of the industrial sector. We failed to come to any analytical conclusions about which prices were administered. Many that we defined as administered 5 years ago do not act that way now. Some might be redefined by the expert economists in this area, but there is no tendency in recent data which anticipates rising prices in the industrial sector.

Now in the food area, Congressman, we have a very complicated lag relationship between price changes for feed grains and allied products on the farm, the expansion or contraction of cattle and pig inventories which then leads some months later into increases or decreases in meat production. We have had a 50 cent to 75 cent per bushel reduction in the prices of grain since the July highs. We are now seeing the effect of lower grain prices in stimulating increased cattle feed and sow farrowings.

We forecast from this that there will be a considerable lessening in the rate of increase of wholesale and consumer prices of meat in the second and third quarter of this year. The omnibus energy bill gives us a price scenario for the coming year for the key components of petroleum products. We are now in the process of evaluating the effects of alternative bills which will change regulation of natural gas.

The Pearson-Bentsen bill has passed the Senate. It is being considered in the House. When this process is complete, our forecast will be more secure. But we do not anticipate under the present controls, you see, that there will be overall energy price increases of more than 6 percent.

The margins there are now under control and the process of unwinding under the energy omnibus bill makes that forecast more uncertain than usual.

In concert with the Council on Wage and Price Stability we have analyzed the situation of aluminum and the situation of price cost margins in bread. And we agree with and took part in the preparation of the reports on these particular products.

I note that during the last few months the wholesale price index for aluminum has declined somewhat. It will go back up. It will go down, too. We are not good at predicting these changes month by month. But we see no overall thrust of rising margins, of rising cost of these basic products that would require a departure from our basic forecast of prices this year.

Representative LONG. Thank you. My time has expired.

Mr. MACAVOY. Perhaps I gave you too much.

Representative LONG. Your discussion was interesting but it didn't really deal directly with antitrust laws and the lack of an effective control over the multinational corporations.

Representative BOLLING. Congressman Brown of Michigan.

Representative BROWN of Michigan. Thank you.

I would remind you that this is a political year. The indignation that has been expressed here this morning seems to me might be observed as a visceral reaction to a concern that what the administration is doing is working and will work to the best interest in the long run.

You know this discussion of Republicans and Democrats and about basic differences in philosophies, I think, as the gentleman has already indicated, may be a bit oversimplified. But I would oversimplify it further. I would suggest that maybe the Republican approach is not that if we give a fish to a man he will eat for a day, but the Republican philosophy is rather that we will teach a man to fish and he will eat forever.

And I would also point out that I don't think there are many economists today who wouldn't agree that the recession and the resultant problems we are discussing here today, there are few if any economists who won't agree that that recession is the result of inflation. And there are few economists who won't agree that a prime cause of that inflation, or shall we say the basic period over which that inflation got its start, was during the Johnson years when you had not a Republican President, not a Republican Congress, but a Democratic President and a Democratic Congress.

And I would further remind you and all those around that although this Congress seems to have solutions for everything, they have had 38 of the last 42 years in which to come up with those solutions. And for practically all of that time they also occupied the White House.

I sympathize and am terribly compassionate with the words of the gentleman from Missouri about the problems of the young blacks and teenagers. Yet it is his side of the aisle that is again advocating substantial increases in the minimum wage law, and there are reports all over the place that—and the record is replete—with representations and conclusions that increases in the minimum wage laws have a particularly adverse effect on young blacks and teenagers insofar as employment is concerned.

I would also remind those present in view of the dire statements that are being expressed, that Mr. Shiskin of the Bureau of Labor Statistics has testified before this committee, if I recall his testimony correctly, that as a practical matter there is a greater percentage of our population employed today than was employed during the good Kennedy years.

It seems to me that those on the other side of the aisle believe that public jobs are better than private jobs because I haven't seen anyone on that side of the aisle come forward and head the troops with respect to legislative enactments, etc., that will basically create jobs in the private sector true to the way in which we drew up tax laws and other things.

I was very pleased with the chairman's statement. I'm sorry that he had to leave. But I was pleased about his statement that he could put all of these people to work. You know I think maybe we are approaching this in the wrong way. I think we ought to make the chairman the employer of last resort and then we could have him sitting where you are.

By this committee, by the Banking Currency, and Housing Committee, by all the committees in the Congress who exercise oversight functions, if he were in your position, he would be before us most of his time as you are. And frankly he would never have an opportunity to even carry out a proposal if he had one. Because I think the amount of time that you gentlemen and the others from downtown spend on the Hill, under both Democratic and Republican administrations alike, but obvioustly more significantly when you have a Democratic administration here and a Republican one downtown than when you have both of the same party, but anyhow I don't see how you can operate a department with the amount of time you spend on the Hill.

I would just conclude, since the questions being asked are basically a critique and a criticism—and I think more in a visceral way than a judgmental way this morning—I would just conclude by again admonishing you that this is a political year. I think that although we are all concerned about the speed with which we make this recovery, but I thought Mr. Malkiel drew a very good parallel when he said that if we are going to have the patient recover, we certainly don't want to put him in a situation and do things which would cause a relapse. And I think that is a valid concern and it is awfully good that many members of this administration have been admonishing the Congress about it. And I happen to agree with them.

Thank you very much.

Representative BOLLING. Before I recognize Congresswoman Heckler, Mr. Chairman, I would like to call your attention——

Representative BROWN of Michigan. You are the chairman.

Representative BOLLING. I was referring to Mr. Greenspan.

Mr. Chairman, I would like to call your attention to your prepared statement where you state: "Over the past years we have examined a large number of specific proposals such as public service, public employment programs which are often advocated to reduce unemployment directly or rapidly."

Now could we have for the record a list of the specific public proposals you examined—and you can refer to what I just read—and your conclusions about each one? I would also like to ask you to submit for the record your estimates for the full employment budget by quarter through the end of calendar 1976.

Mr. GREENSPAN. We shall.

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

POLICIES TO INCREASE EMPLOYMENT

The Council of Economic Advisers has examined a number of policy proposals to increase employment. The main issues are: (1) for a given increase in fiscal stimulus can employment be increased more with a selective policy aimed at doing so rather than with a neutral policy such as a tax cut; and (2) the extent to which selective policies and measures contain defects that pose other problems which are not inherent in the use of general fiscal measures.

The conclusion of the analyses which we have conducted is that selective policies such as public service employment, private employment tax credits or public works construction may temporarily add more employment than a neutral tax cut (though only after a long lag in the case of both the tax credit and public works program). However, at the same time resources are misallocated and on balance we may therefore get less economic growth and employment with selective policies than with a neutral cut of personal and business income taxes. In addition, selective policies are more difficult to control in amount, in timing, and in termination.

A tax cut has the great virtue of assisting the normal forces at work in the economy to stimulate growth and employment. If relative prices are not distorted it is reasonable to assume that expansion will be greatest in those activities with the highest economic payoff, and that capital and labor will be used in the most efficient (i.e., least cost) way.

The three selective policies which have attracted the most attention as ways of getting more of an increase in employment than from a tax reduction with a similar cost to the Federal budget are public service employment, an employment tax credit and public works.

PUBLIC SERVICE EMPLOYMENT

Public service employment (PSE) programs are a special form of grant that aims to encourage a temporary expansion of state and local employment. A general Federal tax cut could also result in an increase in public sector employment. However, to do so state and local governments would be required to divert the reduction in Federal revenues to their own use by raising their taxes, and if taxpayers preferred private goods to public goods, this would be difficult to do.

Proponents of public employment programs argue that it is a less expensive and a surer way to guarantee that a given amount of Federal outlay or tax reduction will result in increases in employment. However, there is no easy way of distinguishing a worked filling a PSE slot from a worker who would in the ordinary course of events be hired by a state or local government. Although many state and local governments have been retrenching, significant future additions to employment are likely to continue to take place there.[1] And, state and local governments now have more experience with, and can plan for PSE slots. Hence, they may now be more effective in using PSE funds for job slots that they would otherwise fund from their own resources. On the basis of experience with the Public Employment Program (PEP) of 1971-1973 it has been estimated that a PSE program does initially create more jobs than an income tax reduction. However, the effect diminishes over time, becoming negligible after two years, as state and local governments substitute Federal funds for their own funds.

A $1 billion PSE program for example could pay for approximately 110,000 PSE job slots at $9,000 per job (wages and the 10 percent allowance for other costs). Based on research of previous programs, however, state and local government displacement of the funds is estimated to be about 40 percent after two quarters, 60 percent after one year and 90 percent after two or three years. There are, however, also lags in program spending. It is estimated that, compared to a person income tax reduction of a similar magnitude, the impact of a $1 billion PSE program after two quarters would result in about 74,000 jobs created, after one year 48,000 jobs and after two years about 11,000 jobs created (see Table 1). After two years nearly $100 million of the $1 billion program would be for creating net new jobs and nearly $900 million would in effect be supporting jobs that states and localities would otherwise have financed themselves.

[1] State and local government employment increased by 570,000 jobs (4.7 percent) in 1975, more than twice the increase in PSE slots.

TABLE 1.—JOBS PAID FOR AND JOBS CREATED UNDER A $1 BILLION PUBLIC SERVICE EMPLOYMENT PROGRAM

[Jobs, in thousands]

Start of spending and jobs	By end of quarter 1	2	3	4	5	6	7	8
Initial quarter:								
Paid for[1]	55	55	55	55	55	55	55	55
Created[2]	41.3	33.0	27.5	22.0	13.7	5.5	5.5	5.5
Second quarter:								
Paid for[1]	0	55	55	55	55	55	55	55
Created[2]	0	41.3	33.0	27.5	22.0	13.7	5.5	5.5
Total, all spending:								
Paid for[1]	55	110	110	110	110	110	110	110
Created[2]	41.3	74.3	60.5	47.5	25.7	19.2	11.0	11.0

[1] Number of persons in PSE slots.
[2] Incremental jobs created compared to a $1 billion reduction in personal income taxes.

Assumptions for Table 1:

(1) *Total Spending.*—$1 billion annual spending.

(2) *Cost per Worker.*—$9,000. (To cover wages and salaries and the 10 percent allowances for other costs.)

(3) *Maximum Jobs Funded.*—From (1) and (2)—The maximum funding is 110,000 jobs.

(4) *Time Path of Jobs Funded.*—Based on past experience, the time path for the initiation of spending is assumed to be: By end of: 1st quarter, 50 percent; 2nd quarter, 100 percent.

Hence, 55,000 jobs are funded by the end of the first quarter and 110,000 by the end of the second quarter.

(5) *Displacement effects.*—

Based on previous research[2] the replacement effects are assumed to be: 1st quarter, 25 percent; 2nd quarter, 40 percent; 3rd quarter, 50 percent; 4th quarter, 60 percent; 5th quarter, 75 percent; and 6th quarter and thereafter, 90 percent.

While the Federal Government has an incentive to reduce the replacement effect, prime sponsors have an incentive to increase it. The estimates are mainly based on the PEP program, which was the first of its type in the postwar period. The experience gained with the PEP and CETA programs will probably operate to increase replacement ratios in future programs.

(6) *Marginal Propensities to Consume.*—It is assumed that the families of the recipients of the jobs created by PSE have the same marginal propensity to consume as the beneficiaries of a tax cut.

(7) *State and Local Budgets.*—Because of the replacement effect, some of the Federal grant (e.g., 25 percent in the first quarter under assumption (5) can be used for other purposes:

(a) To reduce the size of the state and local government annual deficit (or increase the surplus).

(b) To keep taxes lower than otherwise.

(c) To purchase goods from the private sector.

Dollars allocated under (a) are likely to have a smaller aggregate stimulus than an equal dollar of a Federal tax cut, while dollars allocated under (c) are likely to have a larger aggregate stimulus. No large difference in stimulus would be expected from a tax cut at the Federal rather than the state and local level. In the long run the dollars freed by the replacement effect are likely to appear primarily as lower taxes, but the short-run allocation is ambiguous. In the absence of more specific information it is assumed that the net stimulus from the dollars freed by the replacement effect is the same as an equal dollar amount of a Federal tax cut.

(8) *Time Path of Spending.*—The lag in the initiation of spending under a tax cut is likely to be shorter than under PSE. Then, the procedure adopted

[2] See Alan Fechter. *Public Employment Programs* (Washington, 1975), and George Johnson and James Tomola, "An Impact Evaluation of Public Employment Programs," Department of Labor, 1974, and the references therein.

would result in an upward bias in the short run in the number of jobs created by PSE compared to a tax cut.

The foregoing estimates might vary somewhat for a massive PSE program, i.e., a program which attempts to "create" jobs far in excess of the normal state and local government job needs. However, the spending of funds for such a program would be much slower. It takes time to "create" jobs, and state and local governments would be reluctant to hire a large number of workers who would have to be either discharged when the temporary Federal program ended or funded out of state and local sources.

The difficulty in discharging workers under PSE-type programs leads to the strong likelihood that a massive program would mean a permanent increase in relatively nonproductive public employment. Several European countries have inadvertently created too large a ratio of public to private employment, with significant adverse consequences on economic growth and standards of living.

Other drawbacks of PSE programs in general should be noted. State and local governments are presumably now doing the tasks they, and their taxpayers, view as most important. Although workers undertaking tasks with only marginal value will appear as employed in the labor force data, in an economic sense they are really unemployed. However, they are receiving a higher level of income through the PSE program than would have been received through unemployment compensation. This is not to say that it is better to receive unemployment insurance or welfare than to work. Rather, it forces more consideration of the type of work that can be done in a temporary program, the cost per individual of this kind of program, and the alternatives available.

The workers hired under PSE are usually those with a better than average chance to get unsubsidized jobs (Table 2). While the statutes often contain preferences for the longer-term unemployed, the programs are not able to target on those among the unemployed who have the most difficulty finding regular employment.

Persons in public service jobs (whether essential or marginal) have less time available and less of a financial incentive to search for, and accept, private sector employment. During a period of expanding private sector employment opportunities, such as 1976, it would be more appropriate to be encouraging workers to seek and accept regular, productive private sector jobs.

TABLE 2.—COMPARISON OF SELECTED CHARACTERISTICS OF PARTICIPANTS IN FISCAL 1974 CATEGORICAL PROGRAMS, CETA TITLES I, II, AND VI IN FISCAL 1975 AND THE U.S. UNEMPLOYED POPULATION, JULY 1, 1974 THROUGH JUNE 30, 1975

Characteristic	Fiscal 1974 categorical programs	CETA-fiscal 1975			PEP (EEA)	U.S. unemployed population
		Title I	Title II	Title VI		
Total: Percent	100.0	100.0	100.0	100.0	100.0	100.0
Sex:						
Male	57.7	54.4	65.8	70.2	72	54.9
Female	42.3	45.6	34.2	29.8	28	45.1
Age:						
Under 22 yrs	63.1	61.7	23.7	21.4	19	34.8
22 to 44 yrs	30.5	32.1	62.9	64.8	66	46.0
45 yrs and over	6.2	6.1	13.4	13.8	14	19.1
Education:						
8 yrs or less	15.1	13.3	9.4	8.4	26	15.1
9 to 11 yrs	51.1	47.6	18.3	18.2		28.9
12 yrs and over	33.6	39.1	72.3	73.3	74	56.0
Economically disadvantaged	86.7	77.3	48.3	43.6	38	(2)
Ethnic group:						
White	54.9	54.6	65.1	71.1	60	81.1
Black	37.0	38.5	21.8	22.9		
American Indian	3.5	1.3	1.0	1.1	[1] 40	18.9
Other	4.6	5.6	12.1	4.9		
Spanish-speaking	15.4	12.5	16.1	12.9		6.5
Limited English-speaking ability	(2)	4.1	8.0	4.6		(2)
Veterans:						
Special Vietnam era	15.3	5.2	11.3	12.5	29	7.5
Other		4.4	12.6	14.6	14	9.4

[1] Includes Spanish-speaking Americans.
[2] Not available.

For a public employment program to be countercyclical a mechanism is needed to phase out the program as unemployment falls. The jobs provided must be such that they can be both established quickly and readily "detriggered" as job opportunities in the private sector increase. In part, this will occur if workers voluntarily leave public sector employment for higher paying regular jobs. However, the more attractive public service employment is in terms of current and expected future wages, the more difficult it is to reduce the programs. And the more essential are the services performed, the greater will be the pressure from state and local governments that the Federal funding be maintained.

PSE jobs that are truly temporary in many cases are likely to be filled by persons who would otherwise be out of the labor force rather than by the unemployed who are already receiving benefits and for whom a temporary job may be a deterrent to more permanent public or private sector reemployment. For a public employment program to provide jobs for those who are most needy requires that the jobs be such that they can be filled by persons of diverse prior training, employment experience and age, and that involve at most a very short period of training. It is extremely difficult to design a program which meets all of these criteria.

There is a tendency for PSE legislation to urge that the jobs be such as to lead to permanent careers. But the more closely the jobs resemble the ordinary occupational structure of the sponsoring government and the more career-oriented they are, the more likely is the displacement effect to be large. Thus, to insure that jobs are net additions to the economy it may be necessary for states and localities to try to create distinct tasks for these subsidized workers in separate job categories created for the purpose. This may increase the difficulty of creating programs that provide productive employment.

It should also be noted that state and local government employment is only 16 percent of nonfarm payroll employment. This sector by itself could not be a major factor in generating enough useful employment to substantially reduce the unemployment rate without dramatically increasing the proportion of output devoted to publicly-produced services at the expense of privately produced goods and services.

In summary, a moderate PSE program, whether temporary or permanent, suffers from a high replacement rate, and generates only a small and temporary increase in employment compared to a tax cut of a similar magnitude. If a PSE program is permanent it is likely to become in effect a permanent increase in Federal grants to state and local governments but without a corresponding permanent increase in the number of jobs. A massive temporary PSE program is not likely to substantially increase useful employment within a year or two. In the short run many of the additional jobs would be marginal, and they would soon compete with the expanded opportunities for private sector employment. If the PSE programs were to work over longer periods of time, moreover, they would represent a permanent addition to the size of the public sector relative to the private sector, unless offset by program reductions elsewhere. The long-run costs of funding public jobs programs, to produce public goods and services not now produced, would fall upon a relatively smaller private sector.

EMPLOYMENT TAX CREDIT

A private employment tax credit subsidizes the wages of additional workers in order to encourage more labor intensive methods of production while stimulating output. One version of an employment tax credit would give employers a credit of a fixed number of dollars per month for each full-time equivalent worker on the payroll in excess of, for example, 1975 employment levels. Another version would provide a credit proportional to the increase in the wage bill above the 1975 level.

In either case, it is difficult to estimate the outcome and the final budget cost. Because there is no way of identifying for each firm the increases in employment induced solely by the tax credit, a large component of the Federal expenditure would be for employment increases which would have taken place in any event. Thus, much of the tax credit would simply provide a windfall to private firms. Although the proponents of an employment tax credit have suggested that the Federal cost per net job created would be very low—lower in fact than for public service employment jobs—this windfall effect is likely to raise the cost per job actually created far above the figures usualy cited.

As we approach full employment the problem will arise of either maintaining the credit and perpetuating what was intended to be a countercyclical program or removing the credit and perhaps inducing layoffs and unemployment. A gradual reduction of the credit would reduce or eliminate this disemployment but would extend its life and the program cost several years into the future. Unless the credit is removed, however, the subsidy to the use of labor relative to other factors of production would retard growth by maintaining a less efficient allocation of resources.

Also, it is not easy to design an "equitable" employment tax credit. An employment tax credit would tend to provide larger subsidies to rapidly growing industries, and those that have greater short-term flexibility in employment patterns and to cyclically sensitive industries during periods of business expansion. Stable, slow growing industries which would incur large costs of adjusting temporarily to a higher ratio of labor to capital might not receive any subsidy. The pressures to broaden the scope of the program to prevent inequities would be difficult to resist. It is worth recalling that the investment tax credit was originally proposed as a credit for increases in investment. But equity problems quickly dictating giving credit for all investment not just increases. It is likely that similar pressures could cause an employment tax credit to be converted to a general wage subsidy.

Theoretically, an employment tax credit that is a fixed amount per worker rather than a percent of the wage bill, would have a greater effect on the number of workers, as there would be a substitution toward unskilled workers and the industries that employ them, and away from higher paid skilled workers and the industries that employ a substantial proportion of skilled workers. Although possibly desirable in the short run, such a substitution would adversely effect the long-term growth of the economy.

A tax credit tied to the total wage bill is neutral with respect to the skill level of the workers. It may, however, make it more difficult for employers to resist large wage increases that inflate the wage bill.

Once the precedent is set for an employment tax credit, employers may expect it to reappear in the future. On the basis of this expectation they would have less of an incentive to engage in labor "hoarding" (reducing employment by less than the fall in output) in future recessions. It is interesting to note that one major difference between this recession and the most comparable previous recession, 1957-58, is the smaller percentage point decline in employment for each percentage point fall in output. If one and a half years ago employers had expected an employment tax credit during the recovery, the fall in employment and the rise in the unemployment rate would presumably have been much sharper.

Because of a concern with the high youth unemployment rate, some have suggested an employment tax credit for youths. Minimum wage and mandated social insurance taxes may have raised the minimum employment most of labor above the productivity of many young workers, thereby decreasing their employment opportunities. An employment tax credit for youths applied only to increments in employment above the 1975 level in that firm would encourage a substantial shifting of employment. Some firms would decrease youth employment while others would increase it to qualify for the credit. The net increase in youth employment may be small. To reduce this socially inefficient shift of labor would require providing the credit for all youths who are employed. This, of course, would create a substantial windfall for youth intensive industries (e.g., fast food chains).

From experience with other programs it is known that firms will respond to an employment tax credit program in such a way as to have the subsidy apply to an even larger proportion of workers who would be employed in any case. Because we have not had experience with an employment tax credit the likely magnitude of this effect cannot be estimated. This problem would be more severe for a program that focuses on a particular demographic group (e.g., youths).

COUNTERCYCLICAL PUBLIC WORKS PROGRAMS

Large-scale public works programs as a method of reducing unemployment are subject to several significant drawbacks. Analyses of past efforts to use public work construction projects as a countercyclical fiscal measure do not support the idea that such programs will quickly provide for the unemployed. Large-scale public works programs require long lead times before the projects get under way and even longer lead times before projects are completed. Past experience suggests that only 10 percent of the funds are actually spent in the first year in which the funds are appropriated. Half of the funds are used in the second year and 10 percent of the funds remain to be spent four years after the funds are appropriated. The reasons for the delay are inherent in public works programs, so that efforts to accelerate the procedures can be only partially successful.

It is unlikely, therefore, that such an approach will do as much to reduce unemployment in 1976 or early 1977, the period when unemployment will still be high, as would generalized and neutral fiscal measures. The major effect of public works projects upon employment is likely to occur during the period beginning in late 1977 and 1978, after the economy has made significant progress toward recovery with the full effects not felt until 1980. The enlarged demands of public works projects will then divert resources from other more productive uses at precisely the time that overall availability of resources is beginning to be strained.

A final factor is that a vast expansion in public works projects would tend to create the wrong type of capital. The need in the next several years is for productive plant and equipment in the private sector. Our analyses suggest that a substantial increase in investment in productive facilities is required in the period immediately ahead. If this increase is not achieved the rise in productive employment will be hampered, as will the progress of the nation in meeting its productivity, environmental and energy goals.

FULL-EMPLOYMENT BUDGET ESTIMATES

The full-employment budget balances estimated on the national income accounts basis by the Council of Economic Advisers through 1976 are shown below (Table 1). These estimates are consistent with the economic and fiscal assumptions published in the 1977 budget. Data for 1975 and earlier years appear on page 55 of the 1976 Economic Report of the President.

Although the estimates in Table 1 are shown quarterly at annual rates, it should be assumed that changes in fiscal stimulus or restraint can necessarily be inferred from changes in the quarterly full-employment balances. Averages over longer periods, such as half-years or years, should be used for this purpose.

The apparent increase in the full-employment deficit from the fourth quarter of 1975 to the first quarter of 1976 is a case in point. This rise in the deficit is due to a decline in estimated full-employment receipts. Full-employment receipts are not growing between these quarters, in spite of the ongoing recovery largely because (1) the special fee on imported crude was removed shortly before the end of 1975 (–$3 billion), (2) the earned income credit and the home purchase credit reported on 1975 tax returns are estimated to reduce personal tax receipts (–$2 billion), and (3) the tax-reduction from lower corporate tax rates contained in the President's program is distributed in national income accounting throughout the present year, even though tax rates are to be reduced only by July of 1976 (–$1 billion).

The economic impact of both (1) and (3) lies mainly in the future because it takes time for any reductions in the landed price of crude to affect prices paid by consumers of energy products and because the corporate tax rate reduction cannot be anticipated with certainty until the proposed legislation has passed. On the other hand, the economic impact of (2) lies mainly in the past. The home purchase credit, in particular, was taken into account by persons purchasing new homes in 1975 and the mere realization of this credit when tax returns are filed in 1976 will have little, if any, stimulative effect in the current year. Hence, quarter-to-quarter changes in the full-employment balances should not be overinterpreted.

TABLE 1.—FULL-EMPLOYMENT FEDERAL GOVERNMENT RECEIPTS AND EXPENDITURES, NATIONAL INCOME ACCOUNTS BASIS, CALENDAR YEARS 1975-76

	Full employment receipts	Full employment expenditures	Surplus or deficit (−)
1975:			
I	344.8	329.8	15.1
II	309.8	343.0	−33.3
III	348.6	355.3	−6.7
IV	360.0	365.2	−5.2
1976:			
I	359.5	376.0	−16.5
II	369.9	382.9	−12.9
III	375.6	383.3	−7.7
IV	389.6	386.3	3.2
1975	340.8	348.3	−7.5
1976	373.7	382.1	−8.5

Note: Detail may not add to totals because of rounding.

Representative BOLLING. Congresswoman Heckler.

Representative HECKLER. Well, I would like to say that a few months ago when you appeared before this committee, there was much handwringing going on in the Congress then and you forecasted a steady recovery. There were many who doubted that here. So that I have to say for the record that your forecasts were more accurate than ours were. And there is some measure of consolation in this because, after all, you are deemed an expert and your judgment has proven to have a great deal of validity even in the hallowed halls of Congress.

But nonetheless I have some problems with your report and with the state of the economy today, which I would like to raise with you.

I note that earlier when Marina Whitman was one of your colleagues or on the Council that the Economic Report of the President contained a very valuable section on the impact of the economy on women and women in the economy. Now I would hope that we do not have to have a presence of a woman economist in every instance in order to follow through what is a valid economic question but yet that appears to be the case. I see this report does not contain any analysis of women in the economy.

So that at the same time that women feel they are the victims of the life-old principle of last in/first out, yet many are not getting in. Could you tell me why it is that you omitted this kind of analysis that your prior report contained?

Mr. GREENSPAN. Yes, Congresswoman Heckler, I think that there is a very large number of subjects which are appropriate subjects for inclusion in the economic report. We were constrained by the issues of length and resources. I certainly agree with the issue that you raised. I hope at some point that this issue will become irrelevant, but we have not arrived at that point yet.

We cannot promise what we will do in the future, but, we are all aware of the fact that there are important differences in the role and position of women in the labor force. We are concerned about this as we are about the other issues that were raised this morning.

Representative HECKLER. Did you consider incorporating a statement or a segment of the report on the subject of women in the economy?

Mr. GREENSPAN. No, we did not. We had originally decided to keep this report as short as possible. As a consequence many things were excluded.

Representative HECKLER. Well, I would hope that your consciousness has been raised in terms of considerations of the role of women. And I think that there are a number of Members of this Congress, which is largely dominated, of course, by the opposite sex, overwhelmingly so, who share a great concern about the role of women in this economy. And I think the omission to cover that segment of the population is serious. And I would hope that it will not be the case in future reports.

Mr. GREENSPAN. Well, we shall endeavor in the future to take that into consideration.

Representative HECKLER. Thank you.

I'm concerned about the question of unemployment and yet I find the public answers very unsatisfactory. The CETA program has been very tarnished by political machinations in my district and I think in many sections of the country and that was one of the responses which we in Congress gave to the problems of unemployment. We have the choice of public opportunities, and yet we know in the long run the private sector can offer the most rewarding jobs.

However, I have a city in my district with a 12 percent unemployment rate. And as important as the longrun and a healthy recovery is for the country, what these people have to face tomorrow is also a concern of mine. And I think this is a valid issue that has not been addressed sufficiently. Is it possible for you in terms of the present unemployment rate, Mr. Greenspan, to deal with the short-run ramifications? Is it possible for the executive to propose an answer which will incorporate an incentive to the private sector to handle the short-run problems of a community?

We have looked to the public sector and that has been fraught with political overtures and injury and a lack of results. What can the private sector do? How can we deal with this very important problem now? And I think it is not only important economically, but it is important in human terms.

This committe went to Atlanta, Ga., and listened to a witness who had done an extensive study of unemployment and found a very close correlation between suicide and the unemployment rates. The correlation between crime and unemployment especially in the ghetto is well established. So we are talking about serious questions in addition to the economic ones.

What can we do to deal with this in the short run? What will the executive propose this year to deal with the problems of unemployment that we face now?

Mr. GREENSPAN. Well, Congresswoman Heckler, I am sure we have as much awareness as anybody dealing with it on a day-to-day basis, of what the costs of this current recession have been. I think that they are very substantial. I think you named only some of them. There are many, many more. What this suggests to us is that we should never have allowed ourselves to have gotten into this situation. I think one of the great tragedies of the last decade or so is that we did not foresee that the types of policies and events that were occurring would lead us here.

Now that is not to say that we can just wring our hands and say, "Well, we can forget all of the consequences." Nevertheless, it does say that the first or the highest priority is not to allow this type of situation to happen again.

I think that is the absolute first priority. And I think the fundamental thrust of the policy which the President has proposed is directed at that particular point.

The next question is particular short-term policies to cushion the effects and the difficulties experienced by a large number of Americans. However, it is also very important not to create problems along the way which interfere seriously with the solution of the basic underlying problems. Moreover, some of the short-term programs which we have examined are simply lacking in substance.

For example, we did look at the possibility of a particular type of tax credit which might cause private employers to increase job hiring.

Now on the immediate surface that seems like a very interesting idea. It was raised about a year ago. We looked at it in some great detail and we concluded that the effect of that type of program was not to add significantly to total employment.

What it did do was have a very large displacement effect similar to the problem that Mr. MacAvoy raised in his small town.

Now, we come back to that again. In other words, we said: "All right, in the particular formulation that we used, we couldn't actually construct and implement a program in which we had confidence. So we went back. We thought the whole issue through. We approached it from a number of different directions but we came out the same way.

What I mean by this is that the effect on employment of these types of job credits is not significantly different from other routes we could take.

And in order to make the assumption that you have markedly increased the job creation potential with a particular program of this sort, whether it is on the expenditure side or whether it is on a tax side, you have to demonstrate that it makes a significant difference from a straight expenditure increase or a tax cut.

The evidence is that in the very short run it has some effects but effect fades very rapidly. But more importantly, it leaves as a residual in the system types of problems which will aggravate the long-term problems and make it more difficult to achieve a solution.

We should not support a particular program which on the surface looks good but we know, after thorough analysis, really isn't that good. We should only try to implement those programs which have some chance of success.

So we are looking for something that does not have this displacement effect and which will create lasting and permanent jobs.

Representative HECKLER. But you still have not given us an answer for the short run. Have you addressed that in any sense?

Mr. GREENSPAN. We have addressed the problem in a considerable way. We have concluded that the best short-term solution is to restore the general state of confidence in our private economy as quickly as possible. I believe it is accurate to say that confidence is improving quite markedly and this will help to initiate recovery in the construction industry, the capital goods industry, and to create large numbers of lasting and productive jobs. And I think we are moving in that direction and the quicker the better.

This is not to say that there aren't considerable short-term problems. There is no question of that and I think that we recognize that as well as anybody.

If we could find a way which would realistically and creditably resolve that problem, the President would be proposing such measures.

Representative HECKLER. Thank you.

Chairman HUMPHREY. Thank you.

Congressman Brown of Ohio.

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

Mr. Greenspan, I want to get back to the question of the cost of private jobs versus the cost of creating public jobs and ask if private jobs can be created more economically than public jobs. Do you have some statistics on that? Do you have a generalized figure that would indicate to us that private jobs of a lasting nature are more economically creative than public jobs?

For instance, you used the $50,000 figure for public service jobs. I have seen the figure quoted that it takes about $25,000 to create a job in the automobile industry.

Now, that seems to me to be a capital intensive industry. A sales job I suppose doesn't cost anything to create or at least very little. You just add it onto the payroll.

Mr. MACAVOY. The process of analysis is very indirect. First, we face what Alan Greenspan calls the replacement problem in the creation of public jobs.

Okay. We go out and we put a 17-year-old to work in Braintree or——

Representative BROWN of Ohio. I don't like the 17-year-old example because I happen to run a business where 17-year-olds cannot work because they are prohibited by law from having a job around some kinds of machinery. So you can't put a 17-year-old to work on that kind of a job.

Mr. MACAVOY. Well, we should consider then a 20-year-old or a 25-year-old.

Representative BROWN of Ohio. Okay.

Mr. MACAVOY. The process which I described earlier whereby this works through the federal system to the State and local government to a grant dispersing agency finally results in the employment of this person by some public sector agency at the town level. The town then fits this into its plan for general activity of that year.

We have found that the immediate impact in a large number of cases, Congressman, is that the other job opportunities are reduced by some fraction but not by a whole job. It isn't as bad as the instance in which they take someone off the public payroll in order to fill that job with the new federally funded employee. But we found over a 3-year period for every 10 jobs created, or funded under the public employment programs, no more than one or two are net new jobs.

The others are all replacement jobs. So that if we have a program designed to provide a $10,000 net job, we may have to create 7, 8 or 9 jobs in order to get that one net job. And you have to include the costs of the 7, 8 or 9 replacement jobs in your estimate of the cost of the one new job created. It is a general dispersement of a large amount of funds whereby the Federal Government makes the payments for many local jobs to get one new job.

Now, indeed, looking at the alternatives requires one to look at the impact on the private sector of the level of total investment in this job-creating operation in the public sector. If we want one million new jobs of 21-year-olds that turns out to be on design a $10 billion program. But to actually get that number of jobs via the public service employment route given the displacement problem requires nearer $100 billion of outlays so that indeed this is going to have a very significant impact on the confidence of the corporations and industry and business in the private sector in terms of their investment and production plans for the coming year or 2 or 3.

Now, I have no way of feeding that through a computer to look at the impact on private sector job creation. But there is little doubt that even if one does undertake investment of $20,000 in equipment in the private sector to create a $10,000 job, that in the longer run this would be the cheaper way of doing that. If we cannot reduce the replacement rate——

Representative BROWN of Ohio. In my newspaper and printing business if I buy a $5,000 computer and I put a girl to work on that machine who may be making $7,000 or $8,000, I have made an investment of her salary and I have made an investment in the equipment that I bought. Someone has to build that equipment. It has to be put on order. It is taken out of inventory and somebody else gets a job as a result of that.

My question is if we are spending all of this money on public jobs and taking it away from the taxpayer in Federal taxes or else in inflation and we are just borrowing in most instances because here on the Hill we don't have the guts to tax the taxpayer. If we just take it away from the taxpayer in inflation and put a person in the real estate tax section of the courthouse, it is my experience at the courthouse level back home that you have five people putting out the tax bills that were formerly put out by only four people, and the taxpayer at home has to pay for that person either through his Federal taxes or, when the Federal money runs out you have to raise the local taxes to pay for these five people. I'm not sure how productive that is. But is there a way you can put your minds together to get the information on what it costs and what the benefits are from reducing taxes and giving a company a little bit more money?

I recently spent a little time on weekends going over our corporate interpretations for next year. I find the tax break has given us more money than we thought. We are, therefore, encouraged to buy some more equipment.

Could you put together an econometric model for this committee to give us some information as to the relative merits in terms of costs and the results of public sector job creation versus private sector job creation?

Mr. GREENSPAN. Let me just simply indicate where the broad outlines of the issue lie. I think you pointed out some of the key issues. When you begin to increase significantly the proportions of public employment in a sense you essentially do begin to tilt your system far more toward consumption than investment.

And as for example, several European economies have recently found out that exception emphasis toward public employment vis-a-vis private employment has strange—

Representative BROWN of Ohio. Could I interrupt there, because I don't have very much time. I do want to get what I think are good questions in and I will let you give your answers when you can.

It seems to me that is one of the problems with the developing nations. In the developing nations, the people we are trying to help, they don't have enough capital investment. They are consumer oriented nations. They don't consume much but they are consumer oriented. They cannot consume much because they don't produce much. Therefore, the country can't get any resources with which to consume more and improve its standard of living.

Now, that is what I am worried about. It seems to me that we would be better off if we were a producing economy, but I would like to know what federal processes encourage a producing economy versus a consuming economy? It seems to me that tight credit controls, high taxes, high inflation discourage investment and production. Is that right?

Mr. GREENSPAN. Yes.

Representative BROWN of Ohio. What encourages investments in production? I suppose it would be low taxes, low rates of inflation, loosening up on credit controls, but what else? What can we do beyond that that might encourage our being a producing Nation so we can raise our standard of living in this country and, incidentally, help raise the standard of living in the rest of the world as we have done historically over the last 25 years?

Mr. GREENSPAN. One thing we can do is restore a degree of confidence in the economic rules of the game in the future. By that I mean a great deal of investment in recent years has been discouraged because of the uncertainties with respect to a number of the regulations we have promulgated.

It is not only the regulations per se but also the fact that the regulations and their interpretation changes. If one has to invest facilities with a 20 year life, you are simultaneously confronted with such wide possibilities of what regulatory policies might be over that period.

Now, we are endeavoring to look at this. And hopefully we will find the means to give more certainty or less uncertainty. As it is, it is often so risky that investment is held back.

Representative BROWN of Ohio. Let me speak to an example on that. The agricultural part of our economy is the part that has produced the most positive benefits for our balance of payments in the last few years. Is that correct?

Mr. GREENSPAN. Yes, sir.

Representative BROWN of Ohio. The reason for that is that we are able to produce 25 percent, 35 percent in some products, more than we consume in this country and are able to sell them in a consuming world that can't produce these. Is that right?

Mr. GREENSPAN. Yes, sir.

Representative BROWN of Ohio. And we have had a recent expansion both in terms of the use of land by farmers. More crop land is being used for production than was being used about 4 years ago.

Mr. MACAVOY. As we evolved out of the old support program where there were restrictions on land use, Congressman, into a full production program, use of land in production has increased.

Representative BROWN of Ohio. By terminating those controls over the farmer he has decided to use more land and has made investment in combines and other kinds of equipment that go into increasing his efficiency. And incidentally, jobs result from buying those combines I would assume. So we are also producing more and we are increasing our relative balance of payments situation. Is that correct?

Mr. MACAVOY. Yes.

Representative BROWN of Ohio. Now, are there other segments of the economy—and I wish if you could you would submit this for the record—where you think that same process that we have followed with reference to agriculture and which has given us excellent results in terms of the benefits to our Nation, might benefit us as a nation in terms of stimulation of our economy at literally no cost? Because as I understand, the administration has rather substantially reduced the amount of budget figures to be devoted to agriculture in this next year. Most of those are in those crop support programs that were not producing anything. We are actually getting more results for our economy for less Federal dollars. Could you give me some kind of list of which parts of the economy we might be able to stimulate by following a similar pattern in the future? Not that the Congress would want to do it, but it might be interesting for us to at least have that information to look at.

Mr. GREENSPAN. We will endeavor to do so.[1]

Representative BROWN of Ohio. Thank you.

Representative BROWN of Michigan. We are experiencing a phenomena that rarely occurs where a Republican is sharing a committee in the Congress.

Representative BROWN of Ohio. Good. I have a lot more questions.

Representative BROWN of Michigan. Well, rather than taking further time now, I will yield to my colleague, Congresswoman Heckler.

Representative HECKLER. I just have one question. This is another concern of mine, and it is a complaint I hear constantly, but despite the recovery, which is also substantiated by comments from industry representatives at home, the complaint is that small businesses are not recovering. And I think you have a reference in your statement, Mr. Greenspan, about the capital requirements of industry going to be better, et cetera, but no one feels in my district that the capital requirements of small business will be better nor do they feel the Commerce Department really represents small business.

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[1] The information to be supplied for the record was not available at time of printing the hearings.

Now, what approach would you consider, or what do you suggest in terms of meeting the problems of small business? Because I think most members of Congress on both sides of the aisle feel that the success in the development of small business is very important to this economy. Yet, regardless of the SBA and their support, the SBA still sends the small business applicant to the local bank. And if there isn't credit in the bank, there is no answer, there is no response. So, what do we do about the problems of capitalization of small business to promote their development and help them?

Mr. GREENSPAN. Well, in general, Congresswoman Heckler, small businesses tend to be more vulnerable to economic changes. There is no question that the earnings of small business are more highly violative. In one respect, small business would benefit most by a substantial economic recovery, because they will find that credit eases for them more rapidly than for the larger, more stable corporations, and they will find that their sales will probably tend to do better and certainly their earnings will do better. We have, as you know, proposed lowering the tax rate for smaller businesses. There have been other initiatives by the President with respect to estate taxes, which endeavor to keep small business in family hands and not become part of the larger——

Representative HECKLER. Yes, but what about their capital needs?

Mr. GREENSPAN. Well, in the most general way, the capital needs will respond in the same way as for the entire economy. They will do far better from the capital side, both credit and equity capital, as the economy improves. And I think it is all the more reason why a durable, lasting recovery is essential. And I think we should recognize that that sort of change is apt to do far more for small business than any list of particular programs.

Mr. MALKIEL. Could I just add to that? I think one of the suggestions that we made about the mix of monetary and fiscal policies is particularly appropriate here. Because as we know, to the extent that there is credit rationing in capital markets, it is usually the small business that loses the money first and the large company can normally get the funds. And one of the things that we have been quite concerned about is the degree of balance in our macroeconomic policies.

And what we have seen and what we have done is rely very much on a consumption-oriented fiscal policy stimulation, as opposed to monetary policy. I think one of the things we have been very concerned about is whether that is an appropriate policy for the long run, both because we want to encourage capital formulation in general for a variety of reasons and because, I think, we would like to have funds available for small businesses. If the Government deficits don't decline rapidly, as the recovery proceeds, then the savings that are necessary to insure a proper rate of capital formation, and particularly true in the case of small businesses, Congresswoman, is going to be preempted, and I think also if we were able to get the budget under control, we would be able to pursue any degree of monetary policy with less inflationary risks than would be the case if we had a very expansionary fiscal policy.

So, I think to the extent that we are able to reduce the growth of the Federal outlays, I think it is very likely that we would have quite a bit easier credit condition and I think that disproportionately small businesses would benefit from that. Because as I said earlier, they are typically the first to be rationed out when we do have a problem.

Representative HECKLER. What you are giving us is a general answer. You are, in a sense, rejecting the needs of special constituencies within the economy and your answer is that the general development of economic stability and strength is the answer to everyone, and there should not be specific answers for special sectors. Is that right?

Mr. GREENSPAN. No, the answer is that when you have specific programs which actually do introduce something of a lasting nature and really work, they should be done. It is important, though, to get a sense of balance and relative contributions as a solution to the problem.

When you begin to look at the effects of various different programs, it is very clear that the preponderant influence in each situation would stem from the recovery of the economy. We are likely to do a disservice in our policy analysis and to our general policy stance by failing to recognize that. I think that at that point, when you realize that incredible impact of a viable, sound, and solid recovery on, say, small business you tend, as you should, to put most of your emphasis on that. You also look at other particular types of supplemental programs, but always, in most cases, your programs must be focused in a manner in which you do not, in the process, undercut the long-term solution for the economy as a whole.

I will say this as emphatically as I can because I do not believe that we will have another chance, if we botch this one. If we reignite inflationary forces, through hasty and immoderate economic policy actions, if we introduce a new set of instabilities and inflationary forces in our economy, we are going to find the disruptions and the problems which we cause will dwarf the very difficult problems we have even now.

I say this because in looking at the costs and benefits of a variety of programs, I believe that we are reaching the point where the American economy may not have the capacity of absorbing the costs of many of the disabling policies which we have adopted and expended. We were able to do it for years because the underlying inherent strength of our economic system was sufficient to absorb an awful lot of abuse from the policy side. And it kept coming back. And it has come back again. Perhaps it came back a little less rapidly than we would like. Perhaps the vitality of the recovery is less than we would like. But, one senses the dynamics are still there. What concerns me is another type of massive dislocation would further reduce the underlying strength and vitality of our economic system.

Mr. MACAVOY. Perhaps I could add a particular point?

There is another area of concern for small business in this recovery period, which has a little more of a long-run aspect. In the last 5 years, three massive Federal regulatory programs have begun to affect the small business sector: The environmental protection programs have spread to the small corporations; the occupational safety and health programs determine, for the first time, that small corporations would be subject to mandatory physical standards, to visits by surveillance officers, and to fines and penalties, which had previously been relegated to certain public utility corporations in the economy. The development of product vialibility regulation in this economy, manifiested in the Consumer Product Safety Commission, at the Federal level, but by many other Commissions and rules and regulations at the State and local levels, impacted the business sector on the product side as heavily as OSHA and EPA on the cost side. These conditions worked strongly against small corporations. The continued very strong antagonistic imposition of these complex, detailed, legal rules—requiring the help of experts in engineering and law—will have a strong, negative impact on the growth of the smaller corporation. We have seen this most evidently in Massachusetts in the substantial decline in the formation and growth of new technical enterprises, started by engineers and scientists out of inventions out of university laboratories.

Representative HECKLER. Still, the fact is that the capital requirements of small business have not been met, which was my basic question.

Representative BROWN of Ohio. Would you yield on that point? I want to give you a specific example. In the printing industry when OSHA was created, you were obliged to ged rid of all the papercutting equipment that you previously had in the shop, no matter how big or small you were. The reason is that the Federal Government, through an industry organization, decided that any equipment made up to that point was no longer safe. So, everybody had to buy new papercutting equipment. Now, what about the capital requirements. If you didn't have the money, you went to the bank and borrowed it for that purpose. You didn't create any additional profit for yourself, or any additional income, because you had already been cutting the paper in a different way, although apparently not safely. You were just putting more money into your business to do exactly the same kind of thing. There are the same kind of requirements in the environmental protection arrangement, too. It made a lot of money for somebody in the paper industry, but it was the Federal Government telling the small businessman how he should use his capital and telling him he had to get some capital for this purpose. So, you talk about putting people out of business, and I know some people who quit on that alone.

Representative BROWN of Michigan. Mr. Greenspan, there is a phenomenon occurring, it seems to me, that contradicts the very basic concept of the free enterprise system. It always seems to me we have argued that supply and demand really constitute or provide a price discipline in the marketplace. But, today, we have a serious lack of total utilization of plant capacity, yet prices stay high and there is low demand. It seems to me that consumer purchasing inactivity or reluctance compounds itself, as that attitude becomes more apparent. There are low sales in many areas. Instead of reducing prices to increase demand, et cetera, it seems that sellers increase prices so as to protect their bottom line. Now, do you have any comment with respect to that phenomenon, or am I not correct in my analysis?

Mr. GREENSPAN. No, I think your analysis is correct as far as the facts are concerned. It is not easy to know precisely what the interactions are.

But, one thing that has occurred is an increase in the required rates of return on investment to modernize and expand facilities. In part, it has occurred because of the uncertainties and the instabilities that have evolved in our economy in recent years; and in part it is the result of a number of the regulatory processes, which we related to you before. The net result of these uncertainties which we have generated is to require a higher rate of return to bring on new facilities.

Now that translates into a higher basic, underlying equilibrium price in an industry. In a number of other countries, where there were great political instabilities, one used to find extraordinarily high profit bases largely because nobody would invest without corresponding high returns. In the United States we were able to create vast amounts of capital and facilities at relatively low profits. People were willing to come forth and invest because of the certainty of stability in our system. Now, we have lost that. And part of the problem is that we have raised the general level of price inflation.

Fortunately, some of the recent evidence does suggest at this stage that some of the uncertainties are beginning to unwind. We are getting far more satisfactory price responses now than we did 6 or 9 months ago, when the rate of capacity utilization was even less than it is now. In other words, we are beginning to unwind the inflationary unbalances. And hopefully, we will continue to get a set of disinflationary forces which will allow inflation to simmer down slightly further and that this process will continue to impact the decisionmaking process.

And I think, incidentally, we have seen in the last several months, some very evident changes in attitudes about future inflation. It is reflecting itself in the structure of interest rates and in the bond market. It is reflecting itself in the stock markets. And I think this is a very salutory change, which, as long as we do not embark on policies which reignite inflationary forces, may be a precursor of new views toward capital investment. If we manage to avoid inflation and policies which add to inflation expectation, I think we may restore balance to our system faster than any of us are now forecasting.

Chairman HUMPHREY. Mr. Greenspan, I interrupt because I must go, and I am going to turn the meeting over to Senator Proxmire, who has joined us. We regrettably have a number of votes in the Senate and it is necessary for me to leave very shortly. I want to ask Senator Proxmire if I might make one or two comments.

The last thing you said to me indicates why some of the mistakes have been made in the past. You said the truth; namely, that when you get your plant capacity in greater use, you lower unit costs. That has an anti-inflationary effect. That is exactly what some of us have been giving as a reason why we ought to have an easier money policy. At the very time they were tightening up the money, which kept plant capacity down, they were adding to the inflation.

I happen to believe that recession is the new fuel for inflation. It is the fuel alternative we have today. I just wanted to make my statement, and you can respond, because I think you have disproved, by your most sincere and truthful statement of today, Mr. Greenspan, some of the actions of the past, because we always used to hear that if we generate too much activity, it is going to cause more inflation. Now, we've got more activity than in the last 16 months and less inflation. You brought down unemployment 1 percent, and you've still got less inflation. So, I think you are on the right course. Now, if you just stick with it, I think we are going on the right course.

I want to say something to Mr. MacAvoy. I have listened today to what I consider to be the scenario of the worst possible circumstances for the creation of public jobs. Now, I am not one that believes that public jobs are the answer to our recession. I believe that they are just essential to give people something to do to preserve a worth ethic, to get some service, to get something from people that get paid, that get a check one way or the other. I do not believe in just handouts. I was the mayor of a city in which we had public funds that came to us, and I didn't displace my workers. Let me give you an example.

The city of Minneapolis and St. Paul has had to reduce their snow-removal budget at a time of great snows. The reason we had to reduce the budget was because tax revenues were down and welfare costs and other costs were up, in Henderson County and Ramsey County. Now, are you going to tell me if we get some public service jobs out there, that we are going to lay off more people from snow removal? They may do it in Ipswich, Mister, but not out my way. I can tell you the people are damn mad that the snow isn't removed from in front of their homes, that they want trucks out there, and they want the snow removed. The city is desperately in need of manpower resources or financial resources to hire manpower.

Now, about the Forest Service. If the Forest Service isn't smart enough to put 5,000 or 10,000 men and women to work in the forest within 3 months, they ought to be fired, the whole bunch of them. We don't have to have a sociological evaluation and get all of the psychiatrists and psychologists and sociologists in on it. We just need somebody who knows how to hire and fire and to meet a payroll.

The Forest Service is 15 years behind in reforestation. Now, you really don't have to be college trained to plant a tree. You can go out there with some supervision, and the trees can be planted, and the forests cleaned up and the rivers cleaned. There are all kinds of things that can be done.

But, we've really got to get going. I think Congress has aided and abetted the problems. You've got the CETA program, with one kind of section and another kind of section, but I am a very plain and ordinary fellow: Just put people to work. Just take people out and give them a job to do.

I don't believe all this scenario that I have been hearing. I grant you there is a limit to what you can do in public service jobs, but we proposed, in our 1975 Midyear Report, a structure for an emergency jobs program. I hope you analyzed it. If you have, I want your analysis in writing.

Second, I want your analysis of the public jobs program produced by the Congressional Budget Office in the fall. I want to hear what it is. You said you analyzed all of them. I want to know why you think that is too expensive. I want to know why you think we can't have a flexible emergency public works programs that comes in and goes out. There isn't a city in America who doesn't have need of street and curb and gutter cleaning. There isn't a city in America that doesn't have waste disposal problems. I can give you enough work in Washington to do to keep you busy for many years. Right down from the Capitol down at M Street and right down New Jersey Avenue, you can see that it is filthy. It is loaded with debris. You don't have to be a college worker to be able to clean that up.

Now, isn't that better, to give them something to do, than to just line up these people at an office here across the street in Northwest for their food stamps or whatever? You just go over and have a look at them and see them lined up every day waiting for their stamps or something. Now, I happen to believe these people ought to have a job. I think they will be able to buy their food if they get that job. I know it is not easy. I am not trying to solve all the problems with a public works program. I just think we have alternatives here.

Representative BROWN of Ohio. Could we make them work to get their stamps, Senator?

Chairman HUMPHREY. Yes, I think so. May I say they are not lazy. People, given a chance, will work. But, if we aren't smart enough to even figure out how to empty a wastepaper basket, then there is something wrong. I know that is a dramatic exaggeration. But, I can tell you this: Once we were able to do it.

I am of an age that goes back to the Great Depression. We didn't have trouble with our CCC. They went to work and they went out and cleaned up and did other jobs. We did have work programs. Today, there are a lot of people who think we need some more of them, and I am one of them.

Finally, I would just like to say on the types of jobs, Mr. Greenspan, we have shops where we train people to go into the private sector. I think that Congresswoman Heckler, in her questioning here, brought out the possibility of the use of special concessions to create jobs. I think that ought to be really looked at. I will be frank with you. I have often thought that if a company had, let us say, 100 employees on an average over a 3-year period, and if that company would be willing to step in and hire 10 more people off the welfare rolls, I am willing to give that company a tax concession. I am willing to experiment with it. I don't know whether it is the answer, but I will tell you one thing: You haven't got an answer, except to wait. I think if you don't have an answer except to wait, then you ought to experiment with some other answers. When I hear that it costs $90,000 to create a $9,000 job, that only tells me one thing; that anybody that can goof up something that much ought to quit. We can't afford that. We ought to be able to create an $8,000 or $10,000 job. And if you have to pay 5 percent for overhead, or 10 percent for overhead, that is reasonable.

I will say, also, I have hired people, and I do know a little something about this. I ran a program for the WPA for several years. I was the mayor of my city, and I know what public employment is. We didn't have all of these problems. When did they all come around? When did they all gather up? Is it because we goofed it up this much, really? If it is, then Congress ought to be told about it, because I am not saying we are not also at fault. But, if you think we are, give us a specific program and description of why we ought to clean it up and——

Mr. GREENSPAN. Mr. Chairman, we will give you a detailed analysis, as we see it, of the type of program you are suggesting, the difficulties involved, and the realistic problems that we confront. I think it is a simple issue to address.[1]

As I have indicated to Congresswoman Heckler, we have looked at this type of program that you are suggesting. It looks, on the surface, to be quite an interesting idea until we started to think through how the legislation and the regulatory operations, to make certain that it works, would be written. Our assessment of the results under the existing institutional structures that we have now——

Chairman HUMPHREY. Existing institutional structures. You said it.

Mr. GREENSPAN. I meant it in a very broad way. I mean, for example, the types of ways in which State and local governments function. Now, we did have, as one of our early proposals, the concept of a project type of public service employment. A project-oriented type of program for jobs would tend to phase out as the particular projects were completed. But even so there are some real problems, at least for me, when one visualizes the type of difficulties involved in putting workers at the State and local levels into the project-oriented type of program.

As for the typical public service type of proposal, it is not strictly the inadequacy of the people to oversee these programs. It is very difficult to determine or insure that when somebody leaves for normal reasons, that the vacant job does not get filled with a person funded by public service employment, and so that is one problem you can see. You just have no way of knowing whether the slot would be filled from other means if the public service employment program were not there. There are just very fundamental difficulties that can be handled only under a certain type of batch or project-oriented program. And when you begin to look at that approach, you will find—in fact, as the Congress has found—a great deal of problems with that approach as well.

I will try to lay out for you, Mr. Chairman, the concerns we have with this type of program and our analysis.

Chairman HUMPHREY. And would you also lay out what you intend to do with the 7 million people out of work, except just to pay them?

Mr. GREENSPAN. Our approach is to get them back to work as quickly as possible.

Chairman HUMPHREY. Now you and I know—and there isn't a businessman you can meet with, Mr. Greenspan, or any person in the financial industry or financial institutions that wouldn't tell

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[1] The Council's response, p. 26, evaluates existing employment programs, but does not discuss the Joint Economic Committee's 1975 proposal referred to above by Senator Humphrey.

you that after every recession there is a higher threshold of what is long-term unemployables, or unemployed people.

Mr. GREENSPAN. I might say I do not believe that is correct.

Chairman HUMPHREY. Well, you can deny it, but the facts prove to the contrary. That is No. 1.

No. 2, they are hard to employ, and it is going to take at least an 8 or 9 percent growth rate to get those people back. You don't see an 8 to 9 percent growth rate, at least for the foreseeable future, is that right?

Mr. GREENSPAN. Well, I wouldn't rule it out. I don't think that is either the best forecast today or something, which if it occurs, can be sustained. But I would not say, absolutely, categorically, that the probability of that kind of growth is zero. It is a small possibility, but it is not zero.

Chairman HUMPHREY. All I can come out with is that we are just throwing up our hands now, and saying "I am sorry" to a great number of people. Well, I will come back and talk to you, sometime. If I were a neophyte in this, I could agree with you, but I have hired people on public employment and put them to work. I ran the city for 4 years and we put people to work. I was told we couldn't put housing up in my State, but we had to do it and we did it, we did it in months and not years. So, it can be done. I just don't buy this. I really don't buy it.

Mr. GREENSPAN. We don't have enough Mayor Humphreys.

Chairman HUMPHREY. Well, you give the Mayors the money, and they will work it out. I will turn it over to you, Senator Proxmire.

Representative BROWN of Michigan. I have a few comments to make to respond to the Chair's statements.

Senator PROXMIRE. Go ahead.

Representative BROWN of Michigan. Insofar as work requirements for receipt of public assistance, as far as local funds are concerned, there can't be great working requirements imposed in Michigan, but, of course, it was the Congress who imposed the nonwork program as a condition of public assistance.

Chairman HUMPHREY. I agree with you, and I think we ought to change that.

Representative BROWN of Michigan. Okay. Second, on the tax credit for jobs, you will recall the Senate passed the $2,000 new home purchase credit and we thought that was not an inappropriate price to pay to be able to encourage the purchase of new homes. But, the statistics show that for every new home sold because of that credit, three would have been purchased anyway, so the cost was not $2,000, but about $8,000 per new homes. I think the new jobs credit ought to be examined in that light.

Senator PROXMIRE. Well, welcome Mr. Chairman and gentlemen. I think it is the first time since I have been attending these hearings that all three of you have been here together. I think it is very formidable and impressive council. I think you are men of great ability.

I would like to ask some questions about the inflation situation, and what the administration is really doing about it. Certainly, the standard way of meeting inflation, of beating inflation is through fiscal and monetary policy. I think this has been thoughtfully and carefully considered by the administration.

But, I am wondering if this is enough in the kind of inflation that we face? It just doesn't make any sense at all to have even the level of inflation we have. It has really improved over what it was a year ago, of course, and sharply improved. But, nevertheless, it is high. It is expected to continue at a historically high level through this year and for some years to come.

There is disturbing evidence that it is going to, perhaps, accelerate. A short time ago, and in fact, Sunday, I read an article that the Dun & Bradstreet people had conducted a survey of 1,471 corporate executives. They found that 59 percent, a sharp increase over the expectation in the first three quarters of the year, they found that in the fourth quarter, 59 percent predicted price increases. Now, in addition, we have the fact that profits are up. Of course, this is likely to persuade the labor unions, which in a big way are going to be renegotiating contracts this year, to press for higher settlements. The Teamsters, which will be the first big union off the mark, as I understand it, in 1976, are going to ask for a very, very big increase. They will be followed by other unions, such as the UAW in the fall. It would seem to me that we should have a resurgence of inflation in a substantial way, without inflation being fueled by either monetary or fiscal policies, but by wage settlements, perhaps by the energy situation, possibly by what might or might not happen in the crops.

Now, what is the administration doing in respect to this? We do have an agency; namely, the Council on Wage and Price Stability, that has been a very quiet agency. If this agency is going to have any effect, it should speak out, it should call attention to wage and price increases that are not justified, and focus as much attention on it as possible and get some results. What is the administration doing in this respect? This is a very quiet agency, and has a weak staff, staffwise. It only has some 25 professional staff members, so what is the administration's answer to the inflationary elements in the economy that are likely to come through and that are not related to fiscal and monetary policy?

Mr. GREENSPAN. Let me first answer some of the broader questions, Senator, and then turn it over to my colleague, who has been working with the Council on Wage and Price Stability more directly than I.

First of all, in a historical context, we had a rather abrupt decline in the rate of inflation. Part of it has been the result of excellent crops. But, nonetheless, in the industrial areas, there has been a gradual phasing down. It is slow. It is taking a while. It doesn't happen quickly. But, we are gradually unwinding this inflation and the inflationary psychology which is built into the decisionmaking process. I think we are seeing this, in part, in the interest-rate structure, which is another way of looking at it.

What I think we are seeing is a change in our longer-term expectations at this stage, Senator. The reason we do project a marked further decline, in 1977, is because of a cyclical adjustment to a downward trend. That is to say, our projections that inflation will unwind further in this manner, is being offset to some extent by the cyclical upturn, which things being equal, tends to put some upward pressure on prices. It is for cyclical reasons, Senator, that we have this kind of forecast.

We are, in effect, saying that in 1977, adjusted for cyclical factors the inflationary rate will be less than the rate of 1976. Now, part of the problem in 1976, as you correctly pointed out, is that we are moving into a major collective bargaining cycle. There are a large number of workers this year who, in the course of the collective bargaining agreement which will be negotiated, will move from what we call the tail-end of a new existing 3-year package, to a first-year settlement, which is likely to be in the area of 10 percent. Now, other things being equal, this will tend to raise the wage base.

Senator PROXMIRE. As I understand it, and Mr. Shiskin just told me a few minutes ago in the Appropriations Committee hearing, that the average wage settlements last year were about 10 percent. And because of the front-end load factor that you are referring to here, it would seem to me we could possibly expect more substantial wage increases in 1976 than 10 percent. If we do that, wouldn't that have a direct, explicit, predictable inflationary effect?

Mr. GREENSPAN. There is no doubt that of the 10 million workers in that particular group that you do add to the total wage-rate increases, if those first-year costs go to above 10 percent in any significant way.

Senator PROXMIRE. Let me just interrupt. I am sorry to keep interrupting, but there is something here that I think is critical. And that is that the administration, I think, has a very skillful new Secretary of Labor. His job is not going to be to try to achieve noninflationary wage increases. His job is to get settlements to avoid strikes, to avoid labor disputes. The input we get from the administration to try to achieve noninflationary settlements will come from the Council on Wage and Price Stability. Which, as I say, it seems to be a Council that is very feebly staffed with only 25 professional people and 12 of them will be working on the governmental inflationary element and so will not really be able to focus the attention of the President and Congress and the country on the inflationary consequences of the settlements that will be coming up in the next year.

Mr. GREENSPAN. Well, Senator, I think since my colleague has been working quite closely with me. I think I will yield to him to respond to the questioning.

Representative BROWN of Ohio. Mr. Greenspan, would you yield for one comment? Would you please, in your response, fold-in this question, because I think it is implicit in Senator Proxmire's question, and that is if we believe in free collective bargaining, this could go either way. You could have a major strike in one of these industries, because the industry resists an effort at a 15-percent wage increase in 1 year, and you could have a depressing effect on the economy, couldn't you? I would like to know what the chances of that are? If we are going to interfere in the collective bargaining process, I would like to know whether we ought to interfere on the side of inflation or depression?

Mr. MACAVOY. The answer is complicated and depends, in part, on whether we are talking about wages and prices or particular industries. But, I feel, in general, that CWPS and CEA cooperate closely in terms of analysis and prescriptions for particular industries where rapid price increases seem to be forthcoming.

We have established a strong nucleus of high-level staff members that have price watching and anticipation abilities by industry. And since Mr. Robert Frankel came to CWPS from MIT, we have a system in operation for early detection and anticipation of price changes in the industrial sector.

Senator PROXMIRE. How do you explain or justify——

Mr. MACAVOY. And Mr. Miller and the others are all as good as anybody in this Government in terms of price and wage analysis.

Senator PROXMIRE. I don't deny their ability and their effort, but the results seem to be discouraging.

Mr. MACAVOY. Perhaps we should look at what we have done in three or four of these areas. In the last year, the administration has taken a strong leadership role in the development of domestic and trade policies with respect to agriculture. The domestic supply and price situation is far better right now than for some time. Food prices did not fuel inflation this last summer, and yet agricultural experts have made very real contributions to our balance of payments. We made very important first steps in stabilizing the year-to-year fluctuations in foreign demands, particularly those of the Soviet Union, on our crops. This greater measure of stability will allow farmers to add to their supply capacity and will result in smaller price fluctuations from crop to crop. We have made great progress on the energy front. The Omnibus Energy bill, the way we are working out natural gas regulation, are examples. In particular, I am very concerned with the possibility of continued shortages of natural gas being severely inflationary. The bills that are now working through the House would remove the Federal controls.

So, both on the food and energy side, we are making considerable progress.

I am sure you are aware of the CWPS studies and investigations of profit margins in aluminum, of price-cost margins, in the food industry, and particularly of the very excellent study of the relationship between grain prices and bread prices.

Senator PROXMIRE. Let me just interrupt to say I wouldn't deny the fact that the action by the Congress and the administration with respect to energy and the action with respect to smoothing out the purchases by the Soviet Union of our wheat has been constructive and useful as far as inflation is concerned. There are other problems that have been raised that may be more serious, especially in the energy area, but that is true.

But, in the industrial area, we still get increases in prices, in spite of the fact that they are operating far below capacity and have weak demand and heavy unemployment and no economic reason why prices should be going up. They should be going down, but they continue to rise.

The latest data we have on the wholesale prices indicates an overall drop, strictly because of the fluctuation of food prices. Industrial prices have continued to go up. They have gone up steadily. Recently, they have gone up steadily, month after month. They continue to rise. And I don't see any action that has been taken by the administration to cope with this.

CWPS has investigated and criticized pricing in steel and aluminum, but what is being done about that?

Mr. MacAvoy. The results of CWP's detailed investigation indicates that critical decisions are being made at this time in the metals industry, involving very substantial increases in investment in the early 1980's. If we are going to have adequate capacity for production of metals and materials in the early 1980's, decisions must be made in the next year or so. Now, these decisions are based on long-term marginal costs. We discussed this the last time we were here. Long-term, marginal costs include the costs of capital. If we do not have price relationships and price expectations that take accounts of both the out-of-pocket costs, and long-term marginal costs, we are not going to get that capacity and the pattern of price investment relationships that appears to be replicated again and again in the metals area is that the prices are hitched to the long-term costs. These prices are hitched to the long-term costs of investment expansion, and those costs have increased appreciably since the last big round of investment expansion in these industries.

Senator Proxmire. We had testimony before this committee from the steel industry that their productivity was such that the unit wage costs have not increased; that their productivity is sufficient to overcome the wage-rate increases which they pay. We had testimony that their capital costs seem to have dropped. Their interest rates have gone down. And certainly, in the last 6 or 7 months, they are operating well below capacity. Yet, we don't have any price reductions.

Mr. MacAvoy. They are making investment decisions now for the next 5 years.

Representative Brown of Ohio. Would you yield on that? They are not making investment decisions, because they have to wait for the Clean Air Act. They cannot, as I understand that act, make any investment in new plants until they know whether that Clean Air Act will allow them to build new capacity.

Mr. MacAvoy. That adds to the problem. The Water Pollution Act, meeting the best available technology requirements in 1982–83, that is an important part of the problems as well. To say they are making these decisions is another way of saying they are balanced on the cliffs and they are ready to go. The decisions seem to be characterized by consideration of expected long-term price cost relationships. These seem to have a tendency to be less flexible over the cycle. But on average, they do not decline or rise faster over the entire recovery recession cycle than do prices in other industries. They are phased and the phase is different and we have to recognize that. And if we go in there with a Sherman Act action, we are beginning another process that takes a decade. These cases are never decided within a decade. We are still under court jurisdiction in the *Learned Hand* decision of 1946 in that industry.

Second, the process adds greatly to the uncertainty. Certainly, it doesn't relate in any way to the economic variables that concern you, Senator Proxmire. It relates to structural barriers, technical conditions, barriers to entry. So, the cases don't have anything to do with that. So, that combination of events is not one that I would prescribe for those industries.

I remember sitting in President Johnson's office in 1965 one day when this very same matter came up. I was a senior staff member on the Council of Economic Advisers. And he, in his way, which was unique, tried immediately to get the Assistant Attorney General for Antitrust on the line. The Assistant Attorney General was in the Bahamas and could not be reached by phone. President Johnson's response was "How can I run a Government when my Assistant Attorney General for Antitrust is not available by phone." Well, that was the correct response, because you do not start and complete an antitrust action in 1 month, 1, 5, or 10 years, which relates to the cyclical price performance for aluminum companies in 1965.

Representative BROWN of Ohio. May I just observe one example? In my own district, I visited, within the last 2 weeks, a little steel company operated independently. They were told they had to improve the quality of the emissions from that plant. That plant employed some 350 people. The question was, can we find a sucker to buy us, or shall we close. They found a sucker, because the president of that plant used to play golf with the head of another major steel company. I don't feel I ought to mention the name, because they did buy them. I think they bought them as much for a personal favor as anything else. The result is, you've got concentration in the steel industry.

Now, I am pleased with that, because it saves 350 jobs in my district. Otherwise, we would have had that plant closed. The whole reason was the Federal Government requirements under the Clean Air Act. I am not opposing the Clean Air Act. I am just simply reporting an economic condition that results from congressional legislation. We've got to accept the responsibility for that, one way or the other.

Now, we can break up that big company that bought the small plant, but you can bet that they will never buy another little plant to save 350 jobs, if we decide to take that attitude. Who do we want? What do we want?

Senator PROXMIRE. Well, I agree with much of the implications of what the Congressman from Ohio has said. I think there is a lot of sense in our recognizing, when we move ahead with environmental protection, which I favor, and he does, too, that we identify the economic consequences and that we go into it with our eyes wide open. We haven't done that in the past. We ought to do that. We ought to know what it means to go to almost 100-percent purity, compared to 90 or 95 percent. I think he makes a lot of sense there.

But, still, it seems to me that a clear, firmly stated antitrust policy would definitely be a deterrent to price increases, whether it is taken by the Johnson administration, and I think that the Democratic administrations have been no better than the Republican administrations, so it is not partisan and you are right—but there has been a consistent weakness on the part of our Government to aggressively enforce the antitrust laws. Furthermore, in the past, when President Ford first became President, as I recall, he did speak out against unjustifiable automobile increases. There has been almost nothing from the administration on price increases in the last year or so. There has been very little, at least, that I can recall, yet those price increases have continued. And, in view of the economic situation with unused resources, with unemployment as high as it is, operating at 75 or 80 percent of capacity or less, it would seem that jawboning, might very well be effective.

Representative BROWN of Michigan. Ford Motor Co. did rollback their prices, because of the jawboning——

Representative BROWN of Ohio. It wasn't jawboning at all. It was because they couldn't sell the product.

Representative BROWN of Michigan. But, it was consequent with the expressions from the Council.

Senator PROXMIRE. Well, there may have been one or two incidences, but in view of the very serious inflation problem we have and the emphasis that the Chairman of the Council rightly puts in his statement on overcoming inflationary expectations, if we are going to move ahead, and the economy is going to go, it seems to me this kind of action on the part of the President would be most constructive and helpful.

Now, an occasional reminder, well, not an occasional reminder, but a consistent reminder to Ford Motor and others, a consistent policy of going after all of these companies when they get out of line with their price increases, may——

Mr. MACAVOY. And over the coming year, an area of additional concern is textiles. That is expected to show the largest rate of increases. Here we fact not just problems of administered prices, but of fluctuations of raw material, of changes in plant conditions as capacity realization went down. We have experienced some deterioration in productivity, and we have large seasonable and cyclical variations. Now, you can take the approach of focusing on administered prices or of focusing on those areas with the highest forecast rates of price increases and you will get two entirely different situations. It is not clear that working with either one would be deflationary in the sense of moving us to a higher level of capacity utilization, higher levels of employment, and constant margins.

Senator PROXMIRE. May I ask you——

Representative BROWN of Ohio. Senator Proxmire, first, would you yield again on that?

Now, you discussed the automobile industry and the fiber industry, of which an increasing amount is synthetic not natural fiber. I had occasion to meet this morning with the rest of the Ohio delegation, because we have a certain amount of the chemical industry that produces synthetic fibers and their concern was that the Toxic Substances Act—and of course you use toxic substances to produce synthetic fibers—and their concern was that if you are obliged to have a one-half million dollar protocol that proves that some new sub-
stances Act—and of course you use toxic substances to produce syn-
are going to push a $5 million chemical industry out of business. You are going to close down small business. We had that question raised this morning. You are going to concentrate the industry into the hands of larger companies. Another thing was, that unless they have some charitable organization that contributes to this kind of protocol testing, you are going to raise the price of the product.

So, there are two questions we ask about.

Now let us consider the automobile industry. We just passed the Oil Policy Act, which you referenced in your testimony a few minutes ago, and the Congressman dated full efficiency by 1985. Nobody, at this point, this morning, knows how we are going to accomplish that in the automobile industry. Congress, in its wisdom, once again has probably added to the price of an automobile that in all likelihood will be made not out of steel, but out of plastic, because they can't make it out of steel and get those fuel efficiency levels under any system that we know of. That is going to kick the living daylights out of the steel industry in my State of Ohio. If it is going to make these automobiles a lot less fuel consuming, that is wonderful. But will it make it safer? If you hit a telephone pole with one of those plastic automobiles and the automobile falls apart, the driver will, too, because he will be about 3 inches deep into the telephone pole.

The point of it is that we, in the Congress, are responsible for concerns that we are laying at the foot of private industry. The Council of Economic Advisors and the administration is saying that is silly. It is saying let us be honest, at least, and say who is responsible for what we have done to raise the cost of man-made fibers and to raise the cost of automobiles.

Senator PROXMIRE. Could I just mention one thing? Congressman Gary Brown called this to my attention, and I should have followed up on it. And that is that CWPS, as you pointed out and I think very properly pointed out, is made up of very admirable people, but there are too few of them. And they need more authority than they have. They do have subpena power. The difficulty is they don't concentrate on problems before they occur. Right now, we know we are going to be faced with a big inflationary push, or have the prospect of a big inflationary push from wage settlements.

I am afraid we will get an historical analysis of this next year. That may be useful to people reading it 10 years from now, but what we need is not an analysis. It is some kind of a policy now that would put us in a position to do something in restraining what may be the big inflationary event or events of 1976: Wage settlements that are going to push up prices.

Mr. GREENSPAN. Senator Proxmire, as I recall, there is a study just released by the Council on Wage and Price Stability outlining the underlying elements in a number of these particular contracts and the implications with respect to the future. Now, it is obvious that there is a certain restraint on what can and should be said in a written document pertaining to pending collective bargaining agreements. But, I would indicate to you that they are, as I well know, fully aware of what is going on and the implications of it.

Senator PROXMIRE. I am glad to hear that. We would certainly like to have it. As Congressman Brown says, it must be under a bushel, because——

Mr. GREENSPAN. Well, as I understand it, it is published and——

Senator PROXMIRE. Well, it hasn't been given wide attention.

Mr. GREENSPAN. We do have a copy, and it looks like an official externally available publication and we will undoubtedly get a copy to you.

Mr. MACAVOY. May I make a comment, in line with Representative Brown's remarks of a few moments ago?

CWPS does now spend half of its time and effort and energy on taking part in ongoing Government procedures in an attempt to reduce the spread of inflationary price increases generated by regulations.

Senator PROXMIRE. Including environmental regulations of the kind——

Mr. MACAVOY. Now, they attempted to examine early-on those that might be leading to price increases. Their activities, most recently, have centered on the Consumer Products Safety Commission, because CPSC findings have been closest to the consumer. They took a major position against the 50 to 100 percent increase in the price of lawnmowers that is generated by CPSC's requirements. They have worked diligently in the transportation equipment industry. They have had a great deal to do with the turnaround of the early decisions of the Highway Safety Board on requiring computerized $150,000 truck rigs. The activities are difficult to assess in any quantative fashion, because they analyze and resist regulation which would increase prices.

I believe first and personally they have had some effect in the last year, the effort is new, and it is going to be next year or the year afterward where they will really begin to have some price restraining effects.

Senator PROXMIRE. I realize the time is very late, but I will just take a couple of minutes. I do want to ask some questions on one particular area, and that is monetary policy. The administration's most widely publicized economic initiative is, I suppose, in the budget, the $394.2 billion budget, which is regarded as a restraining change from what we have had in the past, at the very least. And I support that. In fact, I think it should be lower.

But, I think if you are going to make that realistic in the kind of economy we are in, we ought to have a stimulating monetary policy. Now, as you know, for the last 6 months we have had an increase in the money supply at about a 2.3 percent rate. Over the last year, it has been below the goals set by the Chairman of the Federal Reserve Board. In spite of that, we have had a drop in interest rates. Now, doesn't this suggest that the rcovery is weak, is weaker than perhaps would seem superficially? There doesn't seem to be much demand with interest rates falling. And in spite of the drop in money supply, the only way, it seems to me, that makes sense is that the demand for money is also dropping and——

Mr. GREENSPAN. I will let my colleague answer that.

Mr. MALKIEL. First of all, let me say, Senator, I would certainly agree with you entirely that this kind of shift, to the extent that we are able to get some rein on the budget, would in fact permit a more expansive monetary policy with less fear of inflationary consequences. It would loosen the capital markets. It would facilitate investment. And I believe it would have some very beneficial effects on the economy.

The question, however, of an appropriate monetary policy, of what it is, and whether in fact the monetary policy we have had in the last 6 months can be characterized as tight or easy, is in fact, a very difficult and very complicated one. As you said in your remarks, interest rates have fallen. And it is highly unusual for interest rates to fall during a vigorous recovery such as we have had during the last two quarters of last year. The reasons, I think, are precisely the ones that you have suggested; namely, that there may be something that has happened to the demand for money or more generally there may well be some fundamental kinds of things that have happened in the economy that have changed the general relationship between money and other economic variables. Technological changes, if you wish, have taken place which enable us to get along with much less money, and therefore, makes a monetary policy with a particular rate of growth of the monetary aggregates, in fact, more expansionary than it may appear.

Senator PROXMIRE. Let me just interrupt at this point to say that one of the most desirable effects in getting the economy to grow, two of the most desirable effects to get it to grow in times of falling interest rates are in persuading business to invest more money in equipment—and that does not seem to be developing. As the Chairman indicates in his statement, the prospects are that that won't increase that it will decrease during the coming year, although he thinks there may be a change, with higher profits—and the other is housing, where he expects to have a higher increase and much better than anybody else expects.

But still, on a historical basis, it would be a low number of housing starts, and I see nothing in your statement, Mr. Greenspan, indicating that increase would be fueled by a significant fall in mortgage interest rates. What I am saying is the function that lower interest rates should be performing; namely, stimulating economic activity just doesn't seem to be there, either in housing or in business investment.

Mr. GREENSPAN. I am not sure that is true. I think one of the reasons we are getting low interest rates, at a time of low monetary growth and a rapidly expanding economy, is because I think inflation is beginning to fall. The level of interest rates has not been unreasonable in view of the substantial and seemingly intransigent inflation rates. Another piece of evidence is the stock market which has reflected the same type of phenomena. It may well be that what we are looking at now, however, are the very first signs that the inflation psychology is beginning to break. And if that is, in fact, happening that is a most important force which will move the economy upward.

Senator PROXMIRE. And yet, you have this reflection from the Dun & Bradstreet survey that a very large number of executives—and that is a tremendous sampling of 1,400 executives—and almost 60 percent now expect price increases. They are talking about their own prices.

Mr. GREENSPAN. Yes, I am not certain——

Senator PROXMIRE. Where they know what is going to happen.

Mr. GREENSPAN. I must say I have seen some of the results of that survey in the past. And on some occasions it has been accurate, on some it has not.

There is a big difference between what corporations plan on price increases and what they actually do. I have seen many examples of price increases planned 2 months in advance that never came about. Market conditions at the time made it impossible to put them in place. And if the attempt was made the increase did not stick. So, I would certainly say that while the evidence that you cite indicates that the intention is there, past history suggests that the potential for these increases to be implemented is rather loose. But, I grant you, we will have to wait and see how that develops.

At this point the behavior of industrial prices is a lot more favorable than I think would ordinarily be expected. We are coming out of a significant inventory liquidation, which ordinarily would depress prices abnormally. And when inventory liquidation pressures ease, as they have done, you might expect prices to accelerate.

Senator PROXMIRE. Not when you are operating so far below capacity.

Mr. GREENSPAN. I would say even under those conditions, because it is a relative thing which would operate even when you are at low levels of capacity. You can put that 25 percent idle facilities in place quickly and in a 2-, 3-, or 6-week plane, the actual operative capacity may be only, say, only three or four points higher. Those capacity figures we have been talking about are available only after some period of time, during which you can bring on labor, raw materials, and other operations. So, that when we think in terms of the rate of operation, we tend to ignore that it is not immediately available. Another way of saying they can't bring those facilities on that quickly is that backlogs begin to fill up and leadtimes on deliveries begin to stretch out. And that type of phenomena tends to increase prices. So, even when you are dealing with subnormal operations, you still have those price pressures. But even in this context, I think they have been less than one ordinarily would expect.

Senator PROXMIRE. Well, I could argue with you on that, but let me ask one final question.

One of the most conspicuous changes in the budget is there is an increase in real defense spending, while civilian spending is going down. That represents a shift in priorities, which has been widely publicized, and we are aware of that part of the debate. But, I wonder if anybody on the Council has analyzed the economic effects of that kind of change in priorities, such as possibly the inflationary effects. One aspect of defense spending is you are not producing economic goods. If you increase in housing, you are producing more housing; if you increase spending on manpower training, you are getting more skilled people that can go out and work. So you tend to have both an inflationary effect of spending more money, but a deflationary effect of increasing the supply. But that is not true in defense spending. Defense spending is strictly inflationary.

Have you made any analysis of this kind of shift in the budget to more defense spending?

Mr. GREENSPAN. Well, Senator, first of all, let me say that it is certainly true that a small increase is projected in real defense outlays in the final 1977 budget. Nonetheless, the share of real national defense outlays in the total budget is still far below past years. And I think we lose sight of the fact——

Senator PROXMIRE. Well, I don't want to argue with you on military strategy. I have a very strong feeling on that, as you may have, too. What I am talking about is the change from last year and the economic aspects.

Mr. GREENSPAN. The economic aspects, I would say, is impact largely on the military procurement side. For example, the manpower costs issue is not relative to this. It is obviously the same sort of thing——

Senator PROXMIRE. I understand there is a 7-percent real increase in the nonpay portion of the military budget?

Mr. GREENSPAN. I think that is an obligation. I have forgotten what the figure was, but I think probably there is a significant——

Senator PROXMIRE. Oh, I understand. The staff tells me that is in outlays.

Mr. GREENSPAN. I can't dispute that, because I don't have that. But it does, obviously, affect various basic materials requirements and the like. But, I might add that the earlier part of this discussion was a discussion talking about creating jobs. And to the extent that there is a significant increase in materials purchased, it does affect the materials producing industries, which are operating below capacity. And while I do agree with you that you get a somewhat greater inflationary impact, the reason you are getting it is because of the basic impact on the demand for materials.

Senator PROXMIRE. Well, do you have an analysis of this kind, or is this kind of off the top of your head?

Mr. GREENSPAN. No, this is basically on the basis of numerous analyses that have occurred over the years. As you well know, Senator, the differential impact multiplier for various types of defense outlays has been extensively examined in the past and we know of no reasons why those conclusions do not still apply.

Senator PROXMIRE. Thank you.

Representative BROWN of Michigan. Just an observation. It seems to me, when you consider the President's budget and our looking at the defense versus nondefense portions, that you've almost got to feed in the extra tax reduction. Because if you are looking at actual dollars, as you seem to be with respect to the defense budget, those things are negative expenditures, I guess, for negative receipts. And it seems to me, therefore, your proportions change as you look at the total budget and what is contemplated by the budget. I think we tend to oversimplify these things, but just looking at the figures you see that.

Just one further thing, on the problem of monetary growth. Now, do not really feel that when you look at M_1 and M_2, et cetera, that you really have a handle on the money supply situation, in view of the tremendous change in philosophy, and the things that are not encompassed in the M_1 and M_2?

Mr. MALKIEL. No, sir; I would agree with you entirely. I think we do not have a handle. One must recognize the kinds of changes that have taken place in some places, such as the so-called NOW accounts, where one can use a savings account essentially as a checking account. We have the liquid assets mutual funds, which occur in none of the M's now. This is where an individual can buy a share of mutual funds or invest in certificates of deposit and commercial paper and so forth, and can actually, in many cases, write checks against the liquid assets mutual fund in the sene that you can have it go right into a checking account and then write checks on the checking account. Well, again, this is a way in which one can store money and yet it doesn't appear in any of the money supply figures.

Since November of last year, corporations have been allowed to have time deposits of commercial banks. And, in a sense, they can by telephone, transfer this money into their demand deposits.

Representative BROWN of Michigan. They are only talking about the difference between the M_1 and M_2.

Mr. MALKIEL. That is a shift between M_1 and M_2, right, but I think the point of issue then is one has to be very careful about talking about any one of the M's, because these are very large shifts that have taken place in recent months. And, in some cases, we are talking about instruments that are not in any of the M's at all. So, I think we have to be very careful about taking any specific M and saying that is the answer, that is the money supply.

Senator PROXMIRE. Well, that view is hotly disputed by monetary economists who testified before our Banking Committee in the last few months, who said that no matter how you dodge and duck, the fact is that M_1 does measure significantly the change in the availability of credit and the availability of money. It is still, by far, they fell—and I am talking about Mr. Freedman and Mr. Bruner and a number of other economists that you would recognize as being very able, and they feel this is the best single measure. And the difficulty is that all of us in Congress and in the public are pretty overwhelmed by monetary policy, anyway. Economists have made it very complicated and confused and difficult. And when we try to find out exactly what the availability of money is by that one measure, we're told we have to look at M_1 through M_2 through M_9 and then you've got to throw in some other things.

Representative BROWN of Michigan. Mr. Chairman, what I was saying was not so much that this is not the best indicator that we have; but rather its significance today, compared with times in the past, when it hada greater credibility with respect to——

Mr. MALKIEL. Yes, I think that is exactly the point. The recent empirical evidence seems to suggest that the demand for money functions, which we thought had been so terribly stable in the past have, in fact, been running off significantly. And let me say, I don't mean to suggest this is a settled issue, because I think it is not. And frankly, it is an issue that we are now doing a good deal of work on at the Council. But, it is definitely the pace that these stable demands for money functions are now very definitely running off and have been running off since sometime in 1974.

Senator PROXMIRE. Well, gentlemen, thank you very much. The committee stands recessed.

[Whereupon, at 1:15 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, January 29, 1976.]

THE 1976 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 29, 1976

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

The committee met, pursuant to recess, at 10:05 a.m., in room 318, Russell Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, Kennedy and Javits; and Representatives Bolling, Reuss, Hamilton, Brown of Ohio, Brown of Michigan, and Rousselot.

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

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. This morning ladies and gentlemen, we are pleased to have as our witness Mr. James T. Lynn, the Director of the Office of Management and Budget. And, of course, we will discuss with Mr. Lynn the President's budget, his economic proposals for the coming fiscal year. I might say that none of us say it is an easy assignment to be in charge of a budget presentation. While our questions may seem pointed, they carry with them always a note of sympathetic understanding. So I thought we would preface today's hearing with that caveat.

The President has stated, and I think we all agree, that two major economic problems facing our country today are unemployment and inflation.

Frankly, I must say that as I view the budget particularly in terms of its overall outline and categories, this budget addresses neither of these problems in a significant way. As we examine the many individual pieces of this proposed budget, the central focus of our examination should be to determine how each of these many pieces or line items will affect the major problems of unemployment and inflation.

I have to say again that the question isn't whether or not you have $350 billion or $395 billion or $400 billion or whatever it is. The question is, What does the budget do to get at the problems that afflict the economy? Obviously we all have our separate approaches. Some people are deeply concerned about fiscal stimulus because they are worried that it will reignite or further extend the flames and the size of inflation.

There are others that are of the opinion that the fiscal stimulus is necessary and that because of the unused plant capacity, the lack of demand, that the dangers of inflation due to decreased employment, are not nearly as significant as some would paint them.

I think we need to establish the fact that, in general, this budget proposal does represent a reduction in Government services. There are several ways to arrive at this conclusion but the simplest way is to just take a plain look at the figures.

The President has said that he is restricting the growth of the budget to 5½ percent. I suggest that this is an overstatement. If you adjust the total and include the Ex-Im Bank, which was formerly excluded by law, and make a comparison on a year over year basis, as we normally do, the growth in expenditures proposed in this budget is about 4 percent.

I would like, Mr. Lynn, you to address yourself to that at the appropriate time. The administration has projected price increases at about 6 percent. That 2-percent gap means fewer Government services. I would like to know how this general policy aids in the fight against inflation and unemployment.

Another way to look at the budget is to compare it to the current services budget, which by the way was analyzed by the committee some months ago. Now this was an estimate by your staff, by the committe's staff, and by the Congressional Budget Office. And there seems to be general agreement that we would need to spend something between $420 and $425 billion in fiscal 1977 to provide the same level of services as is in fiscal 1976. Now we are not necessarily recommending that, but the staff studies by the OMB and the CBO and the JEC seem to indicate that something in the range of $420 to $425 billion in fiscal 1976 would be required by the same level of services as in fiscal 1976. If I am in error on that, I would like to have you correct the record.

This means that the President is proposing a $25- to $30-billion cut in services. Again, I must ask how this policy aids in the fight against inflation and unemployment.

Turning to specific proposals made in this budget, I find it is even more difficult to understand the President's reasoning when you look at the twin evils or twin problems of inflation and unemployment. The employment policies as outlined in the budget seem to me just incredible. You would reduce the summer youth program by 170,000 jobs and reduce the emergency public service employment by 260,000 jobs. There are 165,000 people now receiving extended unemployment compensation benefits and they would become ineligible, and 290,000 would be eliminated from special unemployment benefits. I would like to know how much the welfare roles will be increased by the employment policies proposed in this budget. I want to say that the League of Cities and the Conference of Mayors and the National Association of County Officials are deeply disturbed over the figures and their interpretation of this aspect of the budget. Because it is very clear that the costs of welfare are skyrocketing at local levels. In fact they are breaking the back of many county governments and city governments and posing a very heavy burden on State governments.

In other words, there is a transfer of costs away from the Federal to the local with the local governments being compelled to lay off the employees at the same time the Federal Government is hiring them under CETA, which to me is just plain stupid. I guess that is a tough word but it is right. I was in New York City when we held a hearing there and some of my colleagues were there. CETA had a program to train and employ 16,000 employees as the city was going to layoff 75,000 employees. That is a sure way to have a problem.

Last year we spent $9.3 billion on medicaid. This budget proposes combining medicaid with 15 other programs and spending a total of $9 billion. I may be in error, and again if I am you must correct me and our staff because I don't want our figures to be in error, but those are my figures.

The increased costs to all elderly patients proposed for medicaid would far extend the benefits a few would receive from catastrophic insurance. I might take note of the fact that the category of people in the American economy that are the poorest of the poor are the elderly by far. And anything that increases their costs is placing a burden upon these least able to pay it.

Tightening food stamp administration would reduce the number of beneficiaries by over 5 million. I can assure you the Committee on Agriculture and Forestry, which I am privileged to be a member, is redoing the entire food stamp program. We will be making appropriate changes to tighten it up.

On the tax side, the President has proposed increasing the two taxes that go directly into employers' costs of labor; and that is the social security tax and the unemployment compensation tax. These two tax increases would largely offset the tax reductions the President has requested—I think about halve the tax reductions that the President has requested. I would therefore like you to explain to this committee how increasing wage costs, which surely social security tax does, or the unemployment compensation tax, how increasing these wage costs will help either inflation or unemployment. And I mention this particularly at a time of very fragile recovery but hopefully real recovery.

In summary, Mr. Lynn, I would repeat my original conclusion that this budget does little or nothing to address the two major problems facing us today—inflation and unemployment. It may address itself to the problem of deficit at the Federal level only to increase costs of Government at the local level, which is nothing more or less than a Mexican bean game that shifting the bean to the person who can least afford it and have the least capacity to digest it. Therefore I look forward to having you show me that these conclusions are not well-founded because I think all of us ought to make sure that we don't exacerbate our situation.

Yesterday I had some exchanges with our old friend, Mr. Greenspan, about the jobs. Mr. MacAvoy was here with us and gave us a dissertation on how it was difficult it was to make a job program work. I thought about this a lot. In fact I talked to Mr. Greenspan last night in the pleasant atmosphere of the Press Club. But I just still can't figure out why it is so difficult to put people to work. That always kind of makes me wonder whether we have gotten ourselves so overorganized that we don't know what to do. And so overorganized that we will be finding out we won't be able to open a door after awhile.

I know it does not take much time to hire anybody. In our little business we hired new employees over Christmas. It wasn't difficult at all and we just hired them. The only problem we had was filling out the Government forms. That takes a special accountant. Then after Christmas we didn't have any difficulty laying them off. We didn't need them. Really it wasn't a problem. I just don't understand it. If you are in business, there is no problem at all in it; the only problem there is is filling out the Government forms. Humphrey Drug, Inc., has no problem at all hiring and firing.

And as mayor of Minneapolis I had no problem at all. I had a public service employment program, believe it or not, right after the war when we thought there was the danger of recession and we didn't have a problem. We got money in from the city and money from the county and we just hired and put them right on the government payroll just like that. No problem. After awhile we found out we didn't need them all so we let them go. No problem. We had the same thing with housing. I didn't have a public housing authority in the city of Minneapolis. I had 8,000 veterans that returned to my city with no place to live. I just went out and got some trailers and I went and got some pre-fabs and we put them up. We did it all in less than 6 months. There wasn't any problem.

I'm going to ask the Office of Management and Budget to show us how to put a job program together where you have more people working on the jobs than you have people preparing the job forms. That is going to be a real zinger.

Mr. Lynn, I think you are a practical man. I think you can do it. You and I have had our differences but I have a high regard for you. And I bet if I turned it over to you and said, "We would like to employ 500,000 people in the next 9 months," I bet you would find a way to do it. If not, give it to the Pentagon. They know how to put people in the Army. I decided they ought to turn the whole Government over to them. There is a reason for it. First, they get more money than anybody else. Second, they can put more people to work than anybody else and they don't overwork them when they do put them in, so there would be no social strains. Third, they know how to get the benefits after they have had to work so nobody would suffer. I would suggest to my colleagues on the committee, if it doesn't sound like I am embellishing the military complex, that we ought to take the social agencies and just do away with them and turn all this over to the generals and admirals. If you give the generals and admirals the money we are talking about as far as public service jobs they would get the ships out of the mothballs, they would get the tanks out of the sandlots, they would get the uniforms out of the storage houses, they would refurbish the barracks just like that, and we would have them all employed. But when we get around to OMB and CEA and the social agencies that we have, everybody is going to collect social security before we ever get them around to getting them working on getting jobs at least according to what Paul MacAvoy said yesterday. I didn't think about that Pentagon thing until last night and about how quickly they get people on when they want them. It is amazing. Even if you don't register them anymore, they get them just like that. Now would you like to comment?

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

Mr. LYNN. Mr. Chairman, you have given me pretty good general questions.

Chairman HUMPHREY. You're so good at it.

Mr. LYNN. It is a little unusual to have the questions come at the front end rather than as we move along.

Chairman HUMPHREY. I thought we would get the relevant testimony.

Mr. LYNN. I would be happy to take the whole agenda and go right through it. My prepared statement was a little shorter I'm afraid than yours.

Chairman HUMPHREY. My point was that I was worried that you weren't going to get at the essential questions in your prepared statement.

Mr. LYNN. Mr. Chairman, I think you know——

Chairman HUMPHREY. There are lots of teams in Washington and I want to tell you something: There is nothing like a wide receiver and a long-range passer with a Hail Mary. [Laughter.]

Mr. LYNN. Yes, sir, I prefer to think that you needed a combination. And that is usually what makes a victorious team. I think that is what we have. I think we have a combination of players that spells victory.

I would ask that my prepared statement be put in the record.

Chairman HUMPHREY. Yes.

Mr. LYNN. And that President Ford's budget message be included in the record, which is the shortest message I think in a long time, but I think it is an important one.

Chairman HUMPHREY. Fine.

[The prepared statement of Mr. Lynn and the budget message of the President follow:]

PREPARED STATEMENT OF HON. JAMES T. LYNN

Mr. Chairman and Members of the Committee, the President has presented his State of the Union Message. He has also submitted his budget. By these actions, the President has set before the Congress and the people of America both his aspirations for our country and his specific proposals to translate these aspirations into reality.

The President's Budget Message is very short. But since those four pages are so crucial to a full understanding of the budget—an understanding of the President's views on budget objectives and on the ways budget decisions should be made—I respectfully request that, rather than my attempting to paraphrase, the Budget Message be incorporated in the record at this point.

Mr. Chairman, we would be pleased to answer your questions.

BUDGET MESSAGE OF THE PRESIDENT

To the Congress of the United States:

The Budget of the United States is a good roadmap of where we have been, where we are now, and where we should be going as a people. The budget reflects the President's sense of priorities. It reflects his best judgment of how we must choose among competing interests. And it reveals his philosophy of how the public and private spheres should be related.

Accordingly, I have devoted a major portion of my own time over the last several months to shaping the budget for fiscal year 1977 and laying the groundwork for the years that follow.

As I see it, the budget has three important dimensions. One is the budget as an element of our economic policy. The total size of the budget and the deficit or surplus that results can substantially affect the general health of our economy—in a good way or in a bad way. If we try to stimulate the economy beyond its capacity to respond, it will lead only to a future whirlwind of inflation and unemployment.

The budget I am proposing for fiscal year 1977 and the direction I seek for the future meet the test of responsible fiscal policy. The combination of tax and spending changes I propose will set us on a course that not only leads to a balanced budget within three years, but also improves the prospects for the economy to stay on a growth path *that we can sustain*. This is not a policy of the quick fix; it does not hold out the hollow promise that we can wipe out inflation and unemployment overnight. Instead, it is an honest, realistic policy —a policy that says we can steadily reduce inflation and unemployment if we maintain a prudent, balanced approach. This policy has begun to prove itself in recent months as we have made substantial headway in pulling out of the recession and reducing the rate of inflation; it will prove itself decisively if we stick to it.

A second important dimension of the budget is that it helps to define the boundaries between responsibilities that we assign to governments and those that remain in the hands of private institutions and individual citizens.

Over the years, the growth of government has been gradual and uneven, but the trend is unmistakable. Although the predominant growth has been at the State and local level, the Federal Govrenment has contributed to the trend too. We must not continue drifting in the direction of bigger and bigger government. The driving force of our 200-year history has been our private sector. If we rely on it and nurture it, the economy will continue to grow, providing new and better choices for our people and the resources necessary to meet our shared needs. If, instead, we continue to increase government's share of our economy, we will have no choice but to raise taxes and will, in the process, dampen further the forces of competition, risk, and reward that have served us so well. With stagnation of these forces, the issues of the future would surely be focused on who gets what from an economy of little or no growth rather than, as it should be, on the use to be made of expanding incomes and resources.

As an important step toward reversing the long-term trend, my budget for 1977 proposes to cut the rate of Federal spending growth, year to year, to 5.5%—less than half the average growth rate we have experienced in the last 10 years. At the same time, I am proposing further, permanent income tax reductions so that individuals and business can spend and invest these dollars instead of having the Federal Government collect and spend them.

A third important dimension of the budget is the way it sorts out priorities. In formulating this budget, I have tried to achieve fairness and balance:

Between the taxpayer and those who will benefit by Federal spending;

Between national security and other pressing needs;

Between our own generation and the world we want to leave to our children;

Between those in some need and those most in need;

Between the programs we already have and those we would like to have;

Between aid to individuals and aid to State and local governments;

Between immediate implementation of a good idea and the need to allow time for transition;

Between the desire to solve our problems quickly and the realization that for some problems, good solutions will take more time; and

Between Federal control and direction to assure achievement of common goals and the recognition that State and local governments and individuals may do as well or better without restraints.

Clearly, one of the highest priorities for our Government is always to secure the defense of our country. There is no alternative. If we in the Federal Government fail in this responsibility, our other objectives are meaningless.

Accordingly, I am recommending a significant increase in defense spending for 1977. If in good conscience I could propose less, I would. Great good could be accomplished with other uses of these dollars. My request is based on a careful assessment of the international situation and the contingencies we must be prepared to meet. The amounts I seek will provide the national defense it now appears we need. We dare not do less. And if our efforts to secure international arms limitations falter, we will need to do more.

Assuring our Nation's needs for energy must also be among our highest priorities. My budget gives that priority.

While providing fully for our defense and energy needs, I have imposed upon these budgets the same discipline that I have applied in reviewing other programs. Savings have been achieved in a number of areas. We cannot tolerate waste in any program.

In our domestic programs, my objective has been to achieve a balance between all the things we would like to do and those things we can realistically afford to do. The hundreds of pages that spell out the details of my program proposals tell the story, but some examples illustrate the point.

I am proposing that we take steps to address the haunting fear of our elderly that a prolonged, serious illness could cost them and their children everything they have. My medicare reform proposal would provide protection against such catastrophic health costs. No elderly person would have to pay over $500 per year for covered hospital or nursing home care, and no more than $250 per year for covered physician services. To offset the costs of this additional protection and to slow down the runaway increases in federally funded medical expenses, I am recommending adjustments to the medicare program so that within the new maximums beneficiaries contribute more to the costs of their care than they do now.

My budget provides a full cost-of-living increase for those receiving social security or other Federal retirement benefits. We must recognize, however, that the social security trust fund is becoming depleted. To restore its integrity, I am asking the Congress to raise social security taxes, effective January 1, 1977, and to adopt certain other reforms of the system. Higher social security taxes and the other reforms I am proposing may be controversial, but they are the right thing to do. The American people understand that we must pay for the things we want. I know that those who are working now want to be sure that money will be there to pay their benefits when their working days are over.

My budget also proposes that we replace 59 grant programs with broad block grants in four important areas:

A health block grant that will consolidate medicaid and 15 other health programs. States will be able to make their own priority choices for use of these Federal funds to help low-income people with their health needs.

An education block grant that will consolidate 27 grant programs for education into a single flexible Federal grant to States, primarily for use in helping disadvantaged and handicapped children.

A block grant for feeding needy children that will consolidate 15 complex and overlapping programs. Under existing programs, 700,000 needy children receive no benefits. Under my program, all needy children can be fed, but subsidies for the nonpoor will be eliminated.

A block grant that will support a community's social service programs for the needy. This would be accomplished by removing current requirements unnecessarily restricting the flexibility of States in providing such services.

These initiatives will result in more equitable distribution of Federal dollars, and provide greater State discretion and responsibility. All requirements that States match Federal funds will be eliminated. Such reforms are urgently needed, but my proposals recognize that they will, in some cases, require a period of transition.

These are only examples. My budget sets forth many other recommendations. Some involve new initiatives. Others seek restraint. The American people know that promises that the Federal Government will do more for them every year have not been kept. I make no such promises. I offer no such illusion. This budget does not shrink from hard choices where necessary. Notwithstanding those hard choices, I believe this budget reflects a forward-looking spirit that is in keeping with our heritage as we begin our Nation's third century.

GERALD R. FORD.

JANUARY 21, 1976.

Chairman HUMPHREY. Will you please identify your associates.

Mr. LYNN. On my right over here is my right arm Paul O'Neill, Deputy Director; on my left is what I call control central at OMB, Dale McOmber, who is Assistant Director for Budget Review; and on my far left is Rudy Penner who is my Deputy Associate Director for Economic Policy and works closely with Alan Greenspan and the Council of Economic Advisers.

Chairman HUMPHREY. These men should feel free to also respond to any questions.

Mr. LYNN. Indeed, yes. I feel very comfortable having them surrounding me.

The initial comment that you made is that the budget addresses neither of the problems of inflation or jobs. We believe it addresses them in a very straightforward, honest, effective way. I think what the President has done is said that we do need to have some stimulus in the economy at this time. We can't go from a $76 billion estimated deficit in fiscal 1976 to a balanced budget and expect the economy to do well under those circumstances. He said in October of last year that he believed a deficit in the range of $40 billion to $44 billion made sense. And his budget provides for a deficit of $43 billion. We are on the way to achievement of a goal of a balanced budget in fiscal year 1979.

Now the key difference between us that emerges from your comments, Mr. Chairman, is that you feel that if there is to be stimulus, the way that stimulus should be provided, in the main, is by the Government doing things—by the Government providing jobs, by the Government putting in this and that program, by the Government adding at least enough to cover inflation and spending a least at current services levels.

We recognize needs as they exist today. We can discuss a little later the unemployment program. The President's proposals in that regard have been up here for over 5 months. It seems to me the approach that we think is appropriate is a balancing between trying to take care of the people that are unfortunately unemployed—and they cover a spectrum of different kinds of people; there is no monolithic group here, for the unemployed cover the whole spectrum—and, on the other hand, using the private sector to provide the kinds of real rewarding permanent jobs, and jobs with choice, that we think that the American people want to have.

Now you mentioned that the President's budget increases by 5.5 percent and it is somewhat lower if you take out the Export-Import Bank. I wasn't clear what else you were taking out to get that figure down to about 4 percent. What was it?

Chairman HUMPHREY. Oh, a year-by-year adjusting for the transition quarter.

Mr. LYNN. Oh, you were adjusting for the transition quarter?

Chairman HUMPHREY. Yes.

Mr. LYNN. I wish you luck in trying to make that adjustment. We tried to face up to that problem in the Budget in Brief and said that the increase year to year was 5.5 percent and even less at an annual rate if the transition quarter is taken into account. But to try to come up with precise figures when you are dealing with a transition quarter that has seasonal aspects to it—which any quarter of the year does both on receipts and expenditures—is extremely difficult. We certainly will concede that when you take the transition quarter into account, the annual growth rate is something less than 5.5 percent.

Chairman HUMPHREY. You said that at the proper time, Mr. Lynn, I think.

Mr. LYNN. We did say that, as a matter of fact, in the Budget in Brief, and made that clear.

Chairman HUMPHREY. The figure that stands out is 5½ percent.

Mr. LYNN. And the figure is accurate for the year-over-year change: Fiscal year 1976 and fiscal year 1977, year over year.

Chairman HUMPHREY. What do you do with those 3 months?

Mr. LYNN. Counting the 3 months, we say in the Budget in Brief it is even less, if you take the transition quarter into account, Mr. Chairman.

Chairman HUMPHREY. Could you estimate on that since you made estimates on everything else?

Mr. LYNN. I tried, sir. There is no good way of doing it.

Chairman HUMPHREY. We tried and we came up with that rate.

Mr. LYNN. Well, then we will work out numbers with you, and we will come in with them.

Chairman HUMPHREY. That is all right.

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

If one assumes that there are no seasonal aberrations that occur in the transition quarter, the growth in outlays from fiscal year 1976 to fiscal year 1977—excluding the effect of adding Export-Import Bank outlays to the 1977 outlay total—would be about 4 percent.

Mr. LYNN. But going on, it is true that this is a budget that tries to moderate the growth in the Federal sector. There is no doubt about that. In fact, it is a pivotal point in the President's program. We really do believe that we should start toward getting to a balanced budget in 1979. At the same time we are moderating the growth in Federal expenditures to make room for tax reductions in this coming year, and perhaps again within 2 or 3 years. We really do believe the time has come to start reemphasizing the private sector.

You know you mentioned your drug company. I think that is an excellent example that what really holds back the private sector is, in part, governmental regulation. We agree with you totally. And the private sector is where we want to see those jobs. We want to see drug companies across American like your family business; we want to see larger and smaller corporations hiring people; we want to see the sign go on at the plant gate that says we need more mechanics, we need more unskilled labor, we need more women, we need more men for these jobs. We want that to appear across the country.

Now we can't announce a grant or a project when that happens, but the people get the kinds of jobs that are really important I think.

Now on the current services budget; we never said $423 billion was a current services estimate. Our current services estimates were lower. What we said was that $423 billion was our best prediction as to where the figures would go on a business-as-usual basis by the Congress. If you will look at our reconciliation of the figures between our budget estimate and the $423 billion, you will notice, for example, an item in there of $4 billion for new congressional programs. So that $423 billion isn't a current services estimate.

That alone would bring our current services estimate down below $420 billion. Our November estimates were in the $410 to $415 billion range.

Chairman HUMPHREY. That is the current services?

Mr. LYNN. Yes, I think the range you said was $420 billion or $425 billion. And I did want to point out if we were doing a current services estimate, it would be lower than that.

Now moving on, if I might—you mentioned the public service employment program. I did note from this morning's paper that the House Labor Committee has decided that the right thing to do is increase that program to 600,000 subsidized jobs. We now provide for about the same level for the temporary employment assistance program as was planned for at the early stages of the recession. And jointly, cooperatively between the Congress and the President, we do say let's continue those temporary jobs that are in areas of high unemployment throughout all of calendar year 1976. And then we say, beginning in 1977, beginning a year from now, let's start phasing them out between January 1 and September 30, 1977; but not reducing the regular CETA title II programs, which fund about 50,000 additional jobs.

Senator JAVITS. Do you have the number of jobs you are speaking about? You said, "continuing the number of jobs" but how many?

Mr. LYNN. That is about 310,000 in total, sir. That is 260,000 temporary employment assistance jobs (of which 15,000 are in low unemployment areas) plus 50,000 from title II. Now you made another point, though, that is very interesting and went along with your other comments. I agree that it defeats the legislation's purpose if State and local governments just lay off people and then rehire them under the public service employment program. But, let's look at it from the standpoint of a mayor. If you were there, if you had fiscal problems, you would still want to continue to have your regular services. Even though you think there is need for restraint, you would certainly push pretty hard to try to get your regular people picked up under the public service employment program. And frankly that happens. It happens to a large extent even if there are regulations that try to prevent it, regulations about waiting periods and so on. After a period of time it happens. The longer the program is in place, the more you get just a substitution effect. We have seen that before with public service employment, and we are beginning to see it again. Therefore, public service employment can have a place, particularly in the early stages of a recession when unemployment is at its worst. But the longer you continue, the more you get no net job additions. You just don't. We most surely care about jobs.

One of the other things we heard was perhaps we ought to increase the public works program. Well, the fact of the matter is that the 1977 budget as presented by the President has roughly $6½ billion more of public works and public works type investments—more specifically, of increases in physical assets—by the United States Government than does the 1976 budget.

Chairman HUMPHREY. Would you give those figures for us?

Mr. LYNN. Yes, thy are across a wide range. Let me give you one example that comes to mind—

Chairman HUMPHREY. Besides prisons.

Mr. LYNN. Yes, besides the prisons is——

Chairman HUMPHREY. And by the way, how much are those going to cost?

Mr. LYNN. On the prisons? About $4 million.

Chairman HUMPHREY. That is $4 million for prisons. You are not talking about garages are you?

Mr. LYNN. No, sir, we are not.

Chairman HUMPHREY. You can't build then for $4 million.

Mr. LYNN. Well, we will check that.

Chairman HUMPHREY. My gosh, let's get with it. How much? You can't build a lean-to around town for that much.

Mr. LYNN. That is just first-year outlays, sir. We will be happy to give you the total dollars to be spent throughout the construction period. You characterize these as public works and you made a very good point, Senator. In any public works program where you put in new obligational authority, you really feel the spending impact 2 or 3 years later. No matter what you try to mandate by statute or we try to do my regulation, you feel it that late. Even if the obligation is turned into a contract within 3 months let us say, the outlay effect is going to come in the second or third year, at a time, I might add, Senator, when you are really going to have an improved economy. You are going to be competing with that economy when it has least unused capacity. So it offers the greatest competition to the private sector then.

The 1977 budget provides $40 million in budget authority for construction for two new installations, a youth facility in Alabama and an adult facility in New York. Five million dollars is included for planning and site acquisition for two new correctional centers in Detroit and Phoenix. We also have $13 million to continue the rehabilitation of existing institutions and $5 million in additional staff to open three new institutions to be completed during fiscal year 1977; namely, the Bastrop, Tex., Youth Center; the Memphis, Tenn., Youth Center; and the Butner, N.C., Correctional Center.

But let me return to the point of where does the increase in public works come from. Let's take a look at EPA. Spending from EPA construction grants for sewage treatment plants and sewers will be 60 percent over last year. It will be up to a level of $3.8 billion in 1977. Highway outlays in 1977 will increase over 1976. All of us working together during the recession said, Mr. Chairman, that something more there would help. But having made those obligations last year, the impact is going to come during the time that we do need it, which is this year and the year thereafter. When you start adding more obligational authority now, it is actually going to be real activity, putting the spade in the ground and creating the employment, a year or 2 or 3 years from now.

Chairman HUMPHREY. Weren't those earlier appropriated funds that are just being released under EPA?

Mr. LYNN. On the highway program?

Chairman HUMPHREY. On the EPA, too.

Mr. LYNN. Of course.

Chairman HUMPHREY. I mean in other words they are——

Mr. LYNN. But the point, Mr. Chairman——

Chairman HUMPHREY. Well, I know what the point is.

Mr. LYNN. The point is that indeed we are also saying no new starts on a number of programs this year. When we looked at the out-year effects of new starts, we found there isn't any way of getting the deficits down and getting a handle on inflation if we keep doing what we have been doing.

But the point I want to make to you is there is more for public works kinds of things, for equipment purchases and the rest, Mr. Chairman, in this budget.

You spoke of welfare roll increases and the hiring by CETA of those that are laid off. You commented that it was stupid. What I have seen—and gosh knows I am not an expert in this anymore than I am on many other things but I have tried to learn some things about it—the people that are unemployed in this country are not all the same. They are not fungible. They are individual human beings. They are all people with their own grief from being unemployed. But they are different people with different problems. There is the short-term unemployed person who is now going back to work. The number of layoffs is now exceeded by the number of people returning to work. That is the kind of thing that the regular unmployment program has been intended to meet. There are second-wage earners in families who are temporarily out of work now; who, when we have good employment figures were all employed, wanted to be employed, and we want them to be employed. And only as the economy comes back much more strongly will they be employed, although some of them are being employed now, too. There are some people I suppose—no one has ever been able to convince me that this is major—maybe it is and maybe it is not, that put a quirk into the statistics. When the husband gets laid off, for example, you add two to the unemployed because the wife or eldest child in the family, who wasn't employed before, seeks employment. I heard people make a good point of this. I do not necessarily go along with it, but the fact of the matter is I don't know its magnitude.

Then you have marginally employed people. Then you have people who are in and out of the labor market and are actively seeking work and can't find it. They always seem to be in the unemployment fig·

ures whether the level is 4 percent or 8 percent. Moving onto other groups, we have kids—in the inner city particularly—who have never had a work force attachment at all; who because of their surroundings and environment just haven't been turned on to jobs or have been turned off because they sought employment and haven't gotten employment. Going to the far end of it, you have the drug-related scene of people that are totally messed up in their lives. We have to do something about that.

Now, no one program is going to address all of those needs. No one program is going to solve all of them. What you need is a blend of things and that is what the President has been trying to propose.

On medicaid, you mentioned the $9 billion. Mr. O'Neill said that wasn't right? What is right?

Mr. O'NEILL. I think, Senator, what you said about the 1976 estimate level was $9.3 billion. And, in fact, it was $8,184 million for 1976.

Chairman HUMPHREY. Well that is better. The figure is what?

Mr. O'NEILL. $8,184 million.

Chairman HUMPHREY. Our staff says it is $9.3 billion.

Mr. O'NEILL. Perhaps we have a different estimate, but the number we printed on the budget which we believe is right, Senator, is shown on page 127 about four lines from the——

Chairman HUMPHREY Well, I said the one thing we need to have is an agreement on figures. We can always argue about policy.

Mr. LYNN. Absolutely. That is the whole reason I made that comment

Chairman HUMPHREY. That is why I mentioned the figures. I want people to come up now and show us what the facts are. On page 127 of the budget, and maybe I am simple minded about this, it says: "Medicaid recommended budget of $9.29 billion."

Mr. O'NEILL. Senator, that is 1977, the 1977 level and you were, I think, referring to 1976. I think that's been the problem. And I just wanted to make sure everyone understood what the correct number was for 1976.

Chairman HUMPHREY. Wait a minute. Let me get the statement so I can get it straight, I don't want to use up your time, but let me check. It says: "Last year we spent $9.3 billion." You're right. That is what I said. And last year what did we spend?

Mr. O'NEILL. $8,184 million.

Chairman HUMPHREY. That was the estimated figure for outlays?

Mr. LYNN. Well, that is the best we can do at this point halfway through the year, Senator, is to estimate. And it is a perilous business to estimate.

Chairman HUMPHREY. But the point is that medicaid would cost $9.2 billion in the coming year without your legislation.

Mr. O'NEILL. Would you like to talk about that and——

Mr LYNN. Well, why don't I just finish up before you do that. We will come back to that.

You also made another key point, Mr. Chairman, that impressed me because it was something I saw time and time again when I was Secretary of HUD. There are initiatives that can be taken at the local level, and you did it as mayor, Senator, you acted and acted promptly. And your reaction wasn't to a stack of Federal regulations this high that said that if you are going to buy those mobile homes to house the veterans, you have to do it exactly this or that or the other way. Instead, you went out and did it. You didn't have to hire 14 Philadelphia lawyers——

Chairman HUMPHREY. I didn't have to hire anyone. I had a free one.

Mr. LYNN. You had a free one. You had somebody who probably cared.

Chairman HUMPHREY. And by the way, he is a very good Republican.

Mr. LYNN. Good.

Mr. O'NEILL. Now he is probably being hunted by CETA.

Mr. LYNN. You made this point and I see it all the time. This is one of the reasons why I was so much for community development bloc grants. I want to get rid of some of that big stack of regulations so the mayors can act. That is why the President has added almost one-half billion dollars to the community development bloc grants this year over last year. This is why we want the bloc grant proposals. Whether in the educational field, or the child nutritions, or to free up people from the regulations under the social services program. It is precisely the point we make.

Representative BROWN of Michigan. May I stop you there to ask, Do you include the one-half million dollars in community development Mr. Lynn, and basic outlays, in increasing physical assets, et cetera?

Mr. LYNN. No, we don't.

Representative BROWN of Michigan. Because a lot of money is going in bricks and mortar on jobs.

Mr. LYNN. You're right. So in fact my 17 percent increase does not even include the bricks and mortar part of the community development bloc grants, and it probably should.

Representative BROWN of Michigan. I think there are a lot of things in the budget that you don't include in outlets for physical outlays, but which constitute job-producing endeavors under that category.

Mr. LYNN. I think your comment is very well taken.

Moving on, if we might, to Medicare, as a general matter, we really have two separate problems. One problem is that fear of illness that will last a long time is a terrible fear to the elderly. It is a terrible fear to the children because the children feel responsibility for their parents, which they should, and know it cannot only bring agony to their own parents but can also wipe them out financially, too. Even worse than that, even when they have no money, the parents may still need the care. So the President has opposed catastrophic protection. I must admit I haven't heard much criticism of the idea. What I have heard is criticism of the other proposal. What the President is doing is making a proposal to try to get a handle on the runaway costs that we have for health expenses that comes out of the taxpayer's pocket. And that we have done is to propose that, as far as medicare payments are concerned, there should be a 7-percent limit year to year on the increases for hospital care and a 4-percent limit for doctors' care.

We feel that this is fair and a way of getting a handle on the runaway increases. After all, even with our proposals medicare expenses go up $2.2 billion a year from 1976 to 1977.

Chairman HUMPHREY. I want you to tell me why.

Mr. LYNN. A good part of it is the increases in expenses, and another part is the growing population.

Chairman HUMPHREY. What about fees and hospital costs?

Mr. LYNN. Well, that is what I meant by the cost of service. Even with the 7-percent and the 4-percent limit you have that kind of increase plus a growing number of eligible people. We also thought it made sense to say that while a person is going into the hospital he or she should pay 10 percent. Let's suppose the daily hospital bills is $110. That would mean an $11 a day cost for that person, but he would always be assured every year that his hospital expenses would never run over $500. On the doctor's bills, we have it the same way: we keep the existing 20-percent match, but we insure that this match never will exceed $250 a year for an elderly person or his children. There is no doubt that the 10-percent hospital cost sharing does help slow down the rate of growth of medicare spending, but it by no means stops the $2.2 billion for the year.

One of the things I think we have to explore together is what it would cost an elderly family to get insurance protection, if they wanted to get it, against even that 10-percent sharing with the hospital. We would be happy to do that with you.

Now for food stamps, I remember, Mr. Chairman, we appeared together on ABC and we both concurred that something had to be done about food stamps. And you told me and told the American people that night that something will be done and we will cut money out of that budget. And I am delighted to see you are gettting to that Because we have to do something about it.

Chairman HUMPHREY. That is correct.

Mr. LYNN. We made our proposals. I think they make sense.

Representative ROUSSELOT. Can I interject at this point? I have to go over to the House committee to testify on some concepts of con-out of that budget. And I am delighted to see you are getting to that. I will come back.

Chairman HUMPHREY. Do you have any questions?

Representative REUSS. Well I do have a lot of questions but I will defer to my colleagues because I certainly don't want to interrupt.

Representative BOLLING. You will never make the meeting, Congressman Rousselot.

Mr. LYNN. On taxes, you pointed out the President is proposing increases in two types of taxes; namely, unemployment insurance and social security. I do understand that yesterday in your discussions you were talking about unemployment insurance. I would like to point out to the committee ha in July 1975 the Secretary of Labor came before—I think it was the Ways and Means Committee—and said that we had to do something about unemployment insurance. The very point you were making yesterday, the interrelationship between welfare programs on the one hand and unemployment insurance on the other hand, where should one begin and the other

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end, was addressed as part of those proposals. That is a complicated business. One of the proposals made then was a commission to report within a year with respect to the interrelationship of all of those programs. That Commission would be appointed in part by the Congress of the United States and in part by the President. It would include representatives of employers including State and local governments, employees, and the general public. The proposal was also to extend coverage to some 6 million people that are not covered by unemployment insurance—that are not covered I should say by the regular programs: they are getting benefits from the emergency programs but they are not covered by the regular programs. So the propasal was to take some short-term action, yes, to try to restore the fiscal funding side of this, to increase the benefits and as average benefit level State by States, yes. I would urge the Congress to give prompt consideration to those proposals, to all of them that were made by the President and the Secretary of Labor at that time. We agree with you that it is a problem, but it is a problem we made a proposal on. We have not at all ignored it, and we would like you to address our proposals.

Now it is true social security taxes go up. There are three alternatives basically in social security. First, we can reduce benefits, and no one wants to do that. Second, we can go to the general fund and say, "Let's get rid of the concept of a trust fund, and let's just take it out of general revenue." But I frankly think that destroys the whole concept of social security. The third option is a combination of reforms plus a tax increases. This is a tax increase that no one wants to make. Believe me, I agree with you about this. I would love to avoid that kind of tax increases. But, nonetheless, it's the best alternative.

Chairman Humphrey. I think it is a question of timing.

Mr. Lynn. Of course we are not proposing it take effect this year. We are proposing it for January 1 of 1977. But we have to face up to it, it seems to me, eventually. And we are talking about an increase that is less than $1 a week at most even at the upper end, and at the lower end I think it is 20 cents or 30 cents a week. The President is also proposing other reforms. He is proposing decoupling which, as you know, deals with a serious problem that I think got into the law unintentionally. Currently there is a double adjustment of benefits for inflation. So if we have inflation, the benefits a worker will be entitled to when he retires increase faster than inflation. That doesn't have much short-term effect. But when you get out to the 1990's or the year 2000, it just blows the system. And the President is saying, as has every advisory committee that has looked at this, that we should eliminate this double adjustment.

Second, we have other things that need reform. For instance, as the law is now, if a person has a job for one month—and let's take something rather exotic—and he brought in $20,000 or $30,000 during that month, he can elect to go on monthly eligibility and collect social security for the other 11 months. The President believes, and so do I, there should be an annual eligibility level. There is the same problem, incidentally, with food stamps. We are not suggesting a year there, but we are suggesting the eligibility period be increased. There are a number of proposals that the President is making.

With these proposals we think we can restore the integrity of the social security trust fund.

Representative BROWN of Michigan. Would you clarify what you just said? You said you think the same problem is applicable to the food stamp program.

Mr. LYNN. It is the same perspective that should be applied, yes.

Representative BROWN of Michigan. And eligibility for food stamps should be based upon a monthlitizing of annual income, which is not true now. It is based upon actual income.

Mr. LYNN. Going on, if I may, you mentioned the Pentagon. The Pentagon's situation today is not one of adding people. The Pentagon's situation is one of reducing employment due to initiatives both by the administration and by the Congress. The number of employees in the Defense Department, in both the military and in the civilian area, has been going down drastically. If I recall correctly I think on the civilian side, and I may be wrong, but I think it is 100,000 in 2 or 3 years. And the proposal, as you know, is a 25,000 decrease in the civilian side from the beginning of the year to the end of the year in fiscal year 1977, with no further decline in the military side. But I do believe that the "problem" in the Pentagon at the moment—although we believe it is a good kind of change, not a problem—is reduction of employees, not an increase.

Chairman HUMPHREY. Mr. Lynn——

Mr. LYNN. Mr. Chairman, I'm about to conclude.

Chairman HUMPHREY. Good, because I want to know if we can get some questions in before the votes.

Mr. LYNN. To conclude, we really do believe that this budget does slow down the growth of the Federal Government. There isn't any doubt about that. We think that is desirable. We think it is the only way that we are going to get the opportunity to return choice to the American people, and give them a break on the tax side. We really do think it is the only way we are going to create the kinds of jobs that we all want; namely, the real rewarding, permanent jobs. And as we move on the road to recovery, we do believe that the budget does take care of needs and gives due recognition of the kind of situation we have now.

Chairman HUMPHREY. All right. What we are going to try to do here, because we have a big assignment in a limited period of time, is to get as many participants as possible. I'm going to ask we keep our questions to the point and our answers to the point.

Senator JAVITS. Mr. Chairman, do we have a limitation on time?

Chairman HUMPHREY. Yes.

Senator JAVITS. I would suggest 10 minutes and they be given notice of the time.

Chairman HUMPHREY. All right, we will cease and desist at the time limit. All right, do you want to start, Congressman Brown of Michigan?

Representative BROWN of Michigan. I'm in no hurry. Do you?

Senator JAVITS. I would love to, if I may.

Chairman HUMPHREY. Should we go on the basis of our attendance here today if that is agreeable?

Representative ROUSSELOT. No, why don't we go by seniority?

Chairman HUMPHREY. All right.

Senator JAVITS. That is all right.

Representative BROWN of Ohio. It certainly is.

Senator JAVITS. I will just take 5 minutes.

Chairman HUMPHREY. I'm going to ask the first round of questioning to last only 5 minutes and then we will come back. Is that agreeable? All right, let's go.

Senator JAVITS. I have one central question. And that is you made the statement that it was up to the private sector to find the permanent jobs. And, of course, we are very discouraged by the continuance of deeming it acceptable to have this high level of employment for all these years.

My question is: Exactly what are you recommending, aside from this special tax credit for capital investment income in high unemployment areas—other than just the fact that the vitality of the economy will move it forward—to endeavor to materially reduce the amount of unemployment out of the private sector? I see nothing that reflects any new program.

You are cutting out opportunities and CETA. You are cutting even the summer jobs for youth, which involves 170,000. You had not a new idea in the whole package that I can see except the bread and butter of tax indulgence and that is of a very modest kind. What are you doing to stimulate private enterprise to do what you think they are going to do?

Mr. LYNN. Well, you spoke of a tax stimulus to the private sector of a modest size. My first comment to that would be, Senator, as the President said in his State of the Union message, he looked upon his proposal to encourage investment in high unemployment areas as a supplement to his main proposals and not as his centerpiece. The centerpiece is making permanent reductions in taxes for small business; reducing corporate taxes from 48 to the 46 percent; giving public utilities the six-point package of tax aids; making the higher investment credit, which was initially an emergency measure, a permanent provision of the law; increasing the purchasing power of the American people above what it would be otherwise by reducing taxes—for a family of four making $15,000 a year, by reducing their tax about $227, not counting the social security increase, which is about $45.

Now we really do believe that this will bring the private sector to a point where it will be producing the kinds of jobs we want them to. At the same time on CETA, Senator, we are not cutting back the regular CETA programs, as I understand it, at all. We do look to CETA to get at the endemic kinds of problems. Now we ought to look at CETA together. We ought to ask: Does it need improvement? If it does, then let's improve the programs of the local communities working with people that are chronically unemployed or don't have real attachment to the labor force. If the program isn't working the way it should be, then we ought to work together to improve it. But, in any case, the main part of the jobs for the unemployed ought to come from the private sector in our judgment.

Senator JAVITS. Mr. Lynn, the main part of the job does have to come from the private sector but you are not giving the stimulus to the private sector which it needs because there isn't any single innovative program here. Even your tax cut is conditioned upon other expenditure cuts, and you are already going to strangle the cities with your special revenue sharing proposals which are simply going to give the people who need it the least, the most money. You are going to hit New York very hard. You are going to hit New Jersey and Connecticut very hard because when it comes to making a change in the revenue sharing formula on the floor of the Senate and the House, the big city States get taken every time. And the people who need it the least, get the most.

Mr. LYNN. The health program, for example, in my judgment will afford New York more money than New York would get the way it is going right now. I say that because New York is on a matching program. New York is taking steps to slow down its medicaid increases. And as it does, for every dollar that they save of their own money, they lose a dollar of Federal money. Under the President's proposal New York would get more in 1977 than it is getting in 1976, not a lot, but certainly wouldn't get less than they have now.

Senator JAVITS. They are going to get $35 million less for mass transit alone and millions in Federal funds for health, education, and social grants, especially in the long run.

Mr. Chairman, I ask unanimous consent to include a news story on revenue sharing cuts that appeared in the January 22 issue of the New York Times as a part of the record.

Chairman HUMPHREY. Fine, we will place it in the record at this point.

[The news story follows:]

[From the New York Times, January 22, 1976]

THREE STATES DEPLORE HEALTH FUND CUTS

New York, Connecticut and New Jersey Fear End of Many Federally Aided Projects

(By Martin Tolchin)

Washington, Jan. 21.—Officials of New York, New Jersey and Connecticut declared today that President Ford's budget proposals would cost their states and cities millions of dollars in health funds, and predicted that this would compel the elimination of many hitherto federally funded programs in education, social services and health.

The President also made a mass transit proposal that would cost New York City $35 million in operating subsidies and lead to a 5 cent increase in the subway rate, according to city officials and members of the city's Congressional delegation.

The states would lose health funds, state and city officials said, because of the $10 billion limitation on Medicaid and a package of health programs that would be distributed according to a new formula in which a state's per capita income was a major factor.

New York State, which has a large, rich population as well as a large population of poor people, ranks sixth in the nation in per capita income. New Jersey ranks fourth and Connecticut, second.

Any disbursement of funds with per capita income as a major factor would thus be detrimental to these states in the long run, although the President has proposed that no state receive less in the coming fiscal year than it received last year. The other factors in the formula would be the poverty population and tax effort.

MRS. ABZUG DISPLEASED

"We'll probably lose about $300 to $500 million," said Representative Bella S. Abzug, Democrat of Manhattan. "This again is a question of the President's not meeting the needs of the American people in New York or elsewhere, but trying to out-Reagan Reagan."

Roberto J. Morgado, New York State's Director of Operations, said that "we believe that we stand to lose millions in Federal funds under the proposed formula."

"We would lose a significant amount of our Federal assistance," he added. "A tradeoff of more flexibility at the cost of dollars is not necessarily a fair trade."

Officials in New York City and the three states predicted that President Ford's proposal to replace 59 grant programs in health education and social services with block grants would mean the elimination and curtailment of many federally funded programs that had been retained because they had been heavily supported by Federal funds. Thus, despite worsening fiscal crises, the elimination of those programs would not save localities much money, since the Federal Government paid 50 to 80 percent and sometimes 100 percent of the costs.

Under the President's proposal, the state would get Federal funds to use as they saw fit.

"A lot of times you could justify not cutting back a program because you would lose Federal funds," said Paul Gibson, New York City Deputy Mayor for Planning. "This would no longer be the case."

Kenneth Axelson, New York City Deputy Mayor for Finances, said that "if we were given greater freedom in the use of our funds, our system of priorities would have a greater impact on our dcisions."

LAYOFFS A PROBLEM

Jay Tipper, Connecticut Commissioner of Finance and Control, said that "if layoffs were going to occur, we were not going to lay off people funded 90 percent by the Federal Government; we would not go after those with high reimbursement levels, because you'd have to lay off so many more people to have a substantial saving of state tax dollars."

A New York State official, who declined to be named, said that "basically, the consolidation is going to be very detrimental.

"New York gives conscientiously to health manpower, medical schools, venereal disease programs, a wide range of health programs," the officials said. "Other states do not and let New York take care of their health problems."

Marilyn Berry, director of New Jersey's office in Washington, who is one of the Governor's leading advisors on Federal programs, said that President Ford's proposed consolidation of health, education and social service programs would be "a fiscal disaster" for her state.

Miss Berry noted that Medicaid costs had risen 22 percent a year, and that the state had already eliminated all optional medical services, leading to a lawsuit against the state by the New Jersey Hospital Association.

"From here on out, we will be forced to incur the increased costs in our Medicaid program," Miss Berry said. "We just don't have the resources to do that."

Miss Berry noted that the Federal Government provided 70 percent of New Jersey's health budget and 50 percent of the funds for the venereal disease program.

"The VD program is strong in New Jersey," she said, "but as the pressures grow, I don't know what we're going to do."

Similarly, programs for maternal and child health, immunization and comprehensive health planning will be jeopardized, she said.

The President's mass transit proposal would limit to 50 percent the amount of special grant funds that could be used for operating subsidies. There is no limit now, and all of the $71 million goes for operating subsidies. The proposal would remove $35 million.

"That's going to be fought," Mrs. Abzug said. "He's not going to succeed."

Representative Edward J. Koch, Manhattan Democrat, who is an author of the present legislation, said that "I wish that the Transportation Secretary used the mass transit facilities, or better still that all had Government-financed limousines.

President Ford's proposed budget gives New York, New Jersey and Connecticut a total of $52.6 million in harbor and reclamation projects under President Ford's proposed budget.

New York State would receive $25.8 million, including $2.3 million to build anchorages in New York Harbor. In addition, $790,000 is earmarked for the collection and removal of harbor drift.

The new budget would appropriate $1.8 million to build a Fire Island inlet, and $1.2 million for an East Rockaway inlet to Rockaway Inlet and Jamaica Bay.

The budget also allots $530,000 to demolish the Federal Pavilion in Flushing Meadow, where it was built in 1964 for the New York World's Fair.

New Jersey would receive $13.9 million under the proposed budget. This would include $1.78 million to build a flood-control project in Elizabeth, $7 million to operate and maintain Delaware River navigation facilities and $1.1 million to operate and mantain of Newark Bay.

Connecticut would receive $12.9 million. This would include $1.6 million for flood control in Danbury, $9 million for control of the Park River and $100,000 for a hurrican barrier in Stamford.

Comparative figures for previous years were not available.

Mr. O'NEILL. Senator, the news story is just incorrect.

Senator JAVITS. Fine, well you put the facts in the record. I will ask unanimous consent that they be included.

Chairman HUMPHREY. Certainly.

Mr. O'NEILL. We will supply the facts, Senator Javits.

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

FINANCIAL ASSISTANCE FOR HEALTH CARE, GRANT AMOUNT BY STATE, FISCAL YEAR 1977

[Obligations in millions]

	Fiscal year 1976 estimate	1977
Alabama	$150.6	$165.7
Alaska	11.1	12.0
Arizona	12.1	13.3
Arkansas	107.3	118.0
California	1,086.2	1,174.6
Colorado	88.9	96.2
Connecticut	106.7	115.3
Delaware	12.5	13.7
District of Columbia	71.7	77.5
Florida	158.9	174.8
Georgia	227.8	250.4
Hawaii	28.3	30.5
Idaho	30.0	33.0
Illinois	442.4	478.5
Indiana	152.4	167.6
Iowa	83.8	92.2
Kansas	68.5	75.3
Kentucky	147.2	161.9
Louisiana	155.0	170.5
Maine	62.2	68.4
Maryland	163.9	177.3
Massachusetts	341.9	369.7
Michigan	445.6	481.9
Minnesota	186.7	201.9
Mississippi	112.4	123.6
Missouri	101.1	111.2
Montana	24.9	27.4
Nebraksa	39.2	43.1
Nevada	15.2	16.7
New Hampshire	24.8	26.8
New Jersey	236.0	255.2
New Mexico	33.4	36.7
New York	1,609.2	1,740.2
North Carolina	168.2	185.0
North Dakota	20.4	22.4
Ohio	291.9	321.1
Oklahoma	130.0	143.0
Oregon	75.6	83.2
Pennsylvania	436.4	480.0
Rhode Island	58.5	63.2
South Carolina	100.0	110.0
South Dakota	22.4	24.6
Tennessee	155.4	170.9
Texas	486.5	535.1
Utah	37.3	41.0
Vermont	30.9	34.0
Virginia	135.2	148.7
Washington	132.8	143.7
West Virginia	47.9	52.7
Wisconsin	266.6	288.3
Wyoming	7.7	8.5
Other [1]	42.2	44.3
Total	9,184	10,000

[1] Puerto Rico, Guam, Virgin Islands, American Samoa, Trust Territories.

Chairman HUMPHREY. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman. I'm not going to concern myself, Mr. Lynn, with public versus private. I just want to focus on the following issue. Your upcoming budget projects an unemployment level at 4 percent in 1977 and a surplus of $3 billion as opposed to a projected full-employment deficit in the current 1976 fiscal year of $16 billion. That is a $19 billion switch. This is at a time when, according to the Federal Reserve Index, 30 percent of this country's industrial capacity is not being used; a time unemployment, as Mr. Greenspan admitted yesterday, is continuing to be "distressingly high."

So, the President's program, irrespective of whether it is governmental or private, therefore continues to waste 30 percent of our industrial capacity and continues to have a "distressingly high" percentage of our population unemployed. By what screwy reasoning do you continue to repress the economy?

Mr. LYNN. We are not——

Representative REUSS. What is your motivation?

Mr. LYNN. We are not doing any screwy reasoning, Mr. Reuss.

Representative REUSS. What is on your mind? Where are the bottlenecks that you see? Can you name them? Are they steel? Are they aluminum? Are they widgets? I don't know. You tell us, because we would like to get the work and do something quickly about those bottlenecks.

Mr. LYNN. If we want to talk about screwy reasoning, a screwy reasoning is the reasoning that says——

Representative REUSS. No, I want to talk about your screwy reasoning.

Mr. LYNN. Okay. I don't have any I will say I am a little bit baffled by reasoning that says we could increase receipts by *x* amount of money if we——

Representative REUSS. Just answer the question and don't take up my time. Just get on with the answer.

Mr. LYNN. Okay. My answer to this. Implicit in your question is a theory that unless the Federal Government continues to grow and in fact and even to grow faster——

Representative REUSS. No, it isn't implicit. I want you to tell me where are the bottlenecks in the economy which you see exploding if public activities get bigger? Why are you repressing private activity? I mean I will go along with you Why do you insist on unemployment that, by your own admission, will continue to be "distressingly high" next year? Tell me is it steel? Is it aluminum? Is it cement? Where are the bottlenecks? Why are you repressing things?

Mr. LYNN. I don't believe we are repressing things and I don't think we are insisting on high unemployment. In fact what we want to do is get unemployment down as quickly as we can. But we don't want to fool the American people by some quick fixes that result in this country going back up to double-digit in either 1977 or 1978 and then having an even bigger recession.

Representative REUSS. Now how do you get all of this resurgence of inflation in an economy where only 70 percent of the industrial capacity is being used and where unemployment of over 8 million is distressingly high? Maybe you are right, but we would like to know about it so we can take some corrective action. Where are the bottlenecks?

Mr. LYNN. First of all, you are right. You are right on our capacity. Our capacity overall is measured two or three different ways, there are different ways of doing it, but by any measure we have unutilized capacity. And we want to get that capacity to be used more We do believe that that capacity will be used more if there is continued consumer confidence. And we have seen a resurgence of consumer confidence in the last months. We do believe that confidence will also return if the private sector thinks we are for real in getting the Federal Government out of markets over a period of time, and if we are for real in trying to get a handle on inflation, and if we are for real in tax reductions. If they think we are for real, they will go out and make the investments that produce construction jobs—and this results to some extent from the program that the President has proposed—and these things will result in that capacity being utilized.

Now, let me say what we are afraid of. If we add to the deficits and keep adding to these deficits, the private sector and the public at large are going to do just the opposite, as they have done for the last year and a half. When inflation started increasing, people didn't go out and hoard goods, they saved money. When they saved it and didn't spend it, that hurt the economy. So the bigger the deficits have gotten, the more people save their money; and the higher the rate of inflation was, the more they saved. Just look at housing. I have lived with that problem and you certainly have too, Congressman, for a fair period of time. The best thing you could do for housing in my judgment, and the most important thing you could do for housing, is to get the deficit down. If you got the deficit down, and also gave that extra $227 a year in tax breaks to the American people less the social security offset that we talked about, what will happen is interest rates will come down. After all, we talked about current interest rates having come down. There we were talking about short-term rates. The long-term rates are still up around 9 percent. That is a heck of a lot of money to put in a monthly payment on a house. If you are a banker, are you going to lend money at 4 percent or 6 or 7 percent if the dollars you get back 15 or 20 years from now aren't worth anything?

Chairman HUMPHREY. Congressman Brown of Michigan.

Representative BROWN of Michigan. On the job figures, Mr. Lynn, I don't believe I heard the figure that you think that will be produced by this budget in fiscal 1977 in theprivate sector. I have heard the figure of 3½ million jobs. A good portion of those would accommodate, in effect, the new people coming into the work force, an additional amount would accommodate the unemployed. That is how you come up with your unemployment figures; is that right?

Mr. LYNN. Yes.

Representative BROWN of Michigan. What areas do you feel will cause this phenomena to occur? What factors in the budget?

Mr. LYNN. The factors are the fiscal policy reflected by the budget as an element of overall economic policy. And the economic policy that we think will cause it is trying to get a handle on inflation, and the business confidence that will follow. The other facet that will do it is providing the stimulus in a way we think will concentrate on private sector job development.

Representative BROWN of Michigan. Is it not correct then to say that basically you are trying, in effect, to reverse the trends that caused the present problem?

Mr. LYNN. That is right.

Representative BROWN of Michigan. And that is that unemployment has been caused by a recession and that recession was caused by inflation. And I had to remind the people here yesterday that inflation had its base back in the 1960's when there was neither a Republican Congress nor a Republican administration. So what you are saying is if we can reduce inflation, we will not have recession; we will have a recovery, and we will not have the unemployment? The important thing is to make sure that we add as much stimulus as possible to the economy that it can accommodate without more inflation. so that we have no recession and we have greater employment?

Mr. LYNN. Exactly.

Representative BROWN of Michigan. Right. The Congressional Budget Office apparently came out with an estimate that the proposed tax increase, outlined in the budget. If it were deducted from the proposed tax cuts, that the net reduction in taxes contemplated would be only $1.7 billion. How would you respond to that?

Mr. LYNN. I don't have the details in front of me. But I can say this. A number of these calculations that I have seen take into account, as tax increases, increases that would occur anyway quite apart from the President's proposal. By that I mean for instance, that the base goes up under social security twice, on January 1, 1976, and on January 1, 1977. To tie that into the President's proposal I think is totally unfair because whether you accept his proposal or not, that is going to happen. Therefore, what the President is saying is let's at least offset these increases by reductions in the income tax. Let's make them permanent, and make them larger then what would happen with a simple extension of the law that was passed in the dying days of the last session.

Representative BROWN of Michigan. There is one thing in the budget——

Mr. LYNN. The tax increases attributable to the President's proposals were, if I recall correctly, $3.3 billion under social security and $2.1 billion on the unemployment insurance in fiscal year 1977. But again on the unemployment insurance, what choice is there in that regard? What would happen if you make those hard choices on unemployment insurance and social security and do nothing to reduce the income taxes? The reduction at least offsets something that has to be done. Whether the exact time, Mr. Chairman, is this month, next month, a year from now; the President chooses January 1 of 1977.

Chairman HUMPHREY. After the election.

Mr. LYNN. First of all, it is a very convenient date with respect to a start-up date.

Chairman HUMPHREY. July is convenient, too.

Mr. LYNN. But with respect to taxes I meant. But what I am saying is we want the Congress to look at that suggestion hard and come up with their proposal. Now, if your proposal is different, then tell the American people what that is.

Representative BROWN of Michigan. A further couple of anomalies that occur to me in connection with the budget that I would like to explore. One is you treat receipts from offshore drilling as a negative expenditure. Why is it done that way?

Mr. LYNN. Well, we give a little discussion of why it is handled that way in the budget proper. It is not a tax so we don't put it on the receipts side. Generally on the receipts side we limit it to——

Representative BROWN of Michigan. But technically then your expenditures are $3 billion above what you show.

Mr. LYNN. As a matter of fact, as far as totals go, the total stimulative effect of the Federal Government may be appreciably more than the budget shows. That is why we are so careful in the very first part of the budget after the President's message, Congressman, to show the amount of off-budget outlays and so on, and of guaranteed loan programs and so on.

Representative BROWN of Michigan. My time has expired. But likewise why don't you treat your additional $10 million tax cut basically as an expenditure in the social area? Insofar as stimulus and everything else is concerned, shouldn't it be treated as that?

Mr. LYNN. We show tax expenditures. With Congress' direction under the Congressional Budget Act of 1974, we show tax expenditures program by program—for housing, for deducting State and local taxes, and also for social security programs not being taxable. Now, some people call these provisions loopholes and some people call them stimulative incentives for social action. It depends on which side of the issue you are on. We show tax expenditures in full in the budget.

Representative BROWN of Michigan. There is much greater stimulus in the budget than the expenditure level would reflect?

Mr. LYNN. Oh, I think that is true.

Representative BROWN of Michigan. All right.

Mr. LYNN. But anything that is added to it will increase that stimulus even more.

Chairman HUMPHREY. Next is Congressman Bolling.

Representative BOLLING. Mr. Lynn, I have had the pleasure of course, of meeting you before, but this is the first time I can take the opportunity of appearing with you. It is a pleasure. I congratulate you on your knowledge of the subject, on your ability, and on your sincerity. And I would love very much to have the time sometime to play the numbers game with you.

Mr. LYNN. I would look forward to that opportunity, sir.

Representative BOLLING. I think it would be good fun and stimulating. But first, I would like to do a small chore. I would like to ask unanimous consent that the statement of Senator Humphrey to the House Committee on the Budget of January 26 be included in the record at the appropriate point in this hearing.

Chairman HUMPHREY. That is a very important document. We will place that in the record at this point.

[The statement follows:]

STATEMENT OF SENATOR HUBERT H. HUMPHREY TO THE COMMITTEE ON THE BUDGET, U.S. HOUSE OF REPRESENTATIVES, JANUARY 26, 1976

Mr. Chairman, members of the committee, it is a pleasure to appear here before you this morning. It is an honor indeed to serve as the first witness at this set of hearings on the 1977 budget.

I cannot, of course, present the budget recommendations of the Joint Economic Committtee this morning. Those recommendations, which will be based on our own hearings and further study, will be transmitted to you in early March, as required by the Congressional Budget Act. What I can do today, is to give you my own assessment of the economic situation, the objectives policy must meet, and the hard questions Congress must examine during the next few weeks.

May I say I believe you are wise to begin your hearings with congressional witnesses. For it is the Congress which will determine the components and the overall shape of next year's budget.

For the second year in a row, the President has submitted a budget proposal which is flagrantly inadequate as a guide to congressional action. The president's proposal does not meet the needs of the economy. It provides for the creation of neither private nor public jobs. It fails to meet the social needs of our people. It allows for excessive spending in the defense establishment.

Certainly the President's budget contains a number of individual proposals which have merit. These should, and will, be carefully considered by the Congress. Taken as a whole, however, the President's budget proposal is unrealistic and unhelpful. Most importantly, it will not put our people back to work.

Last year, when the President proposed a budget which was both unrealistic and inadequate to our needs, the Congress, aided by its new budget procedures, acted decisively to set its own budget totals and its own priorities.

I am proud of this congressional success in setting budget policy for the current fiscal year. True, we have not done all that we should have done. True, some of our actions have been thwarted by vetoes which we could not override. Taken as a whole, however, congressional action on the 1976 budget has been responsive to the needs of the economy.

Last year at this time we faced a situation of plummeting output and spiraling unemployment. Strong action was needed to reverse that situation. Congress took the initiative in proposing and enacting a major tax cut. Congress also stood firm in rejecting destructive program cutbacks proposed by the President. Congressional action played a major part in halting the recession and initiating an economic recovery.

Last March, when the Joint Economic Committee reported to the Budget Committees for the first time under the new procedures, we recommended specific targets for output and employment. We recommended a budget policy designed in our best judgement to achieve those targets.

It is with some gratification that I report to you this morning that the overall budget position adopted by the Congress for fiscal 1976 is quite close to the recommendation our committee made last March. That budget policy has been instrumental in achieving the output target our committee recommended for the end of 1975. The fourth quarter gross national product estimates released last week indicate that real output in the fourth quarter was less than 1 percent short of the target we recommended.

On employment we did not do quite so well. Last March we estimated that achievement of our recommended output target would serve to reduce the unemployment rate to approximately 8 percent by the end of 1975. The actual rate of 8.3 percent in December was still somewhat above this objective, but it does represent a distinct improvement from the 8.9 percent average of the second quarter.

The inflation rate diminished during 1975 from over 10 percent early in the year to above 7 percent at year end. As our Committee has so often tried to reduction in inflation. Output per manhour rose at a 7 percent rate during the point out, productivity gains associated with recovery contributed to this second and third quarters of 1975 and unit labor costs actually fell slightly.

The initiation of economic recovery in 1975 was, I repeat, a Congressional achievement. Had we accepted the President's recommendations, there might have been no recovery. The unemployment rate might still be 9 percent, or higher. Thus when the President says that "the State of our Union is better:

he should add, "Thank you, Congress. Thank you for overruling my objections and making this improvement possible."

1975 is over now, and we must turn our attention to 1976, 1977 and the years beyond. With unemployment still above 8 percent, the inflation rate seemingly stuck at 7 percent, and the pace of recovery faltering, we have much work yet to be done.

Last year, the Joint Economic Committee recommended that an objective of economic policy should be to reduce the unemployment rate to 7 percent by the end of 1976. That still seems to me to be a good target. We should then aim to reduce the unemployment rate to 6 percent by the end of 1977. Let me stress, these are minimal targets. I hope we can do better—much better, but we must do at least this well. If we cannot reduce the unemployment rate at least one percentage point per year, what hope can we hold out that progress is being made toward full employment?

These employment targets are minimal relative to our needs. This does not mean, however, that they will be easy to achieve. By a widely-used and generally reliable rule-of-thumb, 7 percent per year growth of real output is required to reduce the unemployment rate 1 percentage point per year. Only the most optimistic of forecasters believe that 7 percent output growth will be achieved in 1976. No forecast with which I am familiar foresees 7 percent real growth in 1977.

For your convenience, a table summarizing some of these forecasts is attached to my statement. As you can see, the most optimistic forecast in that table—which is the Administration forecast—predicts a 5.7 percent growth rate in 1977. The dilemma is clear: The Administration's forecast is highly optimistic compared to the expectations of others, yet it is far from good enough to achieve even the modest targets I have suggested.

Let me make one more point with respect to these forecasts: Each of the other forecasts shown assumes a significantly more stimulative fiscal policy that the Administration has proposed. The Wharton forecast, for example, assumes fiscal 1977 outlays, on a unified basis of $423 billion. Thus, we face up to the prospect that, in the judgment of many competent experts, even a much more supportive budget than the President has recommended will not produce a strong continuation of economic recovery.

Were we actually to adopt the President's high restrictive budget—which I am confident we will not—the outlook would be gloomier still. The study done by the JEC staff and submitted to you in December indicated that a budget policy similar to that now proposed by the President could actually lead to a renew rise in unemployment in 1977. Ponder for a moment the damage which would be done to the fabric of this Nation if unemployment began to rise again next year, and you will see why I am convinced we must reject the President's proposed budget.

The forecasts to which I have called your attention are gloomy, but I do not offer them as a counsel of despair. Rather they are a warning; a signal that Congress must act. I am confident we will act, and act effectively.

It would be presumptuous of me this morning to suggest actual budget totals or to spell out detailed policy proposals. However, I would like to suggest some directions which I believe policy should take.

First, we have some unfinished business with respect to the 1976 budget. There are three items I particularly want to mention.

We should move quickly to enact budget authority and appropriations for Title VI of CETA, thus carrying out the provision made in the second concurrent budget resolution for an expanded public employment program.

We should send to the White House and, if necessary, override any Presidential veto of, the bill providing for anti-recession aid to State and local government and emergency public works.

We should act to continue the tax reductions now scheduled to expire in June for the full 1976 calendar year.

Before discussing specific policy needs for the 1977 budget year, let me attempt to dispel two misconceptions which are seriously interfering with rational consideration of budget policy.

The first of these myths is that the Federal Government is absorbing a rapidly rising share of our gross national product. Regardless of one's view of the appropriate size of government, it is important to get the facts straight. The fact is this: Federal spending as a percent of GNP has remained remarkably constant in recent years. There has been some temporary fluctuation caused by the drop-off in output and the rise in expenditures during recession, but once the numbers are adjusted for this cyclical factor, there is no upward trend. Federal spending was 20 percent of full-employment GNP in 1970, and it was still 20 percent in 1975. Those who are attempting to scare the public into believing that Uncle Sam is gobbling up an ever-rising share of national income either have not been told the facts, or they have chosen to ignore what they have been told.

The second myth that needs exposing is the notion that Congress is the profligate, big-spending branch of government. Members of Congress know well that this is not the case. Even a cursory examination of Presidential recommendations and Congressional action on the defense budget should convince anyone that it is the Congress which is trying to save—and to some extent succeeding in saving—the taxpayer's money.

Yet the myth persists. Frankly, the Administration fosters that myth by proposing unrealistic budget totals and then somehow implying that it is the fault of Congress if the costs of unemployment compensation, interest on the debt, or receipts from off-shore oil leases depart from those erroneous estimates. For example, the estimate of receipts from oil leases in fiscal 1976 has now been reduced from $8 billion to $3 billion. Whatever the cause of that revision, it is hardly the profligate tendencies of Congress. The estimate for receipts from oil leases in fiscal 1977 is $6 billion, again unrealistically high, illustrating how the same process of revision is in prospect for this new budget.

I believe Congress is working, as it should, to achieve budget savings wherever such savings are consistent with adequate provision for our public needs. Budget cutting is not easy. Miracles will not happen overnight. But with patience and persistence, a great deal can be achieved. The staff study which I forwarded to you in December identifies a number of tax and spending reforms which deserve consideration. If adopted promptly these reforms would produce budget savings of $30 to $35 billion by 1981. A few of these same reforms are also recommended in the President's budget.

The study to which I referred above is a staff document and does not constitute a set of recommendations by the Joint Economic Committee. However, most of its suggestions for budget savings are proposals which I would myself support, as, I believe, would most Members of Congress. This JEC list is not, of course, exhaustive. There are other areas of potential savings which should be examined. I am sure your committee and others are working hard at such an examination. I believe it will prove fruitful. Perhaps we will someday dispel the myth of the profligate Congress.

Now let me turn briefly to the directions which I feel policy should take in the 1977 budget year.

First, we must have budget totals which support economic recovery. It is not for me to suggest at this point what the outlay figure should be. However, it is worth pointing out that, as estimated by both OMB and CBO, the cost of simply maintaining the current level of real services in fiscal 1977 will be in the neighborhood of $420 billion. I suggest that this, rather than the President's unrealistic figure, should be our point of departure for determining where we can cut and what we must add.

On the tax side, the possibilities for tax reductions beyond extension of the recent cuts must be determined in conjunction with evaluation of our spending needs and of economic developments over the next few months. Certainly we should avoid, if we can, increases in social security taxes or other regressive taxes. Taxes like these, which raise the cost of employment, are especially harmful during this period when jobs are already so scarce and inflation still such a problem.

Second, we must have a monetary policy consistent with our budget policy. Improved channels of communication with the Federal Reserve were opened up last year, but there is still a need to develop further mechanisms for insuring that the Fed does not thwart the intent of Congress.

Third, we must supplement overall fiscal and monetary policy with an emergency program of direct job creation. In its Midyear Report last October, the Joint Economic Committee outlined a possible program of locally-initiated community work projects which could offer useful, productive temporary employment to as many as 1½ million persons. Of course, other approaches are possible, but, somehow, more jobs must be created. Until the private sector is able to provide all the jobs we need, some form of government assistance will be necessary.

Finally, we must be more active on the anti-inflation front. The Administration projects no reduction in the inflation rate from 1976 to 1977. That is really rather shocking. Sluggish economic growth and payroll tax increases both contribute to this continuation of inflation.

Faster growth would bring with it productivity gains that will help reduce inflation. Other steps are also necessary: Stronger Presidential backing for the Council on Wage and Price Stability; firmer anti-trust enforcement; the establishment of food reserves; and many other steps. The President seems strangely silent in these areas, but we in the Congress must not let the struggle for price stability be abandoned or diminished when we are not yet half way to our goal.

Thank you for giving me this opportunity to appear. I will be glad to answer questions.

TABLE 3.—COMPARISON OF RECENT FORECASTS

	1976	1977
Percent change, real gross national product:		
JEC staff	6.6	3.8
Wharton	5.9	4.2
IBM	6.2	4.4
DRI	6.2	5.3
Administration	6.2	5.7
Percent change, gross national product deflator:		
JEC staff	6.6	6.1
Wharton	5.6	5.0
IBM	5.7	5.7
DRI	6.2	6.0
Administration	5.9	6.2
Unemployment rate:		
JEC staff	7.9	7.9
Wharton	8.1	7.5
IBM	7.9	7.3
DRI	7.5	6.6
Administration	7.7	6.9

Sources: JEC—forecast underlying staff report of Dec. 22, 1975, "An Economic Evaluation of the Current Services Budget, fiscal year 1977." Wharton—control forecast of Jan. 5, 1976. IBM—forecast of December, 1975. DRI—Data Resources, Inc. Control Forecast, January 1976. Administration—Budget of the United States Government, Fiscal Year 1977, p. 25.

Representative BOLLING. Now, I have, I think, a relatively small request. If it is too complicated, just tell me and we will forget it, but I would like you to supply the committee with something. I had something to do with that act that was passed in 1974, that Budget Act.

Mr. LYNN. Yes, sir, you certainly did.

Representative BOLLING. And one of the things that concerns me and honestly concerns me is the relationship of that act to the theoretical precise implementation of the President's budget.

That act has a series of limitations and reservations and so on. And if it isn't too much trouble, I would like you to supply the committee with an outline of what would have to be done by the congressional committees in what time to accomplish the recommendations of the Budget Act. Now since I ask for it, I do not believe that it would be an intrusion on your business. And my reason for asking for it is that I think—and I haven't had a chance to study it enough to be sure—but my impression is that the speed with which reductions would take place from what would otherwise be the expenditures based on the current services estimates is such that it would be extraordinarily difficult, just in terms of reality, to achieve it if we wanted to. I wouldn't want to suggest that I wanted to do——

Mr. LYNN. I understand.

Representative BOLLING [continuing]. Every one of the things that is in the President's budget, but I think that would be enormously helpful, because I found that very few people have thought of it in those terms. And the Budget Act, I think, if we are able to implement it—and I think that is a very serious question now with the kind of opposition that we have had from a variety of places, at least in the House of Representatives—it puts some limitations on the appearance of the reality of the facility with which the Federal Government as a whole can change its spending and taxing policies. I believe that sort of accidentally we are already on something like a 2-year cycle, instead of a 1-year cycle and perhaps more. And I don't think we are being frank with the American people as to what our problems are.

But, my question is just that. And I don't want you to try to answer it now, obviously, and I don't think it is too onerous a burden to ask, because I think it could be very helpful.

Mr. LYNN. I think so, too, Congressman Bolling. We will do our best to do it. That is one of the reasons why the President said we have to get this legislation up here very quickly. We will get you such a schedule as best we can prepare it.

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

The Administration is making every effort to ensure that legislation affecting the budget is submitted to the Congress soon enough to permit its consideration under the new congressional budget procedures. The Administration is submitting 79 bills that are directly related to the budget. By mid-February some forty of these had already been submitted to the Congress. Nearly all proposed legislation affecting the 1977 budget will be submitted to the Congress by the end of February. This should give the appropriate committees time to consider the Administration's legislative proposals prior to their reports to the Budget Committees that are due March 15. It should also provide enough time for the committees, where necessary, to report new authorizing legislation by the April 15 deadline called for under the budget act.

Mr. LYNN. Incidentally, let me just repeat, as I do every occasion I can, we want to do everything possible to help in any way we can to make the budget process work up here.

Representative BOLLING. Well, at some point, I will probably personally take advantage of that and call you up and personally suggest ways you can help us.

Chairman HUMPHREY. Congressman Brown of Ohio.

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

Mr. Lynn, it is good to have you before us. I just want to make some observations, and then direct a question to you.

The President passes no laws, nor does he appropriate any money. Congress does both of those things. In the case of the budget, as is normal, he merely proposes and then Congress disposes. Now, the way the Congress itself has disposed over the last few yers: In fiscal years 1975, we had a $56-billion increase in Federal spending, and we had a $53-billion deficit; in 1976 we had a $49-billion increase in Federal spending and we had a $76-billion deficit estimated at this point; and for 1977, without the reduction of the $28 billion—and I am sure from this morning you recognize there is some opposition to it—we would have a $49-billion increase in the spending again, and a $43-billion deficit, even with your reduced increase in spending.

My comment is that the President talks about holding down spending increases and cutting taxes and about trying to reduce the deficit. Everybody gets very excited. The stock market goes us. People regain confidence and start spending their money again. We get predictions that the recession is coming to an end, although too slowly, of course. I just think that is all very naive. I think it is terribly naive on the part of the average citizen and on the part of the administration. This Congress is very unlikely, particularly with half the Senate running for President and a good part of the House running for the Senate, and some people even running for reelection, to be able to hold the line on the budget.

Yet, on page 28 of this budget, you have this same optimistic chart that keeps showing up every year in the budget book; namely, that anticipates receipts going up and outlays being leveled off. Then somewhere out there in the cloudy future, you have a prediction of a balanced budget and a surplus.

I don't want to use any southern Ohio colloquialisms, but isn't that a bunch of malarky?

What happens if we don't hold down Federal spending increases, which I think, given the kind of reaction we have seen this morning is almost purely predictable? Where do we go? What steps can we take in the future to achieve a balanced budget or do we just concede that we are not going to have a balanced budget and that we are going to continue to play around with deficits that range from $43 billion to $76 billion in one year. What happens to our interest rate on that basis? I am referring to the interest rate that is needed to start small businesses and expand factories for jobs and build houses. What happens to how much of what we pay of taxes goes just to carry the Federal debt? What happens to the future of the dollar?

Can I go out and buy some German marks now, or should I wait?

Mr. LYNN. You ask what happens and——

Representative BROWN of Ohio. I mean, what is really going to happen, and not all of this stuff. I mean, not all this rosy-glasses stuff. Let's look at the truth in the Congress and——

Mr. LYNN. I have never been known as either a Pollyanna or a Calamity Jane.

Chairman HUMPHREY. What was that?

Mr. LYNN. A Calamity Jane.

Chairman HUMPHREY. Well, good.

Mr. LYNN. But I will say this, Congressman Brown, I have a great deal of confidence in the people of this country.

Representative BROWN of Ohio. So do I, but they are not in the Congress.

Mr. LYNN. Oh, but wait a minute. The people of this country can understand things in ways that sometimes we don't give them enough credit for. I have a feeling that if Congress just rejects the President's proposal and goes its merry way of increasing expenditures as it has in recent years, that if the Congress decides the way to get us out of the recession is by Government jobs of various kinds—and not job of choice, but short-term employment jobs—that the American people will speak to this.

Representative BROWN of Ohio. Let me just answer that. They spoke, but only 38 percent of them spoke in the congressional elections of 1974, and 62 percent of them, I think, have written us off, or at least they didn't participate.

Now, my question is that given that kind of participation in the elective process and given the results we got in the last election, the direction we are going to take is not the direction you paint in this book. Now, if we follow the direction we followed in the last few years, my question is, Where are we headed?

Mr. LYNN. Toward England, toward "stagflation." If Congress continues the way it has in the past, wanting to show that it cares, but the way it shows it cares is by adopting one new program after another, then you are headed for the kind of economy that England has.

For instance, as housing remains in the doldrums, the Congress will then come up with a national housing corporation that will make GNMA and FNMA look very small. Whether we call it the people's housing corporation or something else, it will provide what credit there is for housing and everything else. The taxpayers will be paying for it. Housing will never be growing the way it should.

If we have trouble in the steel industry, then we will have to invent some new Government financing device to deal with that. We will find ourselves just where Europe has found itself. Incidentally, some of the countries are pulling back from it. We will find ourselves where the United Kingdom is, unfortunately, now.

Representative BROWN of Ohio. Where 50 percent of the economic decisions are made by the Government?

Mr. LYNN. That is where we are headed, unless we turn this current trend around. If you include Federal decisions by way of regulation, and what we are doing to the consumer through regulation and overprotection, it's even worse. The proof that we have damaging overregulation appeared when the President made his proposals for regulatory reform of airlines, and trucking. You heard screams from certain sectors of those industries, because they've got it kind of cozy now. They have protection now. Price competition isn't there, and price competition is the thing that keeps rates down.

Whenever we see a problem, some say we need a new Federal Government program. If you don't believe me, here is the catalogue of Federal domestic assistance programs. We were at 100% when we printed this 8 months ago. It is obsolete. There are over 20 more. There have been 20 more added to this book. It keeps growing. The way Government has traditionally shown that it cares for the American people is by adding money and adding programs. I think the American people have awakened to this.

Representative BROWN of Ohio. My time is up. One criticism we already heard this morning is that you don't have any new programs in that budget, so what's the matter.

Chairman HUMPHREY. Senator Proxmire.

Senator PROXMIRE. Mr. Lynn, I just want to join the other members of the committee that commend you in your adroit and articulate defense of the administration's position. And with part of the philosophy of the administration's position, I agree. I think the Government has grown too big, too insensitive. I agree with you we can't solve our problems by throwing money at them. I think you are also wise in pointing out that we can't make as much of a cutback as we would like to make and balance the budget this year. It has to be done over a period of time.

I would also feel, however, that any argument that a more expansive fiscal policy would be stimulative, would be so stimulative as to be inflationary; I think that is very unrealistic; and that any kind of analysis of the status of both capacity and employment and availability of resources would indicate that wouldn't be a source of inflation. Inflation may get worse and, in fact, there is lots of indication that it will.

What I am concerned about in your budget relative to that is the cavalier attitude the administration, and particularly the Office of Management and Budget seems to have towards the weak inflation fighting instruments that you have. For example, the Antitrust Division is one that most people feel can be useful in combating inflation. Certainly, over a long pull, it can be. The Department of Justice came to the Office of Management and Budget requesting 20 new lawyers and 31 nonlawyers. You cut that down to only 3 lawyers and 17 nonlawyers. I think it is evident to all of us that when the Department of Justice goes into battle against these large corporations, they are badly outmanned and outgunned, because they don't have the personnel, they don't have the experts compared to the people they are up against. How do you justify that kind of cut, when the President has indicated he believes strongly in antitrust enforcement, and recognizes that as an element in holding down prices?

Mr. LYNN. Let me—and this shouldn't come out of the Senator's time—but we have put out a book called "70 Issues." I urge everybody to read at least the preface, because it has a mea culpa in it. There are probably things wrong with it, but we tried to use it this year as a bridge between the terseness of the budget and the budget appendix, which is written for the expert in each little area. We tried to make it something that explains a good deal of the issues. I will just, in passing, refer you to page 157, that deals with just your question. We do believe there are significant increases reflected in this budget for both the Antitrust Division and the Federal Trade Commission. What you have to look at is not merely the change from 1976 to 1977, but also the increases in the Antitrust Division over the last couple of years, which have been quite large.

The President has made himself very clear on antitrust enforcement. He believes that it is an important complement to reliance on the private sector. You must have competition.

Senator PROXMIRE. Well, why not put your money where your mouth is?

Mr. LYNN. The problem is—well, let's take energy. We all concur that it is a major priority, right? I won't tell you now how much ERDA requested for additional people. I have never yet seen a department that doesn't request more and more and more. I take that back. I have seen one or two. I will not mention which ones they were this year. A few, recognizing the spirit of what the President was trying to do, made quite modest requests.

Representative BROWN of Ohio. You ought to mention them.

Mr. LYNN. But, every department and agency of the Federal Government, year in and year out, asks for more and more. And just because they serve an important objective doesn't mean the figure they come in with to us is right.

Senator PROXMIRE. Well, I appreciate that. There are areas, I think, should be cut far more sharply. Certainly in the Pentagon, the military——

Mr. LYNN. Well, we would be happy to——

Senator PROXMIRE [continuing]. And the space program.

Mr. LYNN [continuing]. Show you, on antitrust, Senator, the rationale for the President's recommendation. We have analyzed the positions they have and the big cases they have—and you are right, Senator, those cases really require large resources. We would be happy to sit down with you and see whether or not you would agree with the analysis.

Senator PROXMIRE. Well, let's take the Council on Wage and Price Stability. I don't know what they requested. They may have been given everything they requested. But, this is a terribly weak and small agency to do the job of supervising wages and prices in a year when we are likely to get very large settlements, wage settlements, that are very likely to be inflationary, especially with the Teamsters and the UAW. And you have a pitiful number of very able people there. You have 25, I understand, or 26 professional or something like that. About half of them are involved in trying to work with the Government agencies and Government legislation to stem that inflationary effect and about half in the enormous private sector.

We have heard a little bit from Mr. Moskow's operation, but very little. Now here is an area where it seems to me, with a small investment, you can make a real impact. We aren't making that kind of impact in voicing objections to unjustified price increases and wage increases. And this year, those could be very inflationary indeed.

We were told yesterday that last year the wage settlements averaged 10 percent. This year, with front-end load, they could be substantially more than that. That would have an adverse affect, and I think you would agree, on expansion in the private sector. Here again, why can't we get more resources at work in this limited area? The affect on the budget would be infinitesimal. The effect on the public——

Mr. LYNN. Let me say just a few things, if I might?

Senator PROXMIRE. Go ahead.

Mr LYNN. First of all, there are people who try to reach me to complain about what the Council on Wage and Price Stability is doing in various industries. That is a little inconsistent with what you said. There are some people out there who are very unhappy with the strong positions Mr. Moskow and his staff have been taking in various areas.

Senator PROXMIRE. Not enough.

Mr. LYNN. Of course, that is a judgmental decision. I am sure Mr. Moskow has plans in this regard. Now Senator, we look very,

very hard at the employment numbers in the Executive Office of the President. We look awfully hard at those numbers, including our own in OMB. And I must say that part of the problem in this regard is the kind of debate that occurred on the House floor and the Senate floor when we were trying to get an authorization bill for the Executive Office of the President. We heard tremendous rhetoric about how President Ford is trying to expand the White House staff. Now, people can't have that both ways. If people are willing to stand up and be counted and say that you do need more people, or if they even take the position of the chairman of the Appropriations Subcommittee and say let the President have to stand before the American people on whether his staff is too large or too small, just the way we have to with our own staffs here on the Hill, well, that is one thing.

But we believe that in terms of financial responsibility, and of doing a good management job—and that is our main aim—we believe, and the President believes, that the staffing requests are reasonable. Of course, there are various places that could effectively use more people. But you should always try to hold a balance between the taxpayer's dollar and that marginally increased effectiveness that you might get if you had some more people.

Incidentally, on your 17 nonlawyers, as opposed to 3 other people, I don't think Paul O'Neill agrees with that.

Mr. O'Neill. No, I do not. Senator, page 496 of the budget appendix states that the average paid employment in the Antitrust Division in fiscal years 1975, 1976, and 1977, respectively, were 676 persons, 792 persons and 852.

Senator Proxmire. No, I am talking about the fact that the Justice Department requested an adition of 20 additional lawyers and got 3; and requested an additional of 31 nonlawyers, and they got 17.

Mr. O'Neill. I do not, frankly, remember what they requested, but I can tell you that the Office of Management and Budget cannot direct what the composition of that employment would be. I must say I also find it very hard to reach your conclusion, Senator, from the numbers here, because the amount of money for direct personnel compensation for the Antitrust Division in fiscal year 1977 is going up over $1 million.

Mr. Lynn. From 1976 to 1977.

Mr. O'Neill. From 1976 to 1977. And it does not sound like a very few number of people.

Senator Proxmire. My time is up.

Chairman Humphrey. Congressman Hamilton.

Representative Hamilton. Thank you very much.

Mr. Lynn, I appreciate your observations this morning, just as my colleagues have. You said on several occasions that the budget message of the President is very important. I am struck by the first paragraph of that message. I am struck by one of the sentences that says: "That the budget reflects the President's sense of priorities." And, I think, we all know that, of course, is part of any budget.

But, as you look through this budget, the thing that impresses me with regard to those priorities is that it is only in a single area that the President has chosen to increase this budget substantially, and that is defense. I think there may also be increase in energy, which all of us concur with. But, in all of the civilian areas of the government, but certainly in those areas where we provide governmental services to people who are in the low-income and lower middle-class areas, you have reductions.

And so the question is: Is this the signal that the President wants to send to the people of this country that when you look over all of the needs that we have, we are going only to increase the defense budget and you are not going to increase those portions of the budget that the chairman was talking about a little earlier this morning; namely, those that relate to human services?

And you say in this budget message that he reflects his best judgment on how we must choose amongst competing interests. And we know those are very difficult judgments and appreciate that. But, the thing that jumps out of the figures to me is that after the President has made those decisions, he has come down on the side of substantially increasing the defense budget and holding back on almost everything else.

Mr. LYNN. My problem is I can't agree with your premise. I think that is not true. If we took just payments for individuals, the dollars are up 9 percent; if I look at housing payments, they are up 23 percent; if I look at energy research and development—and you did mention energy—spending is up 30 percent. Nonmilitary research and development across the Government is up 9 percent; community development blocgrant outlays more than double; Equal Employment Opportunity Commision is up 8 percent. So, on for page after page——

Representative HAMILTON. Mr. Lynn, the studies of this committee suggest that the President is asking for a 7 percent real increase in the nonpay portions of the military budget and at the same time imposing a reduction in the civilian budget of about 3 percent.

Mr. LYNN. By "civilian" you mean all other function of the Federal Government except for defense?

Representative HAMILTON. I think we mean those portions of the budget that really relate to human services.

Mr. O'NEILL. Congressman, I think as Mr. Lynn has said on many occasions, I think one cannot just look at the summary numbers in this budget and make what we consider to be a correct interpretation. You really have to look at the details of what is happening, program by program. And I think, just to give you some numbers, because you asked, referring to HEW, I think our formula is very well made. In 1975, the actual spending for that agency was $112.4 billion. By our best estimate, in 1976 it is going to be $127.7 billion. And under the President's recommendations for 1977——

Chairman HUMPHREY. By the way, doesn't that include the social security increases? You are not Santa Claus in that one. You have been ordered by the courts——

Mr. O'NEILL. I would be very happy to give you the Federal funds figures for HEW; those are impressive—for 1975, $37.3 billion; for 1976, $41.7; for 1977, $44.3. Those numbers are not going down. They are going up. And I respectfully would suggest to you one of the single most important programs we have is social security.

Chairman HUMPHREY. Right.

Mr. O'NEILL. So when I talk about HEW, I always include social security.

Chairman HUMPHREY. But we directed you to do that. You are not being a nice fellow. We had to beat you over the head.

Mr. O'NEILL. Senator, I was in OMB when you were the Vice President and was part of that process that led to the unified budget.

Chairman HUMPHREY. I mean the cost-of-living increase. I mean we directed that. I am not talking about the uniform budget.

Mr. O'NEILL. I would say it is the statute—

Chairman HUMPHREY. Yes, the statute. And you tried not to do it last time.

Mr. LYNN. Well, the Chairman is right, Mr. O'Neill, in that regard.

Representative BROWN of Michigan. Under the Budget Control Act, from now on they are directed to spend everything that we dictate. In effect, they have no discretionary authority.

Mr. LYNN. But, I would like, if I could, to put in a word for defense. The Budget in Brief this time, I think, compares apples and apples. I was worried as to past budgets. They talked about the growth in domestic programs as an increase in constant dollars, and then switched to defense as a percentage of GNP. And my own comment was that if you are going to talk about the domestic assistance programs on the one basis, you ought to talk about defense on that basis. But, I would refer you to the beginning of the budget overview at the bottom of page 8 and the top of page 9 in the Budget in Brief. It talks about payments to individuals and grants to States and local governments, which rose over 500 percent in constant dollars over the last 20 years. Defense, on a constant dollar basis, declined 10 percent during the same period. The defense budget this year, in constant dollars, is as low as it was in the early 1950's.

Representative HAMILTON. Well, let me point out, in 1974 we had a defense budget of $86.5 billion, and in 1976, it was $92.7 billion. This year, it goes up to $100 billion. So that is a very rapid increase. I recognize there are some needs for defense expenditures and am not really quarreling with that.

My point was that I am under the impression, and I may be inaccurate in this and there may be some difference between your and the committee's figures, but my impression is that the defense budget is moving up very rapidly under the President's proposals, and that those portions of the budget designed for human services are not moving up or, if they are moving up, they are moving up at a much lesser rate than defense.

Now, let me make one other point with regard to priorities. You have a list of tax expenditures in your budget. You've got electric utility tax relief and tax deferrals for funds invested in stock purchase plans and accelerated depreciation for investments and so forth. In the budget you've got investment tax credit made permanent, and a corporate surtax exemption. All of these tax things in here are again designed for one sector of the economy. You are trying to help the private sector, business. You made that point before.

Mr. LYNN. Because five out of six jobs are there. The jobs are there.

Representative HAMILTON. Well, we are not giving any relief in this budget to the fellow at the bottom end, it seems to me. You are not giving any relief to the guy who is really feeling the crunch right now and is looking for money to pay his grocery bill this week.

Mr. LYNN. I don't know exactly what the total figure is. But if you combine unemployment insurance and the public service jobs that are in this budget, Congressman, and add food stamps, and aid to families with dependent children, and social security, and supplemental security incomes, and medicaid, and on and on and on, it is a huge sum of money. It is by far the biggest piece of the budget.

Representative HAMILTON. All of your initiatives in this budget, as I understand it, Mr. Lynn—well, not all of them, but a great proportion of them—a great proportion are clearly designed for one sector of the economy; namely, the business sector. I am not critical of that. They probably need some help. We know they do face some problems. The electric utility does, for example.

But, there is no balance here, it doesn't seem to me, in the initiatives that you have proposed in this budget. That is what comes across to me. I may be mistaken on that. I want you to respond to that.

Mr. LYNN. You say "initiatives" and you mean new programs?

Representative HAMILTON. I am talking right now about the tax expenditures.

Mr. LYNN. Well, you did say we don't have many new programs on the domestic assistance side. You know, you are absolutely right. We have 1,030 of them now that we are trying to——

Representative HAMILTON. Well, we are talking about tax expenditures, right now.

Mr. LYNN. In fact, we do have initiatives; they are initiatives to cut down the number of programs. We have important initiatives for blocgrant programs that we think are very important. We think those are new initiatives on the domestic side that will help people. That is what social services, title 20, is all about. It is about helping people. Health services is helping people. And the funding on those programs goes up, year to year.

Now, it is true we have made recommendations that moderate the growth of those programs from what they would have gone in the absence of new proposals. That is true.

Representative HAMILTON. When you read the budget message of the President—and you said over and over again those are the central points he wants to make—you see——

Mr. LYNN. Indeed they are.

Representative HAMILTON. In that message it talks about an increase in the defense budget, an increase in energy, but there isn't anything in here at all that is directed at the fellow at the low end of the economy.

Mr. LYNN. I would say to you——

Representative HAMILTON. In the budget message, that is. If you are talking about consolidation of programs, that is fine, if that means more efficiency. But, the whole thrust of this budget message isn't in the direction of the people at the lowest income levels of this country.

Mr. LYNN. Well, one of the things that the President is doing is recommending a budget deficit of $43 billion. He is saying to the

American people "Remember last year, we made the reductions in taxes. You will remember those reductions leaned toward the lower income side." I don't think there is any doubt about that, as the tax bill was passed in the Congress. The President is saying that.

Representative HAMILTON. As the result of the initiative of the Congress, Mr. Lynn.

Mr. LYNN. Well, we want to make those tax reductions permanent. In order to accommodate making them permanent and to accommodate making permanent what you did before for middle income persons, in order to help them somewhat more this time around.

Representative HAMILTON. And you knocked out the earned income credit.

Mr. LYNN. Of course, and for a very good reason——

Representative HAMILTON. Which was a very big help to the guy at the bottom.

Mr. LYNN. But it takes an expert like Mr. O'Neill to tell you what you have done in that proposal, Congressman. The concept may be one we ought to be working on, but the way I think it came out, what with the $400 maximum and the phasing out at the $8,000 level and the interactions with aid to families with dependent children, and SSI, and food stamps—well, it just doesn't fit.

Representative HAMILTON. It takes an expert like me to tell you that it didn't take money out of the pocket of the fellow at the bottom end of the scale.

Chairman HUMPHREY. I've got to go down and vote. We have all had one round here. I didn't have any opening questions. I would like to make a few comments.

This has been a very important session. I want to call your attention to a memorandum prepared on January 26 by the staff of the Joint Economic Committee that was sent to all members of the Joint Economic Committee at my direction, and analyzes the budget. We have had a big to-do here about numbers. And I am not going to go over this business of uncertainty about numbers. We are going to get agreement about numbers, because that affects judgment. I want you to take this and analyze it, Mr. O'Neill, and whoever else is here and give us back your commentary. The least we ought to do in this Government is start to agree about numbers. We are constantly having this problem in every discussion.

Mr. LYNN. I couldn't agree with you more.

Chairman HUMPHREY. Mr. Lynn, I want to just make a statement here. In your comments, you show you are an extraordinarily able exponent of the President's philosophy. And you said what we are asking for is the Government to do this and the Government to do that and all we are interested in is the Government doing things. The problem is that the Government does have an impact on everything that happens, particularly when you have a budget that approximates almost $400 billion, which is a little over a quarter of our GNP, which is about one quarter of our total gross national product, and then add to that State and local governments. So you see you have a big hunk of the productive wealth of this country. So the Government does have an impact.

Now, Government expenditures have an impact on private life, on the private economy. As a matter of fact, today Government expenditures in the field of health keep the health industry of this country really going. I mean, it manages Johnson & Johnson and Bauer & Black. These people have got people employed because the Government is buying it, if only for the military. So the private sector is directly related to the Government in a positive way. I think what some of us are concerned about is that the private sector is not going to be able to handle in 1 or even 2 years all of the jobless people of this country. And the question, as I said yesterday, are they going to be kept on the dole or are we going to find something for them to do, instead of getting a computerized printout check? Now, that is the way Hubert Humphrey looks at it. I just happen to believe that when you've got long-term unemployment and particularly amongst the youth, where they never had any work experience and never had any work discipline and never get the therapy of work and never know what it is to mean to work, then we have a real problem. We have a problem.

As you know, we have a program in Government, and it is your Government as well as mine, that simply says just stand in line and get your stamps, or just stand in line and get your checks. Now, I don't want to be misunderstood. I think those are necessary temporary interim measures. But, the important thing is, do we have a design to get people back to work. Now, there is nobody who can come here and tell you you are going to get all of these people back to work if you want to, in the next 2 or 3 years in the private industry. You don't even predict that yourself. You say that at the end of 1977, you predict that at the end of 1977, 6.9, if everything is jolly beans.

Mr. LYNN. That is an average for the whole year; the end-of-the-year figure should be a good deal better.

Chairman HUMPHREY. But that doesn't get to the pockets of unemployment. So, I am not just a Government do this and a Government do that guy. I just happen to think Government has great impact.

For example, why do each of us, as Congressmen and Senators, want to get a Government installation in our city or State? Because it generates private income. The important thing is that people get a check for doing something and not get a check for doing nothing. That is what is important. When the GSA has an office in Minneapolis, we like it, because people get a check and they spend it in the grocery stores, in the supermarkets, in the garage or wherever it is. It is all getting back into private hands. The velocity theory of money exists.

So the budget does affect jobs. Very definitely.

More importantly, we have the reality that the only way anybody is going to get a job is if the Government provides it. That is what Arthur Burns, bless his heart, has come around to saying: That the Government has a responsibility as employer of last resort. That is Mr. Burns, now. We may disagree on how much they ought to be paid, but Mr. Burns at least has come around far beyond where you come by saying there ought to be a Government program. And he doesn't say it is impossible. Arthur Burns says you can do it now. He spoke down in Atlanta. I put his speech in the record.

Second, talking about deficits, there will continue to be deficits until the country gets back to work. These deficits are not because somebody up here is a wild hare. These deficits are because the social costs due to the recession and due to inflation. Many of these increases that we are talking about in the budget are only due to the fact that there has been inflation. You just have to run like the devil to stand in place. So that when you add to the inflation, plus the high interest—and isn't it interesting that during World War II we had short-term financing of one-fourth of 1 percent interest, when 50 percent of the total GNP was going into the budget. We had one-eighth of 1 percent for 30-day notes during a time when 50 percent of all of our production was going into the budget. I mean 50 percent of all our deficit was.

Now, why is this? I think somebody has to think about what has happened to us during this period of time. If it was deficit financing that caused high interest, my dear friend, then the interest should have been 200 percent during World War II, because we had more deficits at any time in our history relating to GNP then, but the interest rates were down.

Now, you say the Government is too big? I tell you what I want you to do. I agree the Government is too big, but I want you to give me a list of all the programs that you want abolished, Mr. OMB Director.

I want you, on behalf of the administration, to give me a list of the programs to be abolished. I want you to give me the impact on the economy, the impact on the groups and on the sectors of the economy, the impact statement. When you list them out, I want you to ask yourself as to the regulations, who writes them. It is not God. They are not part of the Dead Sea Scrolls. You hired a lot of lawyers over there to write them. You write a lot of them yourself in your office. Congress dosn't write these regulations.

I've got an idea. Why don't you put Nelson Rockefeller in charge of a commission to defuse the regulations? Why don't you erase them? Here are a lot of erasers on these pencils. They can all be erased. There isn't a single one of them divinely ordained. Every single one of them has been written by a lawyer or somebody in the Government, and they can all be unwritten within the terms of the law.

Mr. LYNN. Therein lies the trouble; within the law.

Chairman HUMPHREY. Within certain limits.

Mr. LYNN. And the way the courts have construed——

Chairman HUMPHREY. Now, wait a minute. Let's not take the courts apart. You disassembled the executive branch of the Government and the Congress today. Let's not do that to the courts.

Mr. LYNN. I am not criticizing the courts.

Chairman HUMPHREY. You are going to have some kind of a theocratic anarchistic society around here very quickly. This business of the heads of Government coming in here and condemning government I resent. I don't happen to think that government is a blessing all the time, but it is a necessity.

Mr. LYNN. No one has ever disagreed with that.

Chairman HUMPHREY. Well, but every time I hear the present occupants of the executive branch, they are constantly telling us the Government is no good, but they tell you the State and local governments are good. Who has been raising the taxes? Not the Congress. We haven't raised any taxes for God only knows when.

But, I tell you what they are doing. They are putting 8 and 9 percent sales taxes on people and putting property taxes on people. Government is government, Mr. Lynn, and taxes are taxes. And it doesn't make a lot of difference whether it is paid to the Federal Government or the State and local governments.

Now, I want you to tell me what your budget will do to the State and local governments. And by the way, that is the most regressive kind of taxation.

Mr. LYNN. It is here in——

Chairman HUMPHREY. Well, you give us more precise examples of it, because I could run you down a whole list here, as what this budget does to State and local governments. I have a list of them I am going to send to you.

Now, your social security taxes, what will that do to State and local governments, because they both pay that and pay unemployment compensation. What about the reduction of Federal support on water pollution abatement programs?

Mr. LYNN. Up 60 percent.

Chairman HUMPHREY. What about cutbacks in mass transit operating subsidies, which will force additional expenditures.

Mr. LYNN. No; there are not cuts, just a limitation. Mass transit funds in general are increasing.

Chairman HUMPHREY. What about changes in contributions made by the State and local governments and the unemployed compensation fund and so on. I think it is imperative that we get the total picture, because as far as the citizen is concerned, he is not just a citizen of the Federal Government; he is a citizen of the township, the county, the city, the State; and all over America State and local governments are doing two things: Cutting people off and trying to reduce their costs and raise taxes. And when the Federal Government has to come in and chop it up even more, it hurts.

Now, I've got to turn this over to Senator Proxmire. I will be back. You can go after him while I am gone.

Senator PROXMIRE [presiding]. Do you want to wait until the Chairman comes back and respond?

Mr. LYNN. I made some notes.

Senator PROXMIRE. Are you next, Congressman Brown?

Representative BROWN of Ohio. Go ahead.

Representative BROWN of Michigan. Well, I could attempt to answer a little bit of the Chairman's questions. It seems to me the extent that you are advocating a $10 billion reduction in Federal taxes, that you raise $10 billion back there, so that the States can pick it up, so it is not going to cost the taxpayer a cent. You've got your increase in the community development fund. And I would suggest that one thing that would help a lot in the cities and State of Michigan at least is for this Congress, and especially the majority party to move along general revenue sharing. That is a rather significant thing. So, I don't think we ought to say what this budget is doing, but what this Congress is doing to the States and localities.

Mr. LYNN. That is an extremely good point, and I should have made it, because I worry about general revenue sharing and where it is right now.

Representative BROWN of Michigan. Furthermore, with respect to the regulatory aspects of things, I quite agree. I agree with the

Chairman in one regard, in one respect, that is, it seems to me with every statute we pass, if a regulator can write tougher regulations than the statute demands, he will do it. Rarely do they underregulate in their interpretations of the statutes. But, the unfortunate thing is that you find that when a rather relaxed regulation comes out and someone doesn't seem to be quite covered and protected by the statute because the regulation isn't strict enough, then we have 1.000 oversight committees bringing those people in and saying "Why didn't you do this?"

I serve on the Government Operations Committee and the Consumer Monetary Confidence Subcommittee, thank goodness, at least in one respect. You talked about the Settlements Procedures Act and we were able to get the Congress finally to accept the fact that there was overregulation and there wasn't a benefit that was commensurate with the cost. We talk about the cost of it to the industry in time and so forth. And I am glad that Senator Proxmire gave us some help on that.

I just wanted to say that I have some questions, but unfortunately I reacted so to what the Chairman was saying that I forgot the substantive I had. I would just like to say that, Mr. Lynn, it is a pleasure always to have you before this committee, which I serve on. And I think this committee, along with other committees of Congress, would be unanimous in saying if there are bright spots in the administration, you've got ot be one of the bright spots.

Senator Proxmire. Congressman Brown of Ohio.

Representative Brown of Ohio. I just wanted to get one substantive question in. I have always had a terrible time figuring this book out. But the subject was raised a few minutes ago that an increase between 1975 and 1977 fiscal years——

Mr. Lynn. 1975?

Representative Brown of Ohio. Yes; and an estimated one for 1977: an increase of expenditure for the executive branch of the Government and the expenditure for the office of the President and the Executive Office. Can you tell me what the increase is? Can you tell me what the relative costs are?

Representative Brown of Michigan. Would the gentleman yield?

Representative Brown of Ohio. I would be glad to.

Representative Brown of Michigan. I have been jotting down figures, not including the whole executive branch, because that includes——

Mr. Lynn. Do you want the Library of Congress included in the legislative branch number?

Representative Brown of Michigan. The Library of Congress. But just looking at the budgets for the two Houses and their joint operations, we went from $343.9 million in 1975 to $436.4 million in 1977, which is almost a $100 million increase.

Representative Brown of Ohio. I think we ought to include the Library of Congress.

Representative Brown of Michigan. Well, I was trying to restrict is so we can pinpoint it more, which means you had about a 30 percent increase. It is about $100 million. So, you had about a 30 percent or better increase.

Mr. Lynn. It is about 32 percent.

Representative BROWN of Michigan. Thirty-two percent?

Mr. LYNN. For the whole legislative branch.

Representative BROWN of Ohio. For the whole legislative branch itself, it is about a 32-percent increase in 2 years; is that right?

Mr. LYNN. Yes.

Representative BROWN of Ohio. What is it for the executive branch?

Mr. LYNN. Well, for the Executive Office of the President, it is a decrease, but we would have to calculate it for you.

Representative BROWN of Ohio. Well, now you can see that is why I suggest that you are too optimistic about your surplus or even your balanced budget. Increasing the legislative branch figures by 33 percent in 2 years gives you some idea of our consideration of the question of government spending. I just think that is sort of prima facie evidence of our inability to control ourselves. Well, I guess that is all in the family.

Mr. LYNN. For the record, Congressman Brown, the decrease in the Executive Office of the President over the same 2 years is about 21 percent.

Representative BROWN of Ohio. Could you give me the raw figures; 27 percent? Go ahead.

Mr. McOMBER. The figures dropped from $92.8 million to $72.9 million.

Mr. LYNN. Now, again——

Representative BROWN of Ohio. Wait a minute. Do you mean for the Executive Office? That is why I have difficulty reading these things. I've got a figure here, and let me relate it to that.

I looked at all of the——

Mr. LYNN. It does include the construction outlays, too, and one of the things that——

Representative BROWN of Ohio. Well, funds appropriated to the President, now that is something else. Isn't it?

Mr. LYNN. How much is that? Can you add that up?

Mr. McOMBER. Well, if we just look at the amount appropriated for the Executive Office, rather than at the spending, it moved from $75.6 million in 1975, down to $72.9 million in 1977; a smaller decrease.

Representative BROWN of Ohio. No, I wanted the obligations of what was actually expended.

Mr. LYNN. The outlays?

Representative BROWN of Ohio. Is that what OL means? That goes from $92.8 million down to $72.9 million. Now, I included funds appropriated to the President, but that is not, I gather, an appropriate addition, because that includes the regional development program, et cetera. Those are congressionally mandated programs the President spends funds on.

Mr. McOMBER. That is correct. It is simply a technical category. That category, "Funds appropriated to the President," does not include the operations of the President's offices and staff.

Representative BROWN of Ohio. So, the President has reduced his shop 28 percent in 2 years and Congress has increased their shop by 32 percent?

Mr. LYNN. It certainly looks that way. If we find that is wrong, why we——

Representative BROWN of Ohio. I wish you would give me the figures. Because my constituents keep asking me, "Congressman, what have you been doing for me lately?" And I would just like to know what Congress has been doing to them and what the President has been doing to them, just in that one little category, because the rest of this stuff is all mandated by the Congress. And now the President, under the new budget format, doesn't have any choice as to whether he spends and where. He must spend it, isn't that correct?

Mr. LYNN. That is correct. The only place he has a bit of choice is on items that are subject to appropriations, and that are not entitlement programs, and not interest, and not spending from previous obligations or contracts. And when you get down to that category, it is about 25 percent.

Representative BROWN of Ohio. Well, I would like to make a final comment. I will go back to the days of the chairman of the committee here when Lyndon Johnson was President—when the President had the right to withhold spending. I don't want to go back with him to 1936 and 1937, but I do want to go back to the days when the President had the right to withhold spending, because it seems to me that he has reached the pinnacle of political success. Perhaps there would be changes of personal attitude, but if the President had that today, he could at least have the opportunity to have the guts, to have the personal economic and political integrity to try to hold down spending. Unfortunately, I haven't seen that in the U.S. Congress. I just don't see the prospect that we will do it here. It seems to me that we made a mistake in the legislation that denied the President the right to withhold Federal spending that we mandate by law, because if we had it, maybe we could get something done in the Executive Office, as opposed to this legislative branch. If you've got some examples, I would be glad to hear them.

Mr. LYNN. I should say, Congressman Brown, that even if the President had more freedom in impoundment, there would be very limited room for him to influence the budget. When you take a look at the so-called uncontrollables, that is, a combination of interest on debt, contract obligations, and entitlement programs, and then add Federal employee costs with even some real reduction of Federal employees, you are pushing 90 percent of the budget. He could not impound funds for entilement programs. But, even so, more discretion on impoundments surely would help.

Representative BROWN of Ohio. I appreciate that. The folks at home, and at least I found this out at Christmas, suspect we are part of the problem, not part of the solution to this whole situation. I think the figures are evidence of that.

Senator PROXMIRE. Mr. Lynn, the newspapers this morning reported that you have been overruled by the President on a $2.7 billion restoration funds for the Department of Defense; that you had reduced the Department of Defense when they came before you and then Secretary Rumsfeld appealed over your head to the President and the President restored the $2.7 billion over your head. Is that report accurate?

Mr. LYNN. Senator Proxmire, I make it a point, in keeping with a longstanding tradition and the rules of the Office of the President, not to disclose publicly what goes on in any meetings with the President or involving the President in preparing the budget. The budget presented is his budget. It is true that OMB wins some and loses some in our recommendations. OMB goes to the President with a recommendation for each department, and the final figure decided by the President is sometimes over that, and in some cases it is under. But, I don't feel it would be appropriate for me to comment on whatever give and take there might be in a particular budget recommendation.

Senator PROXMIRE. Do you deny that took place?

Mr. LYNN. I don't feel it is appropriate for me to comment. I am reminded of a client I used to have, who was in the merger business. Whenever the stocks started moving, and the press called him, and there wasn't anything going on, he would always say, "That is just not true." Then when something was going on, he would always say, "No comment." The press caught on after awhile. It took me 2 years to train that client to say "No comment" in both cases. After the press learned a couple of times that the old rules were off, we got back to an even keel. I don't think it is appropriate for me to comment.

Senator PROXMIRE. Well, can you tell me how much the Department of Defense requested? You provided in outlays $100 billion. What had they requested?

Mr. LYNN. My recollection is there are procedures where those matters come before the Congress as part of the regular appropriation proceedings.

Senator PROXMIRE. Would you tell us what it was?

Mr. LYNN. I don't think it would be appropriate for us to do so.

Senator PROXMIRE. If we get that in the regular procedure, why can't you tell me now?

Mr. LYNN. I think it should be told to you by the regular procedure. Let me give you are example. Foreign assistance comes under regular procedures, and is part of the presentation by the State Department.

Senator PROXMIRE. Let's see if I can get some information from you on this matter of——

Mr. LYNN. There are things that have their day and in due course they will come.

Senator PROXMIRE. It was disclosed recently, or alleged recently, and I have no reason to suspect the facts weren't correct, that the intelligence agencies of our Government all together—military, FBI, and so forth—have $10 billion. This shocked me. I thought it was about $6 billion. Those are the estimates I've heard before. Is that $10 billion estimate right.

Mr. LYNN. I will not comment on that one for an additional reason. The additional reason is that under the laws of the United States, I am prohibited from telling you that that number in this room.

Senator PROXMIRE. What laws?

Mr. LYNN. The laws with respect to the confidentiality of the information as to what the intelligence budgets are.

Senator PROXMIRE. Is it illegal for anybody to reveal that information?

Mr. LYNN. That I don't know. All I know is when I went up to testify before the Pike committee, I was told that under the laws of the land that it was inappropriate for me, and not permissible for me to comment.

Senator PROXMIRE. Do you know whether or not——

Mr. LYNN. And I would say also, quite apart from that, I would not, without direct instructions of the President of the United States, reveal any figures with respect to the intelligence budget.

Senator PROXMIRE. Do you know whether or not the statement made on behalf of the committee was illegal, or not illegal?

Mr. LYNN. I have no idea, sir. I would assume what they did was legal. I would like to hope the people in the Congress of the United States will obey the law.

Senator PROXMIRE. I understand you have about as much to say as anyone in Government and perhaps more than anybody else in this field, because you have to pass on some of these transfers. And I realize you can't give us any details and I don't want to ask any details about this, because I am sure the details, at least, have to be confidential. But, I would like to know, and I think it would be helpful to know what kind of scrutiny you give the intelligence part of the budget? How many Office of Management and Budget analysts do you have in this area? Would you tell us, roughly?

Mr. LYNN. I am not certain. I'll tell you what I can do, Senator, that I think would be most useful, is this line of inquiry was precisely the same line of inquiry before the House Intelligence Committee, chaired by Congressman Pike. And we set that out. And I think I can provide you just exactly what OMB has done in the past in this connection. And in that testimony are what the limits are and what we do and do not examine and so on. I can provide you those numbers. It is a relatively small staff, but it isn't that small in relation to other functions of the Federal Government.If you take a look at it, compared to social security or other functions of that kind, it, in fact, looks large in comparison to the number——

Senator PROXMIRE. Are you saying you will tell us for the record?

Mr. LYNN. Yes.

Senator PROXMIRE. You will tell us how many people you have in the Office of Management and Budget assigned to intelligence?

Mr. LYNN. Yes.

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

As indicated in Mr. Lynn's statement to the House Select Committee on Intelligence, there are six professionals in the OMB branch that deal with the intelligence budget. Two points about this number should be noted. First, the Intelligence Branch is not responsible for the so-called "tactical" intelligence activity of the military departments, nor for intelligence-related activities of "domestic" agencies, such as the FBI. These budgets fall within the purview of the OMB units responsible for the larger agencies of which they are a part—respectively, the military departments and the Department of Justice. Second, many of OMB's approximately 400 professionals do not have assignments dealing primarily with specific agencies. Some are involved primarily in economic analysis, some in the legislative coordination role described toward the end of Mr. Lynn's statement, and some are involved with aggregate-level issues and analysis.

The statement follows:

STATEMENT OF HON. JAMES T. LYNN, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET, BEFORE THE HOUSE SELECT COMMITTEE ON INTELLIGENCE, AUGUST 1, 1975

Mr. Chairman and Members: I am pleased to be with you today to discuss the role of the Office of Management and Budget. I propose to discuss, first, our general role and then focus specifically on our relations with the Intelligence Community.

OMB's general role is comprised of three major functions:

First, we oversee and manage the preparation of the Federal budget.

Second, we work with the agencies to improve the operations of the Executive Branch.

Finally, we coordinate legislative proposals offered by the Administration and the development of Executive Branch views on legislation pending before the Committees of the Congress.

OMB BUDGET ROLE

There are four major phases in the budget process:

(1) Executive formulation.

(2) Congressional enactment.

(3) Budget execution.

(4) Post audit.

OMB's principal role in the budget process is assisting in executive formulation (step 1 above) and budget execution (step 3 above).

Congressional enactment is, of course, the responsibility of the Legislative Branch, although I testify as appropriate. The post audit phase is handled by the General Accounting Office as well as internal audit groups within the various Government departments and agencies.

PREPARATION AND EXECUTION OF THE FEDERAL BUDGET

The President's transmittal of his budget proposals to the Congress in January or February each year climaxes many months of planning and analysis throughout the Executive Branch.

Preliminary Steps

OMB staff, in cooperation with staff of the Treasury Department and the Council of Economic Advisers, keep under continuous review the relationships between Government finances and the economy generally. This review includes study of recent conditions, as well as the future outlook. Consideration is given to tentative assumptions on the economic environment, projections of revenue expected under these assumptions, and the aggregate range of Government spending levels.

In the late spring, the Office of Management and Budget conducts the Spring Planning Review. Staff prepares estimates indicating a probable range of spending for each of the major programs and agencies for the forthcoming budget. In preparing estimates we draw upon our knowledge of agency programs, agency estimates for particular programs, program evaluation materials and informal discussions with responsible agency budget and planning personnel. We also develop information to relate program objectives to resources requirements.

Paul O'Neill and I then review the fiscal and economic situation, the spending outlook, and the individual program, budget, and management issues posed in the agency presentations. I then discuss our findings with the President, and seek his decisions on planning guidance for each agency and department so that they may reshape their plans and prepare their budgets accordingly. In fact, only a few days ago the planning guidance letters for the FY 1977 budget were sent out.

Compilation and Submission of Agency Budget Estimates

During the next several months agencies revise their program plans in accordance with assigned planning ceilings and program guidance received, and decide upon the budget requests they wish to make for the upcoming budget. They compile schedules and supporting information in accordance with the instructions prescribed by the Office of Management and Budget (Circular No. A-11).

Agency budget submissions are due in the Office of Management and Budget beginning in September. The submission covers all accounts in which money is available for obligation or expenditure, whether or not any action by Congress is required.

Review of agency estimates in the Office of Management and Budget

When the estimates are received in the Office of Management and Budget, they are referred to the examiners assigned to the programs involved. All the knowledge the examiners possess about the agency—whether based on long-run analyses, field investigations, special studies, or conferences held with agency officials—is brought to bear on the estimates at this time. The examiners must be thoroughly familiar with the President's budget policy and previous Congressional action, as well as with the programs of the agency and their relationship to activities of other agencies.

The examiners give considerable attention to the bases for the individual estimates: the volume of work on hand and forecast; the methods by which the agency proposes to accomplish its objectives; the costs of accomplishments; and the estimates of requirements in terms of supplies, equipment, facilities, and numbers of people required. They review past performance, check the accuracy of factual information presented, and consider the future implications of the program. They identify program, budget and management issues of major importance to be raised for discussion with agency representatives at hearings. The hearings, held in October and November, may last only a few hours for a small agency, but often run into weeks for a large department.

After hearings are completed, the examiners prepare their summary of the issues and their recommendations for my review. This so-called "Director's Review" provides an opportunity for me and my principal assistants to obtain an understanding of the agency's program and budget requests, an analysis of the significant issues involved, the relationship of the agency requests to the planning ceiling set for the agency as a result of the Spring Planning Review, and recommendations as to budget allowances.

Budget Decisions by the President

Because of the scope and complexity of the budget, I and my principal assistants meet frequently with the President to present major issues for his decision as portions of the Office of Management and Budget reviews are completed during October, November and December. As soon as the President makes his decisions, OMB notifies each agency head of the amounts which will be recommended to Congress for his agency's programs for the ensuing fiscal year. After any appeals by the agency head to the President have been settled, OMB completes the final preparation and printing of the President's Budget for submission to Congress.

Budget Execution

The Anti-Deficiency Act requires that the Director of the Office of Management and Budget apportion, with a few exceptions, appropriations and funds made available to the Executive Branch. This consists of dividing the total available funds into specific amounts available for portions of the fiscal year or for particular projects or activities. It is a violation of law (31 U.S.C. 665) for an agency to incur obligations or make expenditures in excess of the amounts apportioned.

The objective of the apportionment system is to assure the effective and orderly use of available funds and to reduce the need for supplemental appropriations. It is, of course, necessary to insure flexibility if circumstances change.

Changes in laws or other factors may indicate the need for additional funds, and supplemental requests may have to be transmitted to the Congress. On the other hand, reserves may be established under the Antideficiency Act to provide for contingencies or to effect savings made possible by or through changes in requirements or greater efficiency of operations. Amounts may also be withheld for policy or other reasons, but only under specific procedures established by the Congressional Budget and Impoundment Control Act.

Progress on the budget program is reviewed throughout the fiscal year at successive levels, both in the agency and the Office of Management and Budget. Periodic reports on the status of apportionments are supplemented by more specialized reports which relate accomplishments to cost. Shifts in the agency budget plans are frequently required to meet changing conditions—to finance unforeseen circumstances or to provide savings where the workload is less than was estimated or where increased efficiency permits accomplishment at less cost than was anticipated.

PREPARING THE INTELLIGENCE COMMUNITY BUDGET

I have spent some time providing the general backdrop of OMB's process of preparing the President's Budget because the OMB role and process of preparing the intelligence budget is essentially the same as that with respect to the budget of any other Executive Branch department or agency. Let me cite a few examples of this, particularly as it relates to the 1976 budget process for intelligence.

1. The principal U.S. foreign intelligence activities are examined by a single unit in OMB contained within OMB's National Security Division and reporting to OMB's Associate Director, Mr. Donald G. Ogilvie, who is responsible for national security and international affairs. Under Mr. Ogilvie, this unit, consisting of a branch chief and five professional examiners, reviews the budgets of the Central Intelligence Agency, the Defense Intelligence Agency, the National Security Agency, and those intelligence activities of the Army, Navy, and Air Force that bear most directly on U.S. intelligency capabilities.

By way of a footnote, I should state that they do not examine the domestic information-gathering of the FBI or other non-foreign intelligence-related activities. They also do not examine most of the military or force-related intelligence activities of the Military Departments that are intended for wartime support to military forces during operations. These activities are the responsibility of other branches of OMB.

2. The intelligence programs are examined in the same context and in the same time frame as are all other Executive Branch activities. The current and projected economic situation is considered; pertinent Presidential guidance on intelligence is taken into account; and the effectiveness of the programs is analyzed.

3. During the 1976 budget formulation process, the Director and Deputy Director held in-depth sessions with the Associate Director and the staff on all these activities. Intelligence activities and programs were evaluated in June of last year, major policy and program issues were identified, and alternative long-range program plans were discussed. Guidance in the form of a planning target for the Intelligence Community's budget submission was provided to the Director of Central Intelligence and the Secretary of Defense in July of last year. We follow the same basic procedure each year.

4. After the budgets were submitted in October and reviewed by the OMB staff, the Director and Deputy Director reviewed the total Intelligence Community budget in December. Then two meetings were held to review the issues with the President who made the final decisions.

5. A final allowance letter was sent by the Director of OMB to the Director of Central Intelligence and the Secretary of Defense informing them of the funds included in the President's budget for the Intelligence Community.

DIFFERENCES IN BUDGET PREPARATION WITH RESPECT TO INTELLIGENCE

The only differences between OMB's role in the preparation of Intelligence Community budgets and those of other agencies result from the sensitive classification of the Intelligence Community budgets and the fact that part of the Intelligence Community budget is subject to joint review of the OMB and the Secretary of Defense.

Because most intelligence budget information is sensitive and classified, it is not specifically identified in the President's Budget. This is a legitimate area for review, but it cannot be clearer that:

1. The Director of Central Intelligence, who by statute is responsible for protecting intelligence sources and methods, has determined that most of the budget information is classified, and

2. The Congress has consistently supported the view this classification of intelligence budget information is appropriate, most recently in a Senate vote of June 1974.

Mr. Colby can provide more detail on this matter. As a result of the classification of most intelligence budget information, OMB, both in its relationship with the intelligence agencies and in its relationship with the Congress, has taken measures to protect this information, while ensuring that the Congress has the requisite information so that it can perform its constitutional role in reviewing the budgets of the agencies and in authorizing and appropriating funds for these activities. For example, the Director of OMB has by long-standing practice sent letters to the Chairmen of the Appropriations Committees identifying the amount of funds the President is requesting for the Central Intelligence Agency. These Chairmen annually have responded in a classified letter to the Director of OMB indicating Congressional action on this request.

I shsould emphasize that the classification of intelligence budget information does not mean that Congress is uninformed about the cost, purposes, results, and effectiveness of U.S. intelligence activities. The Director of Central Intelligence testifies annually on the Intelligence Community budget before both the special oversight subcommittees of the Armed Services and Appropriations Committees. The Assistant Secretary of Defense for Intelligence, the Director of the National Security Agency, the Director of the Defense Intelligence Agency, and representatives of the Army, Navy, and Air Force also testify on their budget requests for intelligence.

The second difference in OMB's examination of intelligence activities in comparison to most other non-intelligence activities is related to the OMB joint review with the Department of Defense. For those intelligence activities of the Defense agencies—Defense Intelligence Agency and National Security Agency—and of the Military Departments, OMB participates in a joint review of the budget requests with the Office of the Secretary of Defense.

Let me briefly describe this process. OMB is a formal participant in the joint budget review and plays an informal role throughout the entire Defense program and budget cycle. An outline of the program and budget review calendar is as follows:

January.—The five year Defense plan is updated by the Defense Comptroller staff to reflect decisions made in the just completed budget review.

February.—The Secretary issues Planning and Programming Guidance, including fiscal levels, to the Services for preparation of the next five year plan. These planning levels have historically been higher than those identified in the President's Budget. While OMB has no formal role at this stage, there may be input from the OMB Director to the Secretary regarding appropriate fiscal levels.

March-May.—Based on the Planning and Programming Guidance, each Service submits a Program Objectives Memorandum which proposes a five year force structure and resource plan.

May-August.—The Program Objectives Memoranda are reviewed by the Office of the Secretary of Defense staff, principally the Program Analysis and Evaluation staff with inputs from other components of the Office of the Secretary of Defense. The culmination of the reviews are Program Decision Memoranda issued by the Secretary to the Services which provide both programmatic and fiscal modifications to the Program Objectives Memoranda. The focus of the May-August review is the whole five year period, and the emphasis is on forces, deployments and operating rates. In general, OMB monitors the process and may introduce or critique issues. OMB staff studies may be reviewed by Defense staff at this time and may form a basis for Program Objectives Memorandum issues as well as budget issues at this stage of the process. The historical OMB role has been to maintain an informal presence, reserving a formal role until later when the OMB Director and the President are personally involved.

September.—The Services prepare a budget submission based on Program Decision Memoranda guidance.

October-December (The Joint Budget Review).—The Services submit budgets for "joint" review by the Office of the Secretary of Defense and OMB staff. The joint review is unique to Defense, involving OMB staff working jointly with the DOD staff in reviewing the Service estimates for the Secretary. The function of the joint review is to (a) price out decisions reached during the preceding Program Objectives Memoranda review; (b) allow the Secretary to reconsider decisions made in Program Objectives Memorandum cycle; (c) introduce new program issues. OMB program issues are formally introduced at this stage of the review process. The decisions made by the Secretary of Defense in the joint review form the final budget submission to OMB.

This basic joint review procedure is adhered to with respect to Defense intelligence activities. It culminates, of course, in the final decisions by the President.

DIFFERENCES IN BUDGET EXECUTION WITH RESPECT TO INTELLIGENCE

There are also some differences in the budget execution phase that, while not unique to intelligence activities, I wish to call to your attention.

First, it is normal practice for OMB to apportion funds based on the appropriation structure that is presented and approved by Congress. Since most intelligence activities are included in larger appropriations within the budget, OMB does not take an apportionment action specifically identifiable to intelligence activities. Nonetheless, all intelligence funds are reviewed by OMB prior to apportionment of the larger appropriation within which they are included.

One exception to this is the Central Intelligence Agency where OMB apportions all funds for this agency as a separate entity.

Second, reprogramming is handled somewhat differently. For a typical agency or department, reprogramming controls are based on line item identification in appropriations. Such identification is absent from most of the intelligence appropriations because of security considerations. I believe, however, that in spite of this difference, significant changes in the use of funds do not occur without our knowledge. In the various reviews in which OMB staff participates throughout the year, the intelligence agencies do report on significant changes in their activities and the financial changes to the President's budget.

Finally, some transfers are made into certain intelligence activities under provisions of the Economy Act (31 USC 686). This Act permits purchase of supplies and service by one agency for another when it is more economical to do so. These transfers are not formally approved by OMB. Again, there is no lack of OMB or, for that matter, Congressional knowledge of these transfers which are reflected in both budget submissions to OMB and budget justification material provided to the Congress.

These distinctions in OMB practices with respect to executions do not, I believe, materially affect the way OMB approaches its responsibilities or the way the intelligence agencies carry out their responsibilities. I do not believe that the types of problems that are being investigated would have been prevented by changes in the way OMB has approached its responsibilities in execution of the Intelligence Community budget. In the final analysis, abuses of authority can be prevented only by ensuring the integrity and capability of the people in the Intelligence Community.

On the other hand, it is certainly possible that some revisions in Intelligence Community budget execution may be appropriate. For this reason, I have directed that the OMB staff review the present practices, the options available for changes in these practices, and the advantages and disadvantages of these alternative approaches.

OMB MANAGEMENT ROLE

OMB's second mjor function is to work with Federal agencies in efforts toward better management.

This rseponsibility is carried out by assisting the Federal departments and agencies in the development of new management systems, such as management by objectives and studies of major policy issues and management problem areas.

OMB monitors the management by objectives program with which you may be familiar. In this program, the objectives of the agencies and departments proposed in discussion with the OMB staff are actively monitored to ensure that important agency and Presidential objectives are being accomplished.

These functions are applied to the Intelligence Community in the same way as the other Federal agencies and departments. OMB staff participate in numerous studies and special reviews of intelligence activities. Director Colby has played an active role in the management-by-objectives process.

OMB LEGISLATIVE COORDINATION

The final role of the Office of Management and Budget is to coordinate the Administration position on legislation. On behalf of the President, OMB works with other elements of the Executive Office of the President and with the agencies to carry out the President's legislative responsibilities, including agency proposals, reports, testimony on pending legislation, and enrolled bills.

The legislative coordination function has several purposes:

It provides a mechanism for staffing out agency legislative proposals which the President may wish to include in his legislative program.

It helps the Executive agencies develop draft bills which are consistent with and which carry out the President's policy objectives.

It is a means of keeping Congress informed (through the "advice" transmitted by the agencies) of the relationship of bills to the President's program.

It provides a mechanism for assuring that Congress gets coordinated and informative agency views on legislation which it has under consideration.

It assures that bills submitted to Congress by one Executive agency properly take into account the interests and concerns of other affected agencies and will therefore have the general support of such agencies.

It provides a means to reconcile divergent agency views.

OMB's legislative coordination function with respect to legislation affecting intelligence activities is no different from that performed in any other area of Federal Government activity. For example, during the last year, OMB in conjunction with other elements of the Executive Office of the President and appropriate agencies has:

1. Coordinated the Executive Branch position on bills affecting the tenure of the Director of Central Intelligence and annuities under CIA's retirement plan.
2. Reviewed draft Department of Defense legislation affecting personnel in the Defense Intelligence Agency and the National Security Agency; and
3. Initiated the legislative clearance process with respect to proposed legislation on the protection of intelligence sources and methods.

CONCLUSIONS

That is a brief overview of our role and the ways in which we work with the Intelligence Community. At this time I will be pleased to answer your questions.

Senator PROXMIRE. How many do you have altogether? How many professionals do you have in OMB?

Mr. LYNN. About 400.

Senator PROXMIRE. What proportion of those are working on the defense budget?

Mr. LYNN. Between 40 and 50, isn't is? Yes, about 10 or 12 percent.

Senator PROXMIRE. About 12 percent?

Mr. LYNN. Yes.

Senator PROXMIRE. That seems to me a low proportion in view of the fact so much of the budget is not subject to careful scrutiny. I mean, the same kind of scrutiny. For instance, transfer payments by and large are quite automatic and wouldn't require the same kind of scrutiny that military procurement would.

Mr. O'NEILL. But Senator, we have those 1,030 assistance programs on the domestic side.

Senator PROXMIRE. Yes, but we are talking about dollars now.

Mr. LYNN. By the sheer number of programs and the line items to review, Senator, there are just a lot more of them over there in the catalog of domestic assistance programs.

Senator PROXMIRE. Now, I have a financial summary here. It says the Federal budget outlays for DOD, as a percentage of—for defense budget outlays as a percentage of the Federal budget, it is 25 percent.

Mr. LYNN. It is a little higher than that. It is 26 cents out of every dollar in our budget for 1977.

Senator PROXMIRE. And you say you have 12 percent of your people working on this?

Mr. LYNN. This is our most popular single chart here, on the inside front cover of the Budget in Brief.

Senator PROXMIRE. You have 12 percent of your people auditing that?

Mr. LYNN. Yes, sir.

Senator PROXMIRE. Don't you fall short by about 50 percent, then?

Mr. LYNN. Well, let's take a look at personnel costs as a total within the budget of the Defense Department. That is a very large proportion of the total. Take a look at retirement benefits as part of the defense budget. That is a very large part of the total. On those things, the amount of review that is done by OMB is small relative to the numbers of dollars.

Senator PROXMIRE. Well, the largest two elements in the budget for defense are procurement and operations and maintenance. Both of those, I would imagine, would take some analysis and some expert consideration.

Mr. LYNN. Certainly.

Senator PROXMIRE. Procurement represents, by far, the biggest element in increased defense spending. It goes up by 46 percent between 1976 and 1977 in military procurement. It is a very, very big increase. How is this justified in view of the general restraint on the budget overall, and in view of what appears to be a fairly static and maybe even a reduction in nondefense spending?

Mr. LYNN. We can talk about expenditures for other areas, but let me address myself to defense. The President said, when he announced on October 6 that he wanted to moderate the growth of Federal spending to make room for increased tax reductions for the American people, that he would look at the defense budget from two standpoints. First, what kind of a defense budget does it take to make this country secure and not number two. Second, on the other hand, like every other program—and the President said this again in his budget message—we would be scrubbing it to see where we can take waste out. I believe he has done that in this budget. Now, taking a look at why it goes up, one of the reasons is that we are now coming into the production phase of a number of programs which have already been authorized by the Congress in the past. Therefore, we come into the production runs on the F–15, and we are coming into the production of the Trident. We have other production schedules on tanks, for example, that have come along, and frigates in the Navy and other things of that kind. The increase is not all now starts. There are some new starts, but they are new starts that were looked at carefully item by item by the President, and he felt that it was necessary for us not to become number two.

As a budget director, I sincerely wish that first we could get mutual arms reductions, and second, I wish technology would remain constant. It would be nice if once you reach a number of certain kinds of weapons, that would be it. If it were only that, and updating them from time to time, you could save a lot of money. But, I am afraid that isn't the way the rest of the world works. Technology keeps moving. In order to keep secure, you have to move with that movement.

Senator PROXMIRE. Well, of course we do, and this is a matter of judgement and it is very, very hard for us to come to a conclusion on this, because we just have different views. For instance, I think the B–1 bomber was obsolete years ago. We are going to be spending an enormous amount on that in the coming year, to have both the B–1 bomber and the cruise missile seems to be a duplication, but——

Mr. LYNN. I have a hunch you will be getting into that question very deeply when defense comes before you.

Senator PROXMIRE. We will be. As I understand, the President cut roughly $28 billion in the budget and said that would be spread evenly. How much was taken out of defense?

Mr. LYNN. $4 billion, directly and another $700 million in disposition of unnecessary strategic stockpiles. So, it is $4.7 billion, or $4 billion, depending on how you look at it.

Senator PROXMIRE. How can this be, in view of the fact the defense budget was increased as much as it was, and the rest of the budget was decreased?

Mr. LYNN. First of all, as I said, there was an increase. I gave you the reason for that increase. But, it was an increase from where we were going, in getting to the $423 billion. In other words, looking at our projections on what the growth path would be unless there were these reductions, there was $4 billion in savings. This has to be an estimated number, as are many other things. But, I could give you a detailed list of those. They are provided in the reconciliation——

Senator PROXMIRE. Does that mean the Department of Defense was asking for $112.7 billion plus?

Mr. LYNN. I think it is wrong to say asking for, because many of these reductions were worked out jointly with them. I think you are aware of the budget process in defense. It is a matter that goes on all year long. We work side by side with them during the year. So, there is no exact one figure you can work from. But, these are savings from what would happen if you did business on an "as-is" basis in defense. And I can run through the list of some of the major items, if you care for me to.

Senator PROXMIRE. Well, somewhere, I have it here. And I guess the total civilian personnel in the Defense Department—and I understood you to say that that had been reduced—but in the first place, the total personnel in the Defense Department is more than in all the Government agencies combined, leaving the Post Office aside. It is enormous.

Mr. LYNN. I think that is right.

Senator PROXMIRE. Now, between fiscal year 1975 and fiscal year 1976, that changed very little. It went from 1,078,000 to 1,058,000, and then it goes down a little bit in fiscal year 1977——

Mr. LYNN. Are you dealing with the total full-time, or permanent employees? Just so we are working from the same sheets——

Senator PROXMIRE. I am working from a sheet here labeled "Fiscal Years 1977, Department of Defense Budget: Defense Employment Outlook for the End of the Year in Thousands."

Mr. LYNN. Yes, that should be the total. But you are above it. They aren't the same as the figures we have.

Senator PROXMIRE. These are Pentagon figures. This is from the Pentagon.

Mr. LYNN. Well, we will have to devise for the record some kind of reconciliation. I think you are including civil, aren't you, civil functions, as well as military functions, like Corps of Engineer functions?

Senator PROXMIRE. I am including the Army, the Navy, the Air Force, the defense agencies.

Mr. LYNN. But are you including nondefense functions, like Corps of Engineer projects for building canals and so on?

Senator PROXMIRE. I am told no. It is from a news release from the Department of Defense.

Mr. LYNN. I have a hunch——

Senator PROXMIRE. It is military only.

Mr. LYNN. It is military only?

Senator PROXMIRE. That is what I am told.

Mr. LYNN. We will have to have a reconciliation.

Senator PROXMIRE. Well, I see there is another rollcall vote. I am going to have to leave. Did you have any further comments?

Representative BROWN of Michigan. No.

Senator PROXMIRE. Unfortunately, Senator Humphrey couldn't stay. I want to thank you very much. All of us have properly praised your intelligence and ability. We appreciate it very much. I understand that maybe Senator Humphrey and Senator Kennedy will return. So, could you wait a few minutes?

Mr. LYNN. Yes.

[A brief recess was taken.]

Senator KENNEDY [presiding]. The committee will come to order. I am sorry, Mr. Lynn, to have been absent during your formal presentation and during the exchanges which you have had with the other members of the committee. But I want to express my appreciation for your presence here, and your willingness to comment on some matters of importance. I couldn't fail to let this opportunity go by without raising with you an issue which I am very much concerned about, and I feel that the American people are going to become increasingly concerned about, and that is equipping our regulatory agencies in the health area with the kind of resources and manpower and mandates for adequate protection for the American public.

We have seen, during the course of very extensive hearings on the Food and Drug Administration, that in spite of some administrative difficulties and complexities, essential review and followup and oversight by that agency in the area of drugs is not taking place.

One of the matters that we have found in our own oversight of the drug area is that after the use of various drugs over a long period of time, the drugs are having a very significant and dramatic impact on the health of the American people. I can mention one drug as an example, premarin, which has been on the market since 1942. It passed the test at that time. But there was no follow-up by the company or industry—and there is nothing that compels them to do so. The FDA doesn't have the resources for an ongoing and continuing review. Yet, recent data in the New England Journal of Medicine show a direct relation between that drug and cancer of the uterus and cancer of the breast. And similarly, during other very important testimony we heard last week, the use of some birth control pills caused increased heart problems, increased lung problems, liver problems, hypertension, and so forth, which are dangerous in and of themselves.

Now, the Food and Drug Administration has neither the congressional mandate, which is our responsibility, for this kind of oversight, nor the resources to protect the public in areas like this.

Another area of concern is the artificial colorings and artificial food additives. We have had testimony from parents and from doctors about the relation between artificial food additives and hyperactivity of children. I think we are going to find that the various compounds being added to the American diet, which are being put onto the American table every single day, which are going into the American bloodstream—these substances may seem safe and efficacious and meet the requirements at the beginning, but I think we are going to find they have a profound and harmful impact in terms of the health of the American people.

The only way we are going to protect the public is if the FDA has the resources and congressional mandate to do the job. At this particular time, and we have spent a lot of time investigating the problem, we must conclude the agency does not have it.

Also, Congress is about to give the Food and Drug Administration authority over medical devices. We have passed the legislation in the Senate. It is going to pass in the House. The administration supports it. The bill will provide a whole new area of jurisdiction for the Food and Drug Administration to review. As you know, it is generally assumed by the American people that when a medical device is implanted in the body, either the FDA or someone else has reviewed it and looked at it and found that it was safe and efficacious. That is not the case at the present time. Thousands of American women have actually died because of the use of IUD's. A number of individuals had serious complications with the Dalkon shield, which was one of the most widely used IUD's in America, but we were able to get something done on that. The medical device legislation will reinforce these efforts. It is going to pass the House, I would think, in the next few weeks.

We are also working on a new Food and Cosmetic Act, which will provide additional responsibilities to FDA in the area of cosmetics, food processes, and food labeling, to insure adequate new protections for the consumer. That is going to be enormously important as an area of responsibility. We can look back over recent times and see the botulism problem and other kinds of health questions, which hopefully we will be able to remedy.

Now, I personally don't believe that at the present time the Food and Drug Administration has the resources or the manpower or the scientific expertise to protect the American public. Dr. Rousher, the head of the National Cancer Institute, has criticized the submissions by many major drug companies—submissions of animal data and also on clinical data affecting human beings. We do not have the ability and the resources to set up the requirements or do the policing and inspections that are necessary to insure that scientific data are accurate and that the American public is being protected.

That is not the only area that we are concerned about. The EPA, in terms of insecticides and pesticides, is running into a similar kind of problem. And this is based on direct testimony we had before our committee.

There is an enormous potential for serious health problems because of the pollutants of the air, the water, and food. We must insure that we have protection. And the FDA is the only way to do this. Yet, their increased budget request was turned down by OMB. They got a modest increase of $3 million in this year, which isn't even enough to take care of the cost of living.

Mr. LYNN. There is an 8.3 percent of an increase.

Senator KENNEDY. Well, I am talking about——

Mr. O'NEILL. Those are budget authority numbers.

Senator KENNEDY. My figures are from the HEW briefing we had.

Mr. O'NEILL. Senator, the budget authority figures for fiscal year 1975, 1976, 1977 for salaries and expenses—that is leaving buildings and facilitates out of it—are $199.9 million, $207.8 million, and $223.1 million.

Senator KENNEDY. Well, I am quoting from the figures that were given at a HEW health briefing. I would be glad to have that put in the record. It is a bare minimum, in any case.

Mr. LYNN. But, Senator, that isn't really the point. That is beside the point. They have to have the resources to do the kinds of jobs that are required, and certainly whether it is the President of the United States speaking or whether it is Jim Lynn talking, of course they do. And to the extent this has a strong bearing on health—and your committee has been conscientious in looking at this—you will see complete cooperation from the administration. There is a strong feeling within HEW that on the preventive side of health, there are things that really have not been looked at before and there are some things that have to be looked at more carefully. This is undoubtedly one of them. It is another example of how technology and scientific development are the very things that make our lives better, but at the same time we have to take a hard look at it, to see that the adverse effects not outweigh the positive. I agree totally.

The only thing I would ask, as we approach the budget for an agency, is that we do two things. One, let us not always assume that a requested number is the appropriate number. I was in departments and agencies for some 6 years—Commerce for 4 years, and at HUD for 2 years. And I have to say to you that even when you, as head of the department, conscientiously try to scrub the requests from below, you need help. I found that OMB helped me in that regard. So I would like to see us ask whether, instead of having everything just increase, there is somewhere else where the agency can do the job more efficiently. Look at that first. I don't knew whether there is. There might not be. But, that is a question that should be asked.

The second thing I would ask—and I have no idea of the answer, well, I shouldn't say I have no idea, but I am not as expert as your people on the committee are—the second thing I would ask is what's the magnitude of the problem. Let's fit the remedy to the magnitude of the problem and got the right balance of responsibility as between what the private sector has to do, and under what kinds of penalties, as against what we do in the Federal Government. And that is just generally the approach I would like to follow.

But, as far as identifying problems here and showing health risks, you will find complete cooperation from the administration.

Chairman HUMPHREY [presiding]. Could I just put a few questions in the record here? There is a vote and if you want to follow up, you may. I mentioned to you earlier about the impact of the budget on State and local governments. I have some questions I want to place in the record. And we will see that you get a copy of these questions and so will Mr. O'Neill.

Mr. LYNN. Oh, I want to look at them personally.

Chairman HUMPHREY. All right, sir. I also want to call to your attention that the staff of JEC prepared a list of possible budget savings and made estimates of the amounts which would be saved by 1981, if they were adopted. These were discussed in the December staff report of the current services budget, with which I am sure you are familiar. I would like to ask you to comment on each of those possible budget reduction measures as to which of them would have administration support and which would be included in the President's budget next year, Mr. Lynn, and our own estimates of potential savings, as to whether they are accurate. And if you could do that, we would like to have that information before we publish the transcript.

And then on the current services budget, I do have some questions here that were related to the Congressional Budget Office, which prepared an updated comparison on the current services budget for a number of fiscal years. I was hopeful that we would be able to include in the budget a table dealing with Presidential recommendations dealing with current services budget estimates.

We would like to have you to prepare for us a table, comparing the Presidential recommendations with current services estimates.

Mr. LYNN. To do that on a full-scale basis, the way we did in December——

Chairman HUMPHREY. I mean for prospective——

Mr. LYNN. No, I understand, but what I am saying is we will have to get together with your staff on the degree of detail. I forget how many thousands of hours it took to do the current services budget, but it did take a long time.

Chairman HUMPHREY. Well, we don't want to have unnecessary time spent.

Mr. LYNN. But, I trust we can come to agreement as to the kinds of things you need in this regard.

Chairman HUMPHREY. There is an article, Mr. Lynn, that was published recently by Mr. Palmer and this appeared in the Washington Post. Without objection, I will place the article in the record at this point.

[The article follows:]

[From the Washington Post]

GOVERNMENT GROWTH IN PERSPECTIVE

(By John L. Palmer [1])

It now appears that the size and growth of government is going to be a major issue in elections at all levels in 1976. This is a debate that should be welcomed. But if it is to be constructive, it must be well grounded in fact, and much of the discussion to date appears to reflect some basic misunderstandings about the rate of growth of federal expenditures over the past two decades and the likely contribution of income security programs to their continued expansion.

It is well known that federal expenditures, led by the near explosion in income security program outlays, have grown rapidly over the past two decades even after making allowances for inflation. What is less well known is that this growth did not serve to increase the size of the public sector of the

[1] The writer, who until last fall was director of HEW's Office of Income Security Policy, is a senior fellow at Brookings Institution.

economy relative to the private because federal expenditures expanded no faster than the overall economy as measured by potential gross national product (GNP).

Actual federal expenditures are expected to be in the order of 23 per cent of GNP for 1976, up from a level of 20.5 per cent in 1970. But this recent increase neither reflects nor necessarily portends an upward trend in this figure. The reason is that the current recession has the dual effect of temporarily raising federal expenditures above and lowering GNP below their respective longer run growth paths. If the economy were operating at the full-employment level of 5 per cent ,federal expenditure would be about 20 per cent of GNP. Outlays in major income security programs (such as unemployment insurance, food stamps, AFDC, and Medicaid) are very sensitive to the aggregate unemployment rate. Thus, they will be over $20 billion higher in 1976 than they would be if unemployment had remained at the 5 per cent level of 1973. Similarly, estimates of GNP are on the order of $150 billion less than it would be if we were at this same level of more full employment. As the economy moves out of the recession these temporary effects on GNP and federal expenditures will be reversed and the ratio of federal expenditures to GNP will decline.

Some of the misunderstanding that seems to exist about changes in the size of the federal budget relative to GNP, or of the public sector relative to the private sector, may stem from President Ford's budget message to Congress last February. In this message he stated that:

"Spending by all levels of government now makes up a third of our national output. Were the growth of domestic assistance programs to continue for the next two decades at the same rates as in the past 20 years, total government spending would grow to more than half of our national output . . . It is hard fact, easily demonstrated by simple extrapolation."

How can this projection be reconciled with the trend of a relatively constant ratio of federal expenditures to GNP over the past two decades? The crux of the matter is that for two major reasons it is misleading to use a simple extrapolation to project the future rates of growth of income security programs. (I am reminded by a colleague that back in the 1920s two commissions were created and charged with projecting the population growth of Los Angeles and California, respectively. They worked independently and their results indicated that by today the population of Los Angeles would exceed that of California). First, such an extrapolation does not take into account the temporary effect of the recession. But, more important, the very rapid rate of income security programs over the past two decades was caused in large part by conditions that cannot replicate themselves for the next 25 years. For example:

(1) A major contributor to the explosion in the AFDC and Medicaid rolls in the mid-and late 1960s was the increase in the percentage of people eligible for the programs who participated in them. These are estimated to have gone from below 60 per cent to above 90 per cent, so there is little room for further growth for this reason. Also, the vast increase in the levels of federal outlays under the food stamp program and those programs assisting the low income aged, blind and disabled were due primarily to the legislative changes which made these programs universally available with nationally uniform benefit levels (and in the latter case shifted some of the funding to the federal government from state and local governments). Continued growth in these programs is largely dependent upon increases in the size of their eligible populations due to demographic forces or legislated increases in benefit levels. The combined effect of both of these factors is unlikely to result in a growth rate even as high as that of GNP.

(2) Over the past two decades the largest single item in the federal budget, Social Security benefits, have had their levels more than doubled by Congress, even after adjusting for inflation. In view of the projected sizeable deficits in the Social Security trust funds and the increasing adequacy of future benefits already provided for in the current law, it is very doubtful that Congress will vote increases in Social Security benefit levels over the next 25 years that rise even as fast as GNP.

This indicated slowdown in the growth rate of major income security programs is borne out in a recent report prepared by the new Congressional Budget Office. It shows that spending for these programs at both the state and federal level grew from 3.4 per cent of GNP in 1955 to 9.4 per cent in 1975; whereas, projecting to the year 2000, expenditures will still be 9.4 per cent of GNP even if benefits in all these programs grow with inflation, and will rise to only 10.4 per cent of GNP if benefits are actually increased through legislative actions to keep pace with the growth of wages in the economy. Since such a rapid expansion in income security programs over the past two decades was necessary just to maintain a trend of overall federal outlays as a relatively constant percentage of GNP, this implies that the ratio of total federal outlays to GNP would fall if other areas of the federal budget do not expand even faster than they have over the past two decades.

What are the implications of all this for the debate over the growth of government? There are several possibilities.

First, the debate may actually be over whether to reduce or maintain federal expenditures relative to GNP, not whether to increase them. Of course, this is no less a legitimate debate than the one most people may think is being engaged. It is important to ask ourselves whether a decreasing, constant or increasing share of the additional resources provided by economic growth should be allocated through the federal budget.

Second, income security programs have become a dominant factor in the federal budget and are not likely to decrease in importance in the foreseeable future. This should give us serious pause to consider both the extent to which we wish to continue this emphasis within domestic social assistance and the precise way in which we carry it out. Concerning the size of these programs, it is well to remember that, unlike direct government purchase of goods and services, income transfers do not use up any of the resources represented by our GNP; they simply transfer within the population some ability to purchase these resources. While this may be of small solace to taxpayers solely concerned about how much the government is taking out of their paychecks (and perhaps ignoring how much it is giving back to their parents or will give to them in Social Security benefits), it should be of considerable significance to those concerned about the total control over the specific use of resources that is being exerted by government rather than individual consumers. The trend of an increasing share of the federal budget going to income security programs is in this sense a trend toward a decreasing share of federal control over the specific use of the overall resources of the economy.

In considering the particular way in which we provide income assistance, we should heed the urging of President Ford, also from his budget message: "The growth of these domestic assistance programs has taken place in a largely unplanned, piecemeal fashion. This has resulted in too many overlapping programs, lack of coordination, and inequities. Some of the less needy now receive a disproportionate share of federal benefits, while some who are more needy receive less. We must redouble the efforts of the past five years to rationalize and streamline these programs. This means working toward a stable and integrated system of programs that reflects the conscience of a compassionate society but avoids a growing preponderance of the public sector over the private."

Presumably part of the President's motivation in his earlier quoted statement about the implication of the future growth of domestic assistance was to dramatize the concern raised by the rapid expansion of income security programs. As expenditures for these purposes continue to increase, it becomes even more costly to neglect or postpone needed reforms. It would be most unfortunate, however, if false impressions about the contribution of income security programs to "a growing preponderance of the public sector over the private" prevent us from spending the additional marginal sums that are inevitably required to bring about sound structural reform in a compassionate manner.

Perceptions about the relative size of federal expenditures may be temporarily jaundiced by the current combination of recession and inflation which have resulted in rising taxes and declining purchasing power for the typical household, but we have to look beyond this to other facts. Expenditures by state and local governments over the past two decades, unlike those of the federal government, have increased substantially faster than GNP, thus causing an overall increase in the relative size of the public sector. Also, the more modest growth rate of the federal budget does not reflect the extent to which it has expanded its direct influence over the allocation of resources through often inefficient regulatory processes. I suspect that the public should place greater emphasis on these factors, and less on the dollar flow through the federal budget, as major contributors of their growing unease with government. Maybe it will as the recession abates.

Chairman HUMPHREY. Mr. Palmer's article is a very thoughtful article about growth. And I would like to ask you to look at this article and if possible, Mr. Lynn, to submit a response to it.

Mr. LYNN. Certainly.[1] I think it would be more in the nature of a compliment, sir.

Chairman HUMPHREY. Have you read the article?

Mr. LYNN. Yes; and it is quite a thoughtful article. We might have a little different emphasis here and there, but it wouldn't be a response; it would simply be a supplement.

Chairman HUMPHREY. I think we will adjourn the hearings and any additional questions, if any, will be sent to you and we will communicate with your staff.

Mr. LYNN. Thank you. It has been a pleasure to be here.

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF HON. JAMES T. LYNN TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN HUMPHREY

CURRENT SERVICES BUDGET

Question. In November, OMB prepared estimates of the cost in fiscal 1977 of maintaining the present level of real Federal services. These estimates, which have been termed the "current services" budget, have been most helpful.

What would also be very helpful would be an updated set of these current services estimates and a comparison with the President's recommendations. In that way we could identify precisely where the President has recommended policy changes. I wrote and asked you to prepare such a comparison. You have replied that time constraints and the fact that not all fiscal 1976 appropriations are completed prevent your doing so.

However, the Congressional Budget Office has prepared an updated comparison. May I ask whether you consider their numbers accurate and their comparison fair. That is, since you have not been able to supply this table yourself, will you give the CBO numbers your endorsement?

If you do not consider the CBO estimates adequate, then you would be well advised to give us your own, despite the difficulties involved. The purpose of requiring the current services budget was to facilitate the identification of the President's proposed policy changes, and we intend to proceed to make such an identification as best we can.

In future years, will you be able to include in the budget a table comparing Presidential recommendations with current service estimates?

Answer. We have examined the five-year projections prepared by the Congressional Budget Office using a current services budget concept. The document itself does not contain sufficient detail to permit a full analysis and understanding of the estimates. In addition, it is not always clear what conceptual approach the CBO has followed. However, we have recently received a staff working paper which provides supplementary information and we will analyze their projections in light of this information. In the meantime,

[1] The response to be supplied for the record was not available at time of printing the hearings.

it is difficult for us to know whether the numbers are ones we would agree with. We would be happy to get in touch with the JEC staff when we have received this additional information from CBO and have had a chance to analyze their estimates on that basis. This analysis should provide an adequate understanding of any differences in approach between the CBO and OMB, and this would be more useful than an attempt by OMB to provide updated current services budget estimates. As you are aware, the CBO itself has been working for several months on their projections and we do not believe that an additional set of current services projections by OMB at this time would be justified in view of the very substantial workload involved.

THE BUDGET AND STATE AND LOCAL GOVERNMENTS

Question. President Ford has been very critical of Ronald Regan's proposal to return $90 billion worth of expenditures to the State and local governments on the grounds that it would be an excessive burden to impose on already overused regressive taxes. Yet the President's own budget offers a number of "behind the scenes" changes that will result in higher costs for State and local governments, and thus higher state and local taxes. Can you tell us the additional cost imposed upon State and local governments of each of the following proposed changes?

(1) Social Security tax changes that will require higher contributions from State and local governments.

(2) A reduction in the Federal government support of water pollution abatement programs with no offsetting change in the Federal standards.

(3) Cutbacks in mass transit operating subsidies that will force additional expenditures by local governments.

(4) Changes in the contributions made by State and local governments to the Unemployment Compensation Trust Fund.

(5) Cuts in Federal assistance for management and planning without an offsetting reduction in Federal requirements that these activities be carried out on a region-wide basis.

Answer. (1) The President's proposed increase in Social Security taxes is not scheduled to go into effect until January 1, 1977, at which time the economy should have improved substantially, with a corresponding improvement in State and local government finances. We believe it is appropriate that State and local governments, like other employers, pay the employer share of social security contributions for their covered workers. The increased tax rates would cost State and local governments about $400 million a year once they are in effect.

(2) Using the 1974 "EPA Needs Survey" as a base, the remaining costs for constructing all identified municipal facilities that may be eligible for federal support under P.L. 92–500 after complete obligation of the current $18 billion authorization, are estimated to be $424.2 billion. Under current law, the Federal share would be $318.1 billion, with a non-Federal share of $106.1 billion. The program reform measures proposed by the Administration would reduce the total remaining program cost to $118.7 billion, to be financed with $50 billion in additional Federal funds and $68.7 billion in non-Federal funds.

The major factor in this reduction is the elimination of treatment for storm water discharges as a type of project eligible for construction funds, which assumes that the necessary degree of pollution abatement from these sources can be achieved by management and other non-structural techniques.

It should be noted that Federal water pollution control standards apply to only one type of facility—municipal sewage treatment plants. Contrary to the statement implicit in your quesions, none of the proposed changes would affect Federal funding for projects designed to meet existing Federal standards for the existing population. Rather, the Administration's proposals were designed to make this area top priority for Federal funding. The project features affected by the proposed changes—excess reserve capacity, construction of new sewer systems, etc.—are ones which are determined by State and local governments for which there are no Federal pollution control standards.

In summary, the thrust of the Administration's proposals is to focus Federal funding on project features designed to meet Federal standards, and to return to local communities the financial responsibility for project features necessitated by State and local decisions, including growth and development policies. The Environmental Impact Statement on the proposed legislation will be available shortly, and will contain additional detailed information on these issues.

(3) Funds for the mass transit formula grant program go from $300 million in 1975 to $500 million in 1976 and $650 million in 1977. The formula grant funds can be used for operating expenses or capital investment. The capital grant program also is increased (by $25 million to $1,125 million from 1976 to 1977). Therefore, federal funds available to cities and States for mass transit in 1977 will increase by $175 million over 1976. The Administration is proposing that the $650 million formula grant programs be changed to permit a maximum of 50% or $325 million of the funds to be used for operating subsidies. This would compare with about $400–$450 million of Federal funds used for operating subsidies in 1976. The other $325 million of formula grant funds will be available to the cities for capital investment (e.g., buses). The 50% limit will return to local transit systems—and the governments involved with them—the responsibility for appropriate fare structure, sound management, and efficient operations. If improvements in these respects take place, there should not be a need for a substantial increase in State and local government spending.

(4) State and local governments do not pay taxes into the unemployment insurance trust fund. Rather, they later reimburse the fund for unemployment compensation costs that arise from their workers actually collecting benefits. Thus the proposed increase in unemployment insurance taxes does not impose additional costs upon State and local governments. The President's proposal to extend regular unemployment insurance coverage to save 4.8 million State and local government employees not now covered will, however, result in increased cost. The President feels that covering these workers is an important improvement in our unemployment insurance system and that State and local governments—like other employers—should pay for the coverage of their workers. The proposal would not take effect until late in 1977, when again, an improved economy and an improved State and local fiscal situation should ease its effect. The full-year cost is estimated at about $300 to $400 million.

(5) Planning and management by State and local governments are activities that may be paid for from the consolidated grants recommended in the budget (such as the community development block grant program and the proposed financial assistance for health care program). Hence, there is less of a need for separate, categorical funds earmarked for planning, and these can be reduced. Consolidated funding will give State and local governments greater opportunity to follow their own needs and priorities in setting a balance among planning, management, and direct program activity. Because funds will be available under the consolidated grants, there should be no additional cost to State and local governments. Indeed, the efficiencies resulting from consolidation should lead to savings. The President is concerned about excessive Federal regulatory requirements—in the planning field as elsewhere—and would welcome suggestions for improvement from the Congress.

HOW TO ACHIEVE BUDGET SAVINGS

Question. I may be upset by some of the erroneous statements which are made concerning the size of government and the growth of spending, but this does not mean I am unaware of the need to control spending and to achieve savings and efficiency in government. At my urging, the staff of the JEC has prepared a list of possible budget savings and made estimates of the amount which could be saved by 1981 if these were adopted. These possible savings were discussed in the December staff report on the current services budget, with which I am sure you are familiar.

I would like to ask you to give us your comment on each of those possible budget reduction measures. Which of them would the Administration support? Which were included in the President's budget this year? Are our estimates of the potential savings reasonably accurate?

Answer. The following are our comments on the possible reductions discussed in the December JEC staff report.

National Defense

The Administration supports a reduction in DOD civilian personnel levels by 25,000. This proposal is contained in the 1977 budget and would result in an estimated outlay savings of $100 million in 1977 and $400 million in 1978. The estimated savings from the 40,000 reduction assumed by the JEC staff total $600 million in 1977. It seems unreasonable to expect additional $500 million in savings from an additional 15,000 reduction in civilian personnel levels.

As for the rest, the JEC staff report estimates savings based upon a list of reductions it assumes could be made. No rationale for the reductions is provided other than statements to the effect that "there is now considerable evidence that . . ." and exhortations to the effect that savings could result from the "elimination of wasteful practices and activities." If these reductions were desirable, they would have been proposed in 1977. In short, the JEC recommendations offer no evidence to demonstrate that the assumed cuts could be implemented without jeopardizing our security.

Regulatory Agencies

The Administration has proposed legislation to restructure regulatory functions of the ICC and CAB (and other regulatory agencies as well) to make them more efficient and more responsive to today's needs. The Budget reflects the reforms contained in those legislative proposals, and when enacted, will help reduce inflationary pressures by enhancing the efficiency of our transportation systems. The Administration does not currently propose the phaseout of the Interstate Commerce Commission (ICC) and the Civil Aeronautics Board (CAB).

The Budget savings reflected in the Committee print are relatively accurate for the ICC if it were to be phased out. The estimates for the CAB apparently include the elimination of nearly $80 million of subsidy payments to airlines. It is not clear whether the subsidy program should be eliminated with the phasing out of the CAB. Staff costs of the CAB are about $20 million annually, and that amount would be saved if this agency were phased out.

The cuts in spending are minor when compared to the economic savings that will be realized upon enactment of the Administration's regulatory reform proposals.

Subsidy Payments—Ship Construction and Operation

The budget does not propose the elimination of either shipbuilding or ship operating subsidies, nor does the Administration support their elimination. The ship construction program is intended to help improve the international competitive position of the U.S. shipbuilding industry through payment of current differences in price between domestic and foreign construction. The program aids in the maintenance of a strong U.S.-flag fleet for foreign trade by providing support for the replacement of overage U.S.-flag ships engaged in foreign trade, and by requiring U.S. registry of subsidized ships. Ship operating subsidies are paid to offset the higher cost of operating a ship under the U.S. flag rather than under a foreign flag. This helps promote the maintenance of a U.S. merchant marine capable of providing essential ocean shipping services.

The estimates for these programs are approximately correct. However, $250 million might be a better figure for 1980 and 1981 for your ship construction proposal.

Export-Import Bank Loans

The Administration has not proposed and does not support elimination of Eximbank lending. Such lending offsets the lack of commercial credit in critical areas, particularly the longer maturity ranges, and keeps US exporters on a par with foreign competitors who have access to subsidized credits from their own governments. If an international agreement can be reached to eliminate self-defeating subsidized competition among official export credit agencies, Export-Import Bank lending at below-market rates would no longer be necessary. The 5-year estimates of potential savings are somewhat high, especially the 1977 estimate. Our estimate for 1977 would be only a fraction of yours.

Impacted Area School Aid

The Administration is proposing reform of the Impact Aid program in the FY 1977 Budget. However, the Administration's proposal would go beyond merely limiting savings to the elimination of the "hold-harmless" provisions. The Administration's proposal would limit payments for children whose parents both live and work on Federal property, for certain special provisions and for construction.

The cost estimates for the "hold-harmless" provisions are not verifiable by us.

Federal Retirement Benefits

The Administration agrees that the current overadjustment for cost-of-living increases is inappropriate, and in the Budget recommends the overadjustment be eliminated. Our estimates of the savings to be achieved are slightly lower than yours in 1977, but are lower by a large amount—nearly $½ billion—by 1981. The differences may result from differences in economic assumptions.

Social Security

The Administration agrees that the unintended double adjustment for inflation is inappropriate, and in the Budget promised to propose legislation to remedy it. The legislation will be submitted by summer.

Tax Reform

The estimates of receipts for FY 1976 and 1977 in the budget, as well as the 5-year projections contained in Part 3 of the budget, reflect the President's tax proposals. These proposals are explained in some detail in Part 4 of the budget. Special Analysis F—"Tax Expenditures"—contains a section on proposed changes in tax expenditures.

With respect to the specific tax features referred to in the JEC staff report:

(1) The Administration does not support:

(*a*) Elimination of the Domestic International Sales Corporation (DISC) provisions. (The expected revenue loss from DISC in 1981 is $1.7 billion not $2.0 billion. See the projections of tax expenditures in "Five-Year Budget Projections, Fiscal Years 1977–81," Congressional Budget Office, January 26, 1976.);

(*b*) Abolishing the deferral of income tax on earnings of U.S. corporations generated abroad by foreign subsidiaries. (Note that the Tax Reduction Act of 1975 further limited the deferral provision in the case of subsidiaries in "tax haven" countries.);

(*c*) Elimination of the Asset Depreciation Range system;

(*d*) Reclassifying payments to foreign governments for mineral extraction rights as royalties rather than taxes. (Note that the Tax Reduction Act of 1975 restricted the use of foreign tax credits from foreign oil extraction income.

(2) The Administration has proposed making permanent the provision of the Tax Reduction Act of 1975 for a 10% investment tax credit. This proposal is reflected in the Budget estimates.

(3) As a part of general tax reform the Administration has supported:

(*a*) A tax on "minimum taxable income" as a substitute for the current minimum tax provisions.

(*b*) The revised capital gains provisions contained in the Ways and Means Committee 1974 bill.

The revenue effects of these measures are not reflected in the Budget on the assumption that any legislative package of tax reforms finally enacted would, on net balance, neither gain nor lose substantial amounts of revenue.

Representative BROWN of Michigan. Mr. Chairman, before you wind up, when you were here before telling about the tremendous conditions that existed back in World War II, where we had 50 percent of the budget and low interest rates and so on, you forgot to mention we had no inflation.

Chairman HUMPHREY. Well, we had wage and price controls.

Representative BROWN of Michigan. That is true.

Chairman HUMPHREY. But, I am simply pointing out that a deficit does not necessarily make high interest rates.

Representative BROWN of Michigan. No; but I thought you were suggesting we ought to have a massive defense budget.

Chairman HUMPHREY. Oh, no, I am not suggesting that. I just do not buy the thesis, despite my limited economic understanding, that Federal deficits necessarily mean high interest rates. I happen to believe that interest rates are set by banks, just like price-fixing with some relevancy obviously to the market conditions. But I have yet to see the interest rate announced by the Federal Reserve System, which is the public agency, these announcements come from Chase Manhattan Bank or somebody else, and then that is it. I often think that must be looked upon with some interest and concern, because if interest rates have such a tremendous impact on the economy—well, I am going to take this up with Mr. Burns.

Mr. LYNN. And Secretary Simon, too?

Chairman HUMPHREY. Or, yes, definitely.

[Whereupon, at 1:10 p.m., the committee recessed, to reconvene at 9:30 a.m., Wednesday, February 4, 1976.]

THE 1976 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 4, 1976

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

The committee met, pursuant to notice, at 9:45 a.m., in room 318, Russell Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

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

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

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Secretary Simon, you are here in good nature and good humor this morning and it is good to start the morning like this. I hope we can keep it up. I'm afraid that you will see some immigration and outmigration of members today because of many conflicts, but we really appreciate your attendance once again and welcome your presence here.

There are a number of questions, of course, that we will want to raise.

I want to focus just for a moment in my opening statement on the general question of inflation.

In our discussions with Mr. Greenspan and Mr. Lynn last week, a number of the members of this committee, including myself, expressed a strong dissatisfaction with the lack of a Presidential program for bringing unemployment down. I assure you we continue to feel that dissatisfaction. Our feeling is all the stronger because the administration's program, as it appears at least to this member, lacks any anti-inflation policy as well.

I think we have to ask the question what are we buying by keeping unemployment high or by permitting it to be so high? By the administration's own estimate it appears that we are buying a continuation of the inflation rate at or near its present level, not only in 1976, but in 1977 as well. We are paying very dearly in human suffering and getting very little or nothing whatsoever in return. I consider that a rather bad bargain.

The real tragedy is this: We could have less inflation if we brought unemployment down faster. Productivity gains associated with economic growth would at this early stage in recovery—and I underscore the words "early stage of recovery"—would be strongly anti-inflationary. By settling for a sluggish recovery we are sacrificing our strongest weapon against inflation.

I know the argument has been made that moving too rapidly on the unemployment matter would "fuel the fires of inflation." The administration points, with some justifiable pride, to the fact that this past year unemployment has gone down about 1 percent and the GNP has gone up. At the same time that unemployment has gone down and the gross national product has gone up, the rate of inflation has come down. So it appears that as you get the unemployment down, you get the inflation down. If that is the case thus far, I don't see why a more determined effort isn't made to follow the same prescription.

Productivity gains are not the only weapon we are throwing away. Tax policy could be used to fight inflation. We could have tax changes which support workers' real incomes thereby lessening their wage demands. We could have a tax policy which reduces the costs of employment thereby both encouraging employment to grow and prices to hold steady. But does the administration recommend such changes? I suggest it does not. It recommends a social security tax increase, which would eat into the workers' take-home pay, and at the same time raise businessmen's costs.

I recognize, Mr. Secretary, additional financing of the social security system is likely to be necessary in the future. But there are ways to get at that besides just increasng the tax.

I am not convinced that additional financing is a necessity in 1977. As in all of these matters, it is a question of when you should do it. If additional financing is necessary this year, then we must find a financing source that is less damaging to the economy.

Let me ask why the surplus in the social security fund has been declining: Is it because benefits are too generous and the program inefficiently designed? Possibly in part. However, the main reasons for the decline in the surplus is the drop in employment. The unemployed don't pay social security taxes.

The payroll tax increase recommended by the administration would raise $4.4 billion on an annual basis. I have a proposal to offer you this morning for increasing social security tax receipts by considerably more than that amount and doing it in a way which wouldn't raise anybody's tax rates. My proposal is this. Let's get back to full employment.

The committee staff has estimated that if we were at 4-percent unemployment in 1977, social security tax receipts would be as much as $11 to $12 billion higher, using existing tax rates, than they will be at the 6.9-percent unemployment rate which the administration projects.

In other words, the proposed tax increase would yield $4.4 billion: Full employment with no tax increase would yield $11 to $12 billion.

Now, I was a little skeptical of that number at first. It sounded too good to me. The staff pointed out though that not only would nearly 3 million more people be working and paying taxes if we were at full employment, but those already at work would be working more hours and earning more income and paying more taxes. Wage and salary income in 1977 would be about $125 billion higher at full employment than the $1,001 billion projected in the President's budget. This higher income would result in higher social security tax collections and higher income tax collections.

Now, Mr. Secretary, I ask you to have your experts at the Treasury look into this and let me know if the JEC's staff estimates are correct. Please let us know for the record of this hearing how much you estimate full employment would contribute to increased social security tax receipts. Even if it was only half of what my staff has estimated, we would come out way ahead as compared with the administration's tax increase proposal.

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

Under conditions of full employment social security receipts would be about $106.6 billion in fiscal year 1977 or nearly $10.4 billion higher than the actual estimated level of $96.2 billion.

Unfortunately it is not a matter of simply willing that people become employed. The higher projected receipts in the Social Security funds assume that people find jobs in the private sector. To bring this about more quickly than under the path the Administration's forecasting means an even greater overall budget deficit and the danger of another recession sometime in the future as is outlined in my testimony. One cannot look only at the benefits of full employment without examining the costs of bringing about such full employment.

Chairman HUMPHREY. So what I am saying is there are lots of ways to raise money. One way we can get money is to increase the price of goods, and that is what businesses have been doing. Another way is to have greater volume and to keep the prices down, which is what they ought to be doing. One way to have tax receipts up for workers is to have people at work earning more money and more people making money rather than to raise the level of the taxation.

So I would point out that there are ways and means other than those that have been proposed. Regrettably the President's budget—and I feel very strongly about this— did nothing to curb inflation and did less than that to curb unemployment. What we have depended on is what we call those intangible forces of the marketplace that are going to work their will in due time to get us out of the economic difficulties we are in. I agree that in due time, if you can live through it, if it doesn't destroy you, you will make it. But the problem is there are a lot of casualties along the way.

When people are at the rate of unemployment we have today, we are paying a terrible price for our adherence to an economic philosophy which once had its day but which is, in my judgment at least, all over. This trickle-down theory just won't work any more. People can't wait that long any more. Furthermore, the costs of these benefits we are paying out is just unbelievable. I just can't understand how the administration has become so convinced that unemployment compensation, food stamps, and welfare are the answer to our economic problems. I thought there was a time when some of us Democrats thought that was the answer in part, but never in full. Now, it is relied upon I think, as I said the other day, just because the computer can print the checks faster than we used to be able to print them out on a typewriter.

Now, those are my prejudices and those are my concerns. You have heard them all before. They are very sincere and very real.

Now, we would like to have you tell us how you feel we are going to overcome this problem of unemployment, this lag in our production. How we are going to strengthen this rather fragile recovery that is now underway? So with that as an opener, why don't you proceed with your statement, Mr. Secretary.

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY, ACCOMPANIED BY SIDNEY L. JONES, ASSISTANT SECRETARY FOR ECONOMIC POLICY

Secretary SIMON. Thank you very much, Mr. Chairman. I will respond to that social security matter you raised. There is no doubt that it is a financial fact that full employment today or increased employment could obviously help as far as the social security fund is concerned and that the declining employment in the past year and one-half has hurt as far as the revenue of the trust fund is concerned.

However, we have been spending more than we have been taking in and running a deficit operation with the trust fund. So full employment today would just postpone the day of reckoning, not cure the fundamental problem of the financial integrity of the social security system. But that is just an aside.

You will be delighted to hear, Mr. Chairman, if you haven't seen it, this prepared statement I have in front of me will not be read in full.

Chairman HUMPHREY. Yes, I have your prepared statement. We will, of course, have it printed in full in the record at the end of your oral statement.

Secretary SIMON. Thank you. It is difficult enough to understand without reading it all. But I would sort of summarize as rapidly as I can, Mr. Chairman, this prepared statement that we put together over the past month of our analysis of the current economic outlook and of the policies needed to provide—and I underline this—permanent prosperity and employment. Hopefully it will contribute to a calm, reasoned, and maybe even dispassionate discussion of these issues.

Now, it is obvious that we also support, Mr. Chairman, the same basic goals of sustaining the current output and employment gains, of further moderating the still unsatisfactory rate of inflation, of reducing the unacceptable rate of unemployment, and of correcting the monetary, trade, and investment problems which have periodically disrupted the international economic system. But there can be disagreement about what tradeoffs will be required to achieve simultaneous progress toward all of these goals, about the best mix and timing of fiscal and monetary actions and about the proper time horizon for planning current policies.

A year ago at this time, we were concerned with an economy in the midst of a serious recession. Fortunately, the turning point in the U.S. economy occurred somewhat earlier than anticipated and the pace of recovery during the transition period has been a little bit stronger than expected. Economic historians will likely identify last April as the low point for the recession. Since then, real final sales have increased at an annual rate of 4.9 percent and industrial output has risen at an annual pace of 12 percent after having declined at an annual rate of 10 percent since late 1973. The aggregate pattern of this recovery has matched the pace of earlier cyclical upturns and I believe that expansion will continue throughout 1976 and 1977 if responsible policy decisions are made. Significant progress has also been made in reducing the rate of inflation and as you said in your opening statement in expanding employment opportunities while gradually cutting the overall unemployment rate and in moving ahead on important international monetary and trade reforms. This is an impressive turnaround from the situation at yearend 1974 when construction, personal spending, and business investment were all declining.

Despite the impressive progress of the economy during the second half of 1975 no one can be satisfied with current conditions. An annual rate of inflation of approximately 6½ percent or an unemployment rate of 8.3 percent in December are totally unacceptable.

Furthermore, great concern has developed over the impact of Federal fiscal, monetary, and regulatory policies which have increased the impact of Government decisions on the total economy. Therefore, every economic initiative should be more carefully evaluated to determine: (1) Whether the proposed action is consistent with the Nation's overall priorities and resources; and (2) whether the policy recommended contributes to the long-term achievement of basic goals rather than merely providing temporary relief as we have in the past. Using these two guidelines more effectively would help reduce the constant fine tuning of economic policies and would properly shift the Government's attention to longer term requirements rather than concentrating on "crisis" management. If we fail to apply this discipline, governments will continue to promise more than can be delivered and the chronic Federal deficits reported in 16 of the last 17 years—for the period ending with fiscal year 1977—will persist and the continuation of past trends will eventually make the necessary adjustments even more painful.

As we attempt to further our economic growth and to reduce inflation and unemployment in 1976, current economic policies must avoid creating even more difficult problems for subsequent years. The severe recession of 1974-1975 was a harsh reminder that the costs of serious economic distortions are greater than the temporary benefits provided by excessive stimulus used to achieve short-term goal.

I will not read the next section of my testimony.

Chairman HUMPHREY. What page is that now, Mr. Secretary? The section on "Economic Background and Prospects"?

Secretary SIMON. Yes. But it is important to understand this material as a basis for evaluating our policy recommendations. We anticipate continued economic recovery in 1976 with real output gains of about 6 percent. The rate of price increase in 1976 will probably continue at the level recorded in late 1975 although the figures for individual months may swing widely.

Chairman HUMPHREY. May I please interrupt? You say real output gains of about 6 percent.

Secretary SIMON. Yes, sir.

Chairman HUMPHREY. Is that on the high side or the low side? That is very important.

Secretary SIMON. Well, our estimates in the budget are, I believe, at 6.2 percent for the year. And in looking at the private forecasters, and we look at 20 to 25 of them, they are all in that range. I think the low is 5 and the high is 7 or 8 percent—a couple are at 8 percent but are making different assumptions than in the President's budget.

Now, the rate of price increase for 1976 will probably continue at about the level recorded in there. The GNP deflator increased 8.7 percent. The 1976 figure is expected to be 5.9 percent. That perspective rate of inflation remains a matter of great concern because (1) the personal consumption and business investment decisions are going to be distorted and (2) the overall allocation of resources and general economic stability will be disrupted and (3) the level of inflation continues to ratchet upwards.

Fortunately, the overall unemployment rate has been moving down since the peak of 8.9 percent last spring. Several other encouraging developments in the labor market are occurring: The sharp gain in employment; the turnaround in the average hours worked each week; the gradual improvement in the overtime hours worked; the improvement in the "layoff rate." But, nevertheless, much of our attention is focused on reducing unemployment and continuing to moderate th edisruptive impact for those who have become unemployed.

In general, the economic recovery is moving well into its 11th month of recovery and we believe that our policy recommendations will sustain that healthy recovery without creating unwarranted and unwanted distortions.

Chairman HUMPHREY. What page are you?

Secretary SIMON. The section, on "Economic Policy Background."

Although the prospects for near-term economic performance are favorable, several basic trends require further analysis. Without question, this country has developed the most efficient and creative economic system the world has ever known. It has been particularly responsive in satisfying the consumption demands of our large population and the real standard of living for most Americans has risen sharply during the postwar era.

I then document all of these things which I guess would be, Mr. Chairman, a partial response. I don't mean to be facetious but sometimes we tend to give slogans to our economic policies like "trickle down" and "percolate up" and what have you. And I don't know what the right slogan would be to describe our economy. I just know it is and has been the most efficient system. We have a fundamental disagreement obviously on this——

Chairman HUMPHREY. Right.

Secretary SIMON. A disagreement that these ideals and principles that you say no longer work—well, I just don't buy that.

Chairman HUMPHREY. Well, I don't say they don't work. I say it just depends on how long you last.

Secretary SIMON. Well, it is not a matter of lasting long. Why weren't we considering, when we were creating the economic policies for over the last 10 years, that we were going to have results like this? Now we have to pay a price.

Chairman HUMPHREY. Well, we all have different views as to how this all happened. I grew up listening to my father. My father was the best economist I ever knew. He told me—and he was a retail merchant—if the folks coming in the door didn't have it, we couldn't get it. If they brought it in, we would get our share. I have never forgotten those lessons. They always made sense to us. If those farm people out there in my part of the country haven't got the money, I don't give a hoot whether you graduated from Yale University or whether you have been on Wall Street for 50 years, you still aren't going to make it.

Secretary SIMON. I agree with that.

Chairman HUMPHREY. It is the people, it is the folks that make the difference.

Secretary SIMON. I agree with that.

Chairman HUMPHREY. It is the people that make investments. People aren't going to invest because their father invested and it is an old family heritage. They invest when they think they can make a buck, and they invest when there is a chance people will be customers. There are two kinds of people in economics: Ones that are social visitors and ones that are economic visitors. If you have a lot of money and can afford it, you can afford social visitors: And if you are trying to make it, you have to have economic visitors. I have learned the hard way that you cannot run a business by just having people walk in the door just to visit with you. They have to have income.

Secretary SIMON. I ran a business and I think I have some sympathy with that also, Mr. Chairman, and the point is what the people need back home to run a business, to make investment, is the confidence that their Government is not going to have economic policies that are going to be disruptive of private industry.

Chairman HUMPHREY. I couldn't agree with you more. That is why I think recent policy has been so bad.

Secretary SIMON. Well, over the last 10 years——

Chairman HUMPHREY. No, we had 3.6-percent unemployment in 1968 and we had 4.7-percent inflation in 1968.

Secretary SIMON. That is when we were sowing the seeds of the present policies we got. Of course, we did have a war effort, too.

Chairman HUMPHREY. That is correct. It surely ought to be easier now with the war effort over. I used to hear about the peace dividends that we were going to get. So what do we have instead of peace dividends? We have a $100 billion defense budget and we have a bigger debt and we have higher interest rates and we have unemployment and we have inflation. Where are all the peace dividends we were going to get?

Secretary SIMON. That was all proven to be nonsense because we didn't realize we spent that peace dividend 5 years before. That is why we announced in the Treasury last week that we were going to commerce accrual accounting in the Government, which is going to show the impact of present decisions as far as what our fiscal flexibility is going to be in the future. It has been badly eroded.

Chairman HUMPHREY. I find myself in considerable agreement with your idea of accrual accounting. I have been reading up on that. I think there has been some good economic analysis made of it.

I'm simply saying I will buy the argument as a reasonable man, but if you want to say they loused it up in the 1960's, fine.

Secretary SIMON. And the 1970's.

Chairman HUMPHREY. But I am saying after 3 or 4 years you can't just go ahead and blame it on Uncle Ned out there. There was a time when you could blame it on L. B. J. for about 3 years. But in 3 years you ought to be able to wipe off most scars, certainly in 5 years.

Secretary SIMON. You see I am not blaming it on Uncle Ned or Uncle L.B.J. or uncle anybody. I am saying the mistakes just continued right on.

Chairman HUMPHREY. Well, it just seems to me there were a few more people at work earning a little more income before we started playing games with all of the surtaxes and surcharges and phases and the freezes——

Secretary SIMON. And wage and price controls.

Chairman HUMPHREY. And God knows what else.

Secretary SIMON. I agree with you. But let me continue.

Chairman HUMPHREY. But those are our differences, I know.

Secretary SIMON. We can stop from time to time and disgress——

Chairman HUMPHREY. I figured I would sort of loosen it up here a little bit.

Secretary SIMON. Yet, as I take the soundings of people throughout our country, I sense a growing concern about the long-term outlook for continued economic development. America seems to be on a path that may not hold the same promise for the future. There appears to be declining recognition of the fundamental importance of markets and a narrowing of the boundaries in which individual Americans can make personal economic decisions. Of course, the market system adapts to change. The population has grown, the availability of resources has fluctuated, concerns about the environment of an increasingly integrated world economy.

As our economy has become more complex, new approaches to difficult problems have been needed to achieve our general economic goals, to prevent specific abuses, and to stimulate and preserve competition in the markets. I believe that free, competitive markets are the most effective way to provide for increased output and the equitable distribution of the results of economic activity.

We do need Government regulations and other safeguards to protect the public interest. But I am disturbed by my discussions with individual consumers and businessmen which indicate that the Government at all levels is increasingly constraining innovation, entrepreneurship, and individual spending decisions. In particular, the small businessman attempting to create a new enterprise today, in which you, Mr. Chairman, have expressed such justifiable concern, is curtailed at most every turn.

He must comply with thousands of Government regulations on health, safety, pollution control, hiring practices, product liability, tax reporting, employee pensions and compensation, advertising, distribution practices and other requirements too numerous to list.

Chairman HUMPHREY. May I say I couldn't agree with you more on what you said. Here is where I find both of us on similar wave lengths, and why we can't find some bipartisan or nonpartisan way of getting at these problems I don't know.

Secretary SIMON. On this subject we in the Government get accused—both you people in the Congress as well as we in the executive—of being big-businesss oriented and that we don't give a damn for the small businessman and all the rest. I am sensitive to criticism like that. We just formed an advisory group from all over the country and they are coming into the Treasury Department tomorrow afternoon for 2 hours to meet with me. I am going to go into this in depth with them and start getting some specifics. They represent small business from every area of these United States. I want to go in there and I want to listen for 2 hours and have them tell me about the specific problems and what the Government can do so that they feel they have an ombudsman in the Government, which I think is important.

Chairman HUMPHREY. Mr. Secretary, there is a vote. I am going to turn this over to Congressman Long while I am gone. May I say I think that is very desirable, Mr. Secretary. There isn't any easy answer to what you just said, but I know what you have stated here is exactly what I hear at home. I don't accuse you of being big-business oriented and I don't accuse you of being antismall business. I think what we have here is a condition in the market place that has made it very difficult for small businesses to survive, for them to get the credit they need, for them to get consideration of their needs from the Government. Anything that yon can do that will moderate that and give them a fighting chance is highly desirable because much of our employment in this country—I think 50 percent or more of all employment in this country is from small business.

Secretary SIMON. Fifty percent of our gross domestic product is from small business. That is a significant amount of employment also. You know it is tough to get a handle on small business. That is why I hope the advisory committee is going to help do that.

Chairman HUMPHREY. Go right ahead.

Representative LONG [presiding]. Go right ahead, Secretary Simon.

Secretary SIMON. Feel free to interrupt me.

Representative LONG. I will follow the chairman's example and interrupt occasionally.

Secretary SIMON. Good. These cost ultimately must be passed on to consumers in the form of higher prices. Moreover, such costs are particularly heavy for the smaller businessman because of the fixed-cost nature of many of the regulations. If profits are earned, and that is obviously the basic reason for creating most new businesses, they are taxed by the Federal Government, usually by the States, and increasingly by local governments, to support the enormous growth of Government spending at all levels.

Just the paperwork burden of Government regulation is staggering. Individuals and business firms spend over 130 million people hours—and you notice I didn't say man-hours.

Representative HECKLER. Good. Thank you very much.

Secretary SIMON. Individuals and business firms spend over 130 million people-hours a year filling out over 5,000 Government forms. Even more costly is the paperwork burden within Government itself. The Commission on Federal Paperwork estimates that Federal spending to process forms totals an incredible $15 billion a year.

In fact, just the cost for forms themselves runs to a billion dollars annually, and one department—the Department of Agriculture—maintains nearly a million cubic feet of records and spends $150 million yearly on reporting systems.

Now, when Government and businesses are so burdened, it is just not they who pay the penalty. Everyone pays—the taxpayer and the consumer alike.

I know, Senator Proxmire, that this goes to the heart of many of the things that you had said and I have found out the hard way. And it is just like tax reform. You know you attack a specific loophole, if you will—and one person's loophole is somebody else's subsidy—and the special interest here in Washington raise such a fuss, and you find in attempting to do it on an ad hoc fashion, it is never done. That is why a massive overhaul, which shows equity across the board, is the only way we will ever get true regulatory form as you have proposed. I think it would be sensational if tomorrow morning we could just lock the door of the ICC. I think that would be the greatest contribution we could ever make to the American economy and the small businessman.

Saying that, I will have the teamsters and everybody else on my neck.

Small businessmen are increasingly questioning the desirability of working so hard and bearing so much risk when others are able to claim virtually the same financial rewards in our society with shorter hours, far fewer headaches, much less responsibility, and little risk. Is it any wonder that the entrepreneurial spirit in this country is fading? Employees also have growing concerns about the future as they see an increasing share of their financial resources eroded by personal income taxes paid to several layers of Government, payroll taxes, property taxes, sales taxes on most of the goods and services they purchase and many other indirect taxes. Although earnings continue to rise rapidly, the real purchasing power of these higher incomes is quickly erased by higher taxes and inflation.

These personal concerns raise fundamental questions about the proper allocation of resources and decisionmaking between the public and private sectors. Determining the proper functions of Government and the means of financing those activities is a critical issue facing our society. The key, of course, is what is the appropriate balance? If the balance is almost entirely in the private sector, the public's interest may not be properly safeguarded. There would be little or no national defense, national parks or other public goods of this sort, and we would still have the difficult challenge of providing a basic level of income and services for those Americans who are currently not able to pay for their basic needs. Clearly, there is an important role for government.

However, when resource allocation and other economic decisions become dominated by a government bureaucracy, innovation and productivity are too often restricted.

Moreover, the individual finds he has less freedom of economic choice as greater portions of his paycheck go to support growing government outlays at all levels, as prices rise, and as the total economy becomes less productive. As an economy becomes increasingly dominated by the Government, individual initiatives fade away. The potential entrepreneur considering a new business because he has an idea he thinks is really good finds himself stymied at almost every turn. The danger of all of this is that in many cases he concludes that the risks and inconvenience far outweigh the potential rewards and he drops the idea.

At the extreme, economic decisionmaking by people in the market is supplanted by people in government, individual incentives evaporate, and the economy deteriorates into conditions of stagflation.

Reasonable people will agree that we do not want either extreme. Too little government results in an absense of public goods and safeguards of public interest. Too much government, on the other hand, stymies the workings of efficient and competitive markets and reduces the individual's freedom of economic choice. We obviously must have a balance. But what is the appropriate mix of public and private decision making? There is no exact answer to this question, but I do believe that we can make a reasoned assessment.

We must recognize that the resources of this great country—the number of people, their education and skills, the amount and types of capital goods, the abundance of raw materials, and the infrastructure of transportation, communication, utility, and other services—are limited, particularly in the short run. Yet as we all know there are numerous claims on these resources. Each special interest group assumes that its claim is somehow unique and deserve satisfaction. When we total all of the worthwhile claims, we find that they far exceed our ability as a nation to satisfy them particularly in the unrealistically short time frames that are sometimes expected. So, therefore, hard choices must be made.

In trying to respond to the claims before it, governments at all levels attempt to satisfy as many claims as possible. That is a natural response to the desire to attract future electoral support.

However, this response has resulted in the increasing intervention of government at all levels into our individual affairs. In my judgment, the efficiency of our economic system has been unnecessarily distorted by bureaucratic infringments and by stop-and-go policies which have produced an atmosphere of instability.

The growth in government spending—Federal, State, and local—has far exceeded the rate of expansion of the economy. Total government spending averaged about 35 percent of our GNP in 1975, compared with 27 percent in 1960 and 21 percent in 1950, as shown in chart 1 of my prepared statement.

In 1975, 1 out of 6 workers was a government employee; in 1950 this ratio was only 1 out of 10.

In absolute terms, total government spending at all levels—Federal, State, and local—has gone from $61 billion in 1950 to $136 billion in 1960 and to $525 billion in 1975, as shown in table 1 of my prepared statement.

Increasingly, a greater portion of our ability to produce goods and services is being taken over by government. Each new inroad has implications for the efficiency of the private sector, to which we must look for productivity gains and resulting increcases in the total amount of goods and services produced.

I believe that the balance has tipped too far in the direction of bigger and bigger government at the relative expense of private sector. The American people are beginning to resent this growth, for many of them know that ultimately it must be paid for directly with their taxes and/or indirectly by accelerating inflation.

We must redress this imbalance and restore to the American people greater discretion over personal spending decision. They are usually able to decide what is best for them and, within limits, competitive markets are able to respond to these desires in the most efficient and responsive manner. I am not talking about a reduction in the absolute level of government expenditures. What I am advocating is a slowdown in the upward momentum of government spending that began to accelerate in the mid-1960's so that the relative portion of resource allocation decisions made by the private sector increases. In this way, the overall efficiency of our economic system can increase and we can bring about higher economic growth.

It cannot be emphasized often enough that the true wealth of a nation is in its ability to produce goods and services. Improvements in this ability come mainly from the private sector. We can debate how the total pie should be divided, but we should not lose sight of the fact that we are no better off as a nation unless the pie continues to increase in real terms. To do so and realize a durable prosperity, we should restore incentives to the private sector by tipping the scales toward a somewhat greater relative growth of the private sector.

However, government spending is only one part of the picture. Resource allocation also is affected by the myriad of regulations in the private sector faces.

To be sure, many of these regulations are necessary and important in safeguarding the public interest.

For example, regulations to prevent monopolistic pricing, to assure product safety, to provide reasonable and effective standards for environmental protection and worker safety, to make possible fair employment and other things of this sort are important to us all. However, too many regulations are overlapping, inefficiently administered with long delays, or obsolete. Others are actually anticompetitive. Regulators regulate with a frenzy and in so doing hamper the basic efficiency of competitive markets.

An underlying problem is that many regulations have never been subjected to a true cost-benefitted type of analysis. The benefits are always cited, but very seldom are they documented by evidence showing that the regulation proposed is really going to make a difference.

In other words, is there going to be a measurable and significant benefit which will exceed the combined cost of administering the regulations and the costs resulting from reduced efficiency of the U.S. economic system—costs which ultimately must be borne by the consumer?

In cases where the benefits are less than the total costs, we should consider changing or eliminating the government regulations and administrative actions that have caused the problems. Many regulations designed to cope with yesterday's problems are obsolete today. Frequently these regulations impede innovation by creating barriers to entry which preserves the status quo and limit competition. Other regulations simply are ineffectively administered creating needless redtape and delays.

In those relatively few areas where there is an identifiable need to safeguard the public interest, Government regulation and administrative direction should be used but normally economic decisions must be left to the marketplace.

The consumer would benefit in being able to purchase the product or service at a lower price and/or with less inconvenience than would otherwise be the case. The reform of Government regulation is a principal goal of the administration and many members of Congress as well. I know of no issue that has the agreement of so many people—from liberals to conservatives, from business to labor. Yet the special interest groups are vociferous and tenacious. Witness the reactions of airline and trucking executives to the President's reform proposals for these industries. We should all recognize that we have an enormous stake in restoring competition to the marketplace.

Turning next to the question of economic stabilization, there is certainly an important role to be played by fiscal and monetary policies in evening out extreme moves in the economy. There have unquestionably been times, however, when such moves and policies have been counter productive.

For example, additional government stimulus frequently takes effect at times when the total productive capacity of the economy cannot absorb the increased demand for goods and services. The result is inflation, dislocations in the economy, and, eventually unemployment. Increased Government spending programs have proven to be a cumbersome tool for short-term economic stabilization purposes. There usually is a considerable lag between the time a need is identified, or a claim is made by a special interest group, and the time there is a specific response by Congress to the proposal. Then there is another time lag before the expenditures actually occur and begin to spread throughout the economic system. At the time a proposal was initially considered there may have been underutilization of resources in the economy, but by the time the program actually comes on stream resources are often fully employed so that the additional Government spending leads to greater inflation.

If there were some way that old programs could be phased down or eliminated during a period of rapid economic expansion, fiscal policy might be more effective as a tool for stabilization purposes. However, experience has shown that this is not the case and that programs initiated in a period of economic slack tend to become a permanent part of the budget. It is extremely difficult to reduce or eliminate even the obviously ineffective or obsolete programs; to scale down existing programs for countercyclical purposes has been, for all practical purposes, impossible. This is particularly true when the sizable outlays of the many State and local governments are added to the total.

This implies that we must avoid abrupt and excessive changes in Government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets, in the markets for capital goods, and in financial markets.

In addition to Government expenditures, I am concerned with the size of the chronic Federal deficits, particularly the negative impact on financial markets and capital formation. The rise in Federal expenditures has exceeded the growth in revenues resulting in Federal budget deficits in 16 out of the last 17 years. The traditional view of the Government's role in the business cycle was that deficits would be recorded in periods of economic slack, but that surpluses would occur in periods of high economic activity. As a result, savings would be available to the private sector for the capital formation necessary to sustain the economic advance in real terms. This has not occurred in recent years. We not only have had deficits in periods of economic boom but even larger deficits in periods when there is less than full utilization of our resources.

These deficits, of course, need to be financed and such financing in periods of prosperity harm the economy in a number of ways. Over the past 10 years, the Federal Government will have borrowed in the capital markets a total of nearly one-third of a trillion dollars on a net basis. The national debt now is climbing at a rate of more than $1 billion a week. During the last 10 years, the interest on the debt has more than tripled to almost $38 billion in the current fiscal year and will go to $45 billion in fiscal year 1977—interest is now the third largest budget item, after income maintenance and defense.

As annual interest payments grow, fiscal flexibility is constrained. This "uncontrollable" outlay puts pressure on the total budget, which, in turn, means that programs must be displaced or tax reductions foregone.

Moreover, the deficits place the U.S. Treasury in a position of competing with private investors. The recent avalanche of Treasury securities has created distortions in the traditional patterns of funds being raised by various sectors in the capital markets as well as in the sheer magnitude of total funds raised, as shown in table 2, of my prepared statement.

In my judgment, this has contributed to making our financial markets less efficient in recent years in channeling the savings of society to investment opportunities. As a result, capital formation is impeded.

Furthermore, deficits accumulate over time. Total Federal debt has increased from $329.5 billion at the end of fiscal year 1966, to an estimated $633.9 billion at the end of fiscal year 1976—a rise of 92 percent in only 10 years time. Over the last 10 years the average maturity of the debt has declined from 5 years, 3 months to 2 years, 5 months. What this means is that the U.S. Treasury must be a more frequent visitor in financial markets simply to roll over outstanding securities let alone raising funds for current deficits. In this fiscal year, 1976, the U.S. Treasury will absorb over 70 percent of all moneys in the securities markets; government at all levels will absorb over 80 percent. This percent must be sharply reduced as the economic advance continues or else some private areas will have to go without.

The problem becomes far more critical as the recovery progresses and the financing needs of the private sector intensifiy. If deficits remain large, the Treasury, by being first in the credit line, will always get its needs financed but in so doing will make it difficult for companies with less than prime financial ratings to obtain the financial resources they need at acceptable interest rates.

Another aspect of the crowding out problem is the secular deterioration I see in the financial structure of U.S. businesses. Over the past decade there has been a strong trend toward a much more leveraged corporate balance sheet. Debt has roughly tripled; liquid assets have declined relative to liabilities; the debt-equity ratio has about doubled; and the average maturity of debt has shrunk. Just as the Treasury is a more frequent visitor to credit markets, so, too, will many companies, and if there is a competition for funds, it is quite clear that the less than prime rated company will be the loser. Continuing heavy Treasury borrowing will eventually cause difficulties for these companies, small businesses and potential home owners. In the appendix to my prepared statement, crowding out is discussed in greater detail.

The size of the deficit also affects the rate of capital formation in the private sector, and this is a matter of great concern. As the recovery progresses, private capital investment must rise to sustain the recovery.

If we are to meet our goals for increased employment and productivity in a noninflationary environment as well as our environmental, safety and energy goals, we must have an increase in the rate of national savings and private direct investment relative to the total GNP.

The achievement of our capital formation goals depends on the necessary expenditures being financed in the private sector. In turn, the adequacy of capital flows depends on the savings of society being less and less used to finance Federal expenditures and more and more focused on capital formation. This is the only way we can sustain a durable recovery over the long run and bring down the level of inflation. If the private sector is unable to finance capital formation because of the huge demands on savings by the Federal Government and because of the resulting inefficiencies introduced in financial markets, the boom-and-recession sequence of the last decade will be repeated. Therefore, it is imperative that we reduce the Federal deficit and work toward a budget surplus as the recovery progresses.

Excessive monetary stimulus must also be avoided to prevent renewed inflationary pressures and uncertainty. No one wants to see an explosion of the money supply. On the other hand, it is important that the monetary growth be adequate to support the increase in nominal GNP necessary to sustain the recovery. With the surge in the economy in the last half of 1975, velocity increased dramatically; that is, the turnover of the money stock rose, indicating people and business used money more efficiently. This growth rate in velocity is not sustainable over the long run, but still the average rate of growth of velocity may well be higher than in years gone by. If this occurs, the money supply need not grow at as fact a rate to sustain a given level of nominal GNP as it would need to if there were only a modest growth in velocity.

Representative LONG. May I ask a question? I guess you know, Mr. Secretary, that Mr. Burns, and I guess it was yesterday, before the Banking and Currency Committee was talking about this question of velocity of money and the cutback. And under the M_1 he cut it back or rather the base was changed from a 5 to a 7.5% range. And he cut it back from that to a 4.5 to a 7.5% if I remember correctly.

In view of the velocity of the money supplied during that period, did you agree with that action he took?

Secretary SIMON. I sure do, Congressman Long. I will tell you why. Everybody has become an M_1 watcher in the past 10 years really. I would say that 99.9 percent of the people don't understand what they are watching and that includes some of the people that are supposedly controlling this M_1 or supposedly able to control this M_1, which is impossible over the near-term. You know we go back to the economic debates we were in just a year ago when we were in what turned out to be the bottom of the recession, and then you had economists talking about a 10 to 12 percent growth being needed in the money supply and others were talking about an 8 to 10 percent rate. Arthur Burns said 5 to 7½ percent. Actually the actual figure fell slightly below that 5 to 7½ range. And if you ask these economists at that time, who were predicting 10 to 12, what the recovery would be like with less M_1 growth, some of them were suggesting it would falter and we would even have negative growth in the fourth quarter. Well, the actual M_1 growth fell short of the target, and what happened; what went wrong in the calculation? Well, it was two things:

One, is the velocity, which is extremely important; and two, is the problem of seasonable adjustment in the money supply figures. And Arthur Burns explained this yesterday. He wasn't really reducing the target. He was giving himself more flexibility. The target was a 5 to 7½ percent. It is now 4½ to 7½ percent, which allows the Federal Reserve to do what Arthur Burns has been saying every time he has come up to testify—that the money supply will increase sufficiently to support the economic expansion, but it will not increase to the point where it is going to rekindle the inflationary pressures as it has in the past.

When the economic recovery is clearly underway and gaining momentum, if you will, and when private demands begin to become apparent, at that point the Federal Reserve traditionally—just as the Treasury should get out of the way of the marketplace by having surpluses in periods of high economic activity—the Federal Reserve must moderate the growth in the money supply. This gives them the flexibility in the months ahead to moderate the money supply as it monitors the economic expansion that is already underway.

Representative LONG. What do you attribute this increased velocity going this recent period to?

Secretary SIMON. Oh, boy, that is a very difficult question.

Representative LONG. I gather that no one pursued that yesterday.

Secretary SIMON. You would have to climb into the minds of millions of people in the way they are managing their money today versus the way they used to do so before. And you are finding corporations that are keeping fewer cash balances, if you will; and utilizing their funds in interest-bearing ways, whether it is investments in savings accounts or the like. You see everybody has become a money manager.

Representative LONG. Well, attempting to generalize, is it a danger signal in that it perhaps indicates a lack of a sense of security or conversely a sense of insecurity?

Secretary SIMON. No, I don't think so. Well, you asked two questions there. When we have very great inflationary expectations, which we had a year ago, savings rates increase because people become fearful about the future. They are becoming a little less fearful now about the future than last year. The inflationary expectations are beginning to be reduced, to be wrung out of the economy but that is going to take time.

No, I would suggest that people are becoming more efficient in the use of their money. As I said, they are keeping lower balances, at least primarily the corporations, in the way they handle their money. This has been something that has been occurring gradually over the last 10 years.

Representative LONG. Thank you.

Secretary SIMON. Witness the overdrafts in commercial banks with individuals. You know they will keep $100 in their savings account and have the rest invested in interest bearing securities and then they will run overdrafts if funds are needed. I don't necessarily consider that dangerous.

Representative LONG. As long as they can cover their overdrafts.

Secretary SIMON. Presumably they can with their private savings. If it is temporary enough, they don't want to interrupt the interest they are receiving in their investment.

Representative LONG. I see. Thank you. Go right ahead. Do you want to complete your statement now?

Secretary SIMON. I only have a few more comments.

Representative LONG. Yes, sir.

Secretary SIMON. Given the fact that monetary growth in 1975 was moderate, the Federal Reserve has considerable flexibility in managing monetary growth in the months ahead and still be within its target range on a cumulative basis. Given the anticipated velocity increase and this flexibility in near-term policies, the Federal Reserve's target range of 5 to 7½ percent for growth in the money supply is consistent with the sustained recovery we anticipate for 1976. However, over the longer run, this range is not compatible with bringing down the level of inflation. Therefore, the monetary targets, as I explained a second ago, will need to be reduced in the future as the recovery proceeds.

For both fiscal and monetary policies, the problem of instability is compounded by the present inflation psychology that permeates our society. All too readily the economy will move to a higher level of prices, but only grudgingly will it move to lower prices despite slack demand. This inflation psychology has been building for a decade and its unwinding will not be easy. The achievement of economic growth without accelerating inflation could be upset by fiscal and monetary policies that are, or even appear to be, overly stimulative.

In addition, such excesses will lead to bottlenecks developing in certain key industries well before the economy as a whole reaches full employment. This occurred in 1973 in such industries as chemicals, steel, paper, and fertilizers. The dislocations caused by bottlenecks send inflationary tremors throughout the economy and lead to inefficiencies which ultimately can curtail a recovery in real terms.

I believe that by excessively concentrating on short-term economic stabilization goals rather than on the long-term allocation of resources, stop-go fiscal and monetary policies in the past have been a disruptive influence which has accentuated the business cycle. Too often fiscal policies and, to a lesser extent, monetary policies have lagged economic developments so that when the stimulus or restraint arrives the business cycle has changed. As a result, these policies accentuate rather than dampen the ups and downs in the economy—just the opposite of the intended purpose of these changes.

We must act wisely and responsibly in bringing stability to our economy. The excesses of the past are not easily undone. Excessive spending, excessive credit creation, excessive stimulation all may provide a short-term palliative, but before long additional inflation and production bottlenecks set in and economic performance declines. The stop-and-go policies of the past 15 years have led to an instability which now is deeply rooted in our society. We can undo this problem only through a moderate and steady economic recovery which restores confidence in the prospect for longer run prosperity in a noninflationary environment.

There can be confusion about what is necessary to deal with a current problem and the effect of that action on future fiscal flexibility. Too often we in Government are prone to make decisions without proper consideration of the cumulative impact of those decisions on the future. To deal with this problem, I am proposing—and I go at this point to the accrual accounting that I spoke about to the chairman a few minutes ago: that is, what the purpose is of accrual accounting and the consolidated statements that I believe are critical.

In summary this country has developed the most efficient and prosperous economic system the world has ever known. Over the past 15 years the U.S. economy has increased the real output of goods and services by 60 percent; the real income of the average American has increased by over 50 percent; the number of Americans living in families with incomes below the poverty level has declined from 20.7 to 10.2 percent—1974—of the population; and 20 million new jobs have been created.

Unfortunately, that impressive performance was marred by: (1) A sharp increase in inflation beginning in the mid-1960's; (2) continued unemployment in excess of 5 percent throughout the first half of the 1960's and again in the 1970's, and a sizable GNP gap between actual and potential output during those same time frames; and (3) occasional disruption of international trade and investment. While we clearly are justified in having a great deal of pride in our economic system, there also are sufficient reasons to have concern about the future pattern of economic progress.

Throughout much of this period the concept that the Government must continuously intervene to stabilize the U.S. economy has dominated policy decisions. The repeated use of fiscal and monetary stimulus too often has turned out to be counterproductive because of the lagged impact of such actions. The temporary programs created to respond to current problems have frequently become a permanent Government activity with the result that fiscal flexibility and control have been continuously eroded.

The debate over the proper role of the Government in the total economy will continue. But there is an even more fundamental issue involving the total size and growth of Government spending which has led to chronic deficits and periodic disruption of the entire economy. Merely ranking priorities within the Federal budget is not enough. We must expand the analysis to evaluate total Government outlays as they relate to the priorities of the entire economy. I emphasized the need for considering the combined private and public demand for goods and services in my testimony before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee on April 3, 1975.

The second basic requirement is to lengthen the time horizon of policy planning. And that is important.

There is a natural tendency to concentrate too much on short-run needs without adequate consideration for the cumulative impact of decisions into the future. This point is particularly important at this time because of the short-term benefits claimed for rapidly stimulating the economy with the slack that still remains at this stage of the recovery.

However, because of the painful inflation recently experienced there must be greater concern about the reactions in the private sector to actual and potential Government policies. Employees are anxious to restore their real wage gains and business wants to restore profit margins which have been eroded by inflation. If the real growth in the economy is accelerated too rapidly, both real and perceived inflation pressures could quickly escalate because of concerns about the future. Another repetation of inflation and recession would result in even more unemployment and lost output. Lower rates of unemployment and inflation are obviously the desired goal, but we must consider the prospects over the next few years not the next few months. A mix of policies designed to provide temporary relief at the expense of higher rates of inflation and unemployment in future years is inappropriate.

It is particularly important to consider the longer run Government spending trends. The amount of adjustment in any specific Federal budget may appear to be relatively limited because of the legislative decisions of the past.

However, decisions to better control Federal spending today will have major significance on the levels of outlays in 1978, 1979 and beyond as existing programs continue to expand. It will never be easy to make these fundamental shifts and there is a tendency to wait for a more "convenient" time to begin the painful process of regaining fiscal control, but I am convinced that the longer we permit the existing trends to continue, the more difficult the ultimate correction process will be. To come to grips with this issue we have designed a responsible mix of economic policies that will bring about a durable, lasting economic prosperity which will benefit our Nation with sustainable and increasing employment.

Representative LONG. Thank you, Mr. Secretary. We appreciate your comments today.

[The prepared statement of Secretary Simon follows:]

PREPARED STATEMENT OF HON. WILLIAM E. SIMON

Mr. Chairman and Members of this Distinguished Committee: I am pleased to appear before you to discuss the current economic situation and, more importantly, to consider some of our longer-term economic goals and policies.

The importance of economic issues in shaping the future gives the Joint Economic Committee a basic role in determining these goals and policies. I hope that my analysis of the current economic outlook and of the policies needed to provide permanent prosperity and employment will contribute to a calm, reasoned, and perhaps, dispassionate discussion of these issues.

The Nation's economic goals were summarized in the Employment Act of 1946: "To promote maximum employment, production, and purchasing power" through actions consistent with "other essential considerations of national policy" in ways "calculated to foster and promote free competitive enterprise and the general welfare . . ." It is obvious that we all support the same basic goals of sustaining the current output and employment gains, of further moderating the still unsatisfactory rate of inflation, of reducing the unacceptable rate of unemployment, and of correcting the monetary, trade and investment problems which have periodically disrupted the international economic system. But there can be disagreement about what tradeoffs will be required to achieve simultaneous progress toward all of these goals, about the best mix and timing of fiscal and monetary actions and about the proper time horizon for planning current policies.

A year ago at this time, we were concerned with an economy in the midst of a serious recession. Fortunately, the turning point in the U.S. economy occurred somewhat earlier than anticipated and the pace of recovery during the transition period has been stronger than expected. Economic historians will likely identify last April as the low point for the recession. Since then, real sales have increased at an annual rate of 4.9 percent and industrial output has risen at an annual pace of 12 percent after having declined at an annual rate of 10 percent since late 1973. The aggregate pattern of this recovery has matched the pace of earlier cyclical upturns and I believe that expansion will continue throughout 1976 and 1977 if responsible policy decisions are made. Significant progress has also been made in reducing the rate of inflation, in expanding employment opportunities while gradually cutting the overall unemployment rate and in moving ahead on important international monetary and trade reforms. This is an impressive turnaround from the situation at yearend 1974 when construction, personal spending and business investment were all declining.

Despite the impressive progress of the economy during the second half of 1975 no one can be satisfied with current conditions. An annual rate of inflation of approximately 6½ percent or an unemployment rate of 8.3 percent in December are totally unacceptable. Furthermore, great concern has developed over the impact of Federal fiscal, monetary and regulatory policies which have increased the impact of government decisions on the total economy. Therefore, every economic initiative should be more carefully evaluated to determine: (1) whether the proposed action is consistent with the Nation's overall priorities and resources; and (2) whether the policy recommended contributes to the long-term achievement of basic goals rather than merely providing temporary relief. Using these two guidelines more effectively would help reduce the constant fine-tuning of economic policies and would properly shift the government's attention to longer-term requirements rather than concentrating on "crisis" management. If we fail to apply this discipline, governments will continue to promise more than can be delivered and the chronic Federal deficits reported in sixteen of the last seventeen years (for the period ending with Fiscal Year 1977) will persist and the continuation of past trends will eventually make the necessary adjustments even more difficult and costly.

As we attempt to further our economic growth and to reduce inflation and unemployment in 1976, current economic policies must avoid creating even more difficult problems for subsequent years. The severe recession of 1974–75 was a harsh reminder that the costs of serious economic distortions are greater than the temporary benefits provided by excessive stimulus used to achieve short-term goals. In what follows, I will review the current economy and then move on to consider certain basic underlining problems as they affect current policy needs.

I. ECONOMIC BACKGROUND AND PROSPECTS

The recent recession resulted in a drop in real output of goods and services of 6.6 percent stretched over five consecutive quarters; unemployment rose to a postwar high of almost 9 percent; basic patterns of domestic and international consumption and investment were disrupted; the entire financial structure was severely tested; and inflation continued to be a distorting force despite the sharp decline of economic activity. In planning for 1975 the Administration anticipated that an accelerating economic recovery would begin by midyear if three fundamental adjustments could be accomplished: (1) the unwanted accumulation of inventories could be liquidated and new orders increased; (2) "real incomes" of consumers could be restored by reducing the double-digit level of inflation and initiating tax reductions and rebates which would stimulate personal consumption; and (3) employment would begin to increase rapidly enough to reduce the unemployment rate and strengthen consumer confidence.

These expectations were summarized in the economic assumptions underlying the budget published one year ago:

ECONOMIC FORECASTS AND ACTUAL RESULTS FOR CALENDAR YEAR 1975

[In percent]

	Forecast published February 1975	Actual results
Gross national product (current dollars)	7.2	6.5
Gross national product (constant dollars)	−3.3	−2.0
Gross national product price deflator (yearly average)	10.8	8.7
Consumer Price Index (yearly average)	11.3	9.1
Unemployment rate (yearly average)	8.1	8.5

The actual results were not very different from the earlier expectations. Moreover, the forecast for calendar year 1976, as contained in last year's budget, and the forecast in the current budget also are not very different. If anything, continued and better progress is anticipated now than anticipated one year ago.

ECONOMIC FORECASTS FOR 1976

[In percent]

	Forecast published February 1975	Forecast published January 1976
Gross national product (current dollars)	12.6	12.4
Gross national product (constant dollars)	4.8	6.2
Gross national product deflator (yearly average)	7.5	5.9
Consumer Price Index (yearly average)	7.8	6.3
Unemployment rate (yearly average)	7.9	7.7

The basic turning point in the U.S. economy occurred during the second quarter of 1975 when real output rose at an annual rate of 3.3 percent following five consecutive quarterly declines. Then in the third quarter real GNP increased at an unusually high annual rate of 12.0 percent. However, over one half of the gain reflected a massive swing in inventories toward less liquidation. During the last three months of 1975, preliminary figures indicate that real output expanded at an annual pace of 5.4 percent as the liquidation of inventories effect was largely over. Real final sales increased at a 5.0 percent annual rate, compared with 4.7 percent in the third quarter of 1975.

The forecast for real economic growth in 1976 is now 6.2 percent with the pattern of recovery continuing throughout the year and into 1977. The major strength of the U.S. economy will continue to be personal spending, which represents approximately two-thirds of our GNP. Real personal consumption expenditures are expected to increase 5 percent this year, compared to a rise of about 1 percent in 1975 and to a decline of almost 1 percent in 1974. As consumers increased their spending in early 1975 and continued to purchase a variety of durable and nondurable goods throughout the year, this fundamental shift has proven to be a crucial element in the recovery to date. Personal incomes are expected to rise strongly in 1976, and real purchasing power should continue to improve if inflation does not accelerate. After falling 1½ percent in 1974, real disposable personal income increased approximately 2 percent in 1975.

Furthermore, consumers increased their savings as a percentage of disposable income to the unusually high level of 8.3 percent in 1975 compared to an average annual rate of 6.4 percent from 1960 through 1974. Our 1976 forecast anticipates a continued high savings rate of about 8 percent, which affords the consumer a cushion to sustain the rise in spending. The improvement in household balance sheets—resulting from the rapid accumulation of savings, liquidation of personal installment debts last year and the increase in the value of financial assets—the reduced pace of inflation, further improvement in employment, and general economic recovery all should work to strengthen consumer confidence and spending in 1976.

While personal consumption expenditures will provide a necessary foundation for the economic recovery, the incremental thrust for growth will need to be provided by accelerated private domestic investment. Business spending for new plant and equipment tends to lag behind other sectors during an economic recovery and such real outlays actually fell 11.8 percent in 1975. Fortunately, that decline bottomed out in the third quarter of 1975 and business fixed investment should show good growth in 1976. The quarterly pattern of business spending is expected to accelerate throughout the year as rising corporate profits provide additional incentives, as increased retained earnings provide financing, and as improved corporate financial positions enable managers to plan more confidently for meeting future demands for goods and services. Long-term interest rates, though they have declined, still remain at historically high levels. However, a record amount of long-term financing was consummated last year (primarily in the high grade area). The sharp improvement in the stock market will likely encourage more equity financing which is badly needed to offset the heavy reliance on debt during recent years. The combination of these things would lead me personally to believe that real capital spending will rise in the neighborhood of 3 percent this year.

The liquidation of inventories is now largely completed—except for a few manufacturing sectors—and modest additions to inventory stocks should add to the general recovery in 1976. During the first and second quarters of 1975, inventories were liquidated at annual rates of $24.8 billion and $29.6 billion respectively in current dollars. During the third quarter, only a small decline was reported and in the fourth quarter inventories were essentially unchanged. Businessmen naturally are being very careful about replenishing their inventories following the problems caused by excessive purchases and the drop in sales in 1974, which piled up unwanted stocks that had to be liquidated in 1975. The expectation of a moderate acceleration in inventory accumulation as the year progresses is consistent with the overall economic outlook.

Residential construction is also expected to continue the pattern of gradual recovery begun in 1975. By the fourth quarter of 1975 new housing starts had reached an annual rate of 1.37 million units compared to a level of 1.07 million new starts at an annual rate reported during the second quarter. By yearend 1976 new housing starts will likely reach an annual rate of 1.75 million units which while still below the peak levels of 1971 through 1973 will contribute to the total economic expansion. The availability of mortgage financing has greatly improved but new building activity continues to be constrained by the large backlog of unsold housing units, the jump in average prices for new homes from $38,900 in 1974 to $42,300 last year, the high rates of interest still required on mortgage loans as well as by the general uncertainties associated with the sharp increase in unemployment during the recent recession. The housing sector will benefit from the improvement in personal incomes as the economy strengthens, but a variety of serious structural problems must be corrected. In particular, a more stable economy would help reduce the disruptive swings in home building that have badly hurt this industry over the years.

The surplus in our balance of international trade will likely decline in 1976 from last year's record surplus of around $11 billion. As the U.S. economy continues its economic expansion, imports of raw materials and some finished goods will rise more rapidly than exports to our major trading partners, who generally are not recovering as rapidly. Fortunately, the reduced surplus will not curtail the domestic level of output and employment because exports will continue to grow.

Combining the major private sectors of the U.S. economy and the government into a total GNP forecast indicates that 1976 will be a good year with real output gains of about 6 percent and real final sales of 4½ to 5 percent. Personal consumption expenditures should provide a solid base for continued growth and business spending for plant and equipment should accelerate as the year progresses, which will provide much of the additional thrust to sustain the recovery. Solid gains in residential construction and inventory investment are also expected to add to the total growth. If the economy could be judged only on the basis of output and consumption the forecast for 1976 would seem most satisfying. However, the serious problems of inflation and unemployment will require continued attention.

The rate of price increases in 1976 will probably continue at about the level reported in late 1975, although the figures reported for individual months may swing widely. In 1975, the GNP price deflator increased 8.7 percent. The 1976 figure is expected to be 5.9 percent.

The expected moderation of inflation on a year-over-year basis is, of course, a welcome development but it must be recognized that there is considerable uncertainty surrounding this outcome. It is clear that: (1) inflation at the present level will continue to distort personal consumption and business investment decisions; (2) price increases in the high single- and double-digit categories are disruptive to the allocation of resources in our economy as well as to the stability of existing institutions and they threaten our entire economic system; and (3) while inflation pressures tend to moderate and intensify over the course of a business cycle, each time we start an economic recovery it is from a higher level. The last point is particularly troublesome at this time, for it points to the difficulty of reducing the near-term level of inflation.

The near-term outlook for unemployment is also a matter of great concern. From 1960 through 1975 the unemployment rate averaged 5.2 percent. On a yearly average basis, the low point of 3.5 percent was reported in 1969 and the highest yearly average level was 8.5 percent during 1975 when a postwar record was set. Over this extended time period there have been significant changes in the composition of the civilian labor force and in the development of various government programs to minimize the social costs of unemployment which may be causing some disincentives for returning to work. Despite these structural changes, it still is clear that unemployment is far too high today. In fact, after each bout of stop-go policies, there is a worrisome tendency to start the next economic advance from successively higher levels of unemployment and inflation.

There were several encouraging developments in the labor market during 1975: (1) the gain in employment of 1.1 million workers since the recovery got underway in April; (2) the turnaround in the average hours worked each week which are now almost back to the pre-recession level; (3) the gradual improvement in overtime hours worked; (4) the improvement in the "lay-off rate" from 3.1 per 100 employees in January 1975 to 1.3 in December; and (5) the drop in the unemployment rate from the peak of around 9 percent. While these developments are encouraging, specific effort must be committed to reducing the existing level of excessive unemployment if all Americans are to share in the benefits of recovery.

II. ECONOMIC POLICY BACKGROUND

Although the prospects for near-term economic performance are favorable, several basic trends require further analysis. Without question, this country have developed the most efficient and creative economic system the world has ever known. It has been particularly responsive in satisfying the consumption demands of our large population and the real standard of living for most Americans has risen sharply during the postwar era. Real disposable per capita income has increased by about 50 percent in the past 15 years—after inflation. Over the same 15 years, the percent of persons in families below the poverty line has been cut in half—to approximately 10 percent. The median family income now is approximately $13,000. Personal consumption expenditures now account for almost two-thirds of our Gross National Product and Americans spend around 92 percent of their disposable income.

Yet, as I take soundings of people throughout our country, I sense a growing concern about the long-term outlook for continued economic development. America seems to be on a path that may not hold the same promise for the future. There appears to be declining recognition of the fundamental importance of markets and a narrowing of the boundaries in which individual Americans can make personal economic decisions. Of course the market system adapts to change. The population has grown, the availability of resources has fluctuated, concerns about the environment have increased and the United States has become a major part of an increasingly integrated world economy. As our economy has become more complex, new approaches to difficult problems have been needed to achieve our general economic goals, to prevent specific abuses, and to stimulate and preserve competition in the markets. I believe that free, competitive markets are the most effective way to provide for increased output and the equitable distribution of the results of economic activity.

We do need government regulations and other safeguards to protect the public interest. But I am disturbed by my discussions with individual consumers and businessmen which indicate that the government at all levels is increasingly constraining innovation, entrepreneurship, and individual spending decisions. In particular, the small businessman attempting to create a new enterprise today, in which you, Mr. Chairman, haxe expressed such justifiable concern, is curtailed at most every turn.

He must comply with thousands of government regulations on health, safety, pollution control, hiring practices, product liability, tax reporting, employee pensions and compensation, advertising, distribution practices and other requirements too numerous to list. This compliance burden is costly to large and small businesses alike. These costs ultimately must be passed on to consumers in the form of higher prices. Moreover, such costs are particularly heavy for the smaller businessman because of the fixed-cost nature of many of the regulations. If profits are earned, and that is obviously the basic reason for creating new businesses, they are taxes by the Federal Government, usually by the States, and increasingly by local governments, to support the enormous growth of government spending at all levels.

Just the paperwork burden of government regulation is staggering. Individuals and business firms spend over 130 million person-hours a year filling out over 5,000 government forms. Even more costly is the paperwork burden within government itself. The Commission on Federal Paperwork estimates that Federal spending to process forms totals an incredible $15 billion a year. In fact, just the cost for forms themselves runs to a billion dollars annually, and one department—Agriculture—maintains nearly a million cubic feet of records and spends $150 million yearly on reporting systems. When government and businesses are so burdened, it is not just they who pay the penalty. Everyone pays—the taxpayer and the consumer alike.

Small businessmen are increasingly questioning the desirability of working so hard and bearing so much risk when others are able to claim virtually the same financial rewards in our society with shorter hours, far fewer headaches, much less responsibility, and little risk. Is it any wonder that the entrepreneurial spirit in this country is fading? Employees also have growing concerns about the future as they see an increasing share of their financial resources eroded by personal income taxes paid to several layers of government, payroll taxes, property taxes, sales taxes on most of the goods and services they purchase and many other indirect taxes. Although earnings continue to rise rapidly, the real purchasing power of these higher incomes is quickly erased by higher taxes and inflation.

These personal concerns raise fundamental questions about the proper allocation of resources and decision making between the public and private sectors. Determining the proper functions of government and the means of financing those activities is a critical issue facing our society. The key, of course, is what is the appropriate balance? If the balance is almost entirely in the private sector, the public's interest may not be properly safeguarded. There would be little or no national defense, national parks or other public goods of this sort, and we would still have the difficult challenge of providing a basic level of income and services for those Americans who are currently not able to pay for their basic needs. Clearly, there is an important role for government.

However, when resource allocation and other economic decisions become dominated by a government bureaucracy, innovation and productivity are too often restricted. Moreover, the individual finds he has less freedom of economic choice as greater portions of his pay check go to support growing government outlays at all levels, as prices rise, and as the total economy becomes less productive. As an economy becomes increasingly dominated by the government, individual initiatives fade away. The potential entrepreneur considering a new business because he has an idea he thinks is really good finds himself stymied at almost every turn. The danger of all of this is that in many cases he concludes that the risks and inconvenience far outweight the potential rewards and he drops the idea. At the extreme, economic decision making by people in the market is supplanted by people in government, individual incentives evaporate, and the economy deteriorates into conditions of stagflation.

Reasonable people will agree that we do not want either extreme. Too little government results in an absence of public goods and safeguards of the public interest. Too much government, on the other hand, stymies the workings of efficient and competitive markets and reduces the individual's freedom of economic choice. We obviously must have a balance. But what is the appropriate mix of public and private decision making? There is no exact answer to this question, but I do believe that we can make a reasoned assessment.

We must recognize that the resources of this great country—the number of people, their education and skills, the amount and types of capital goods, the abundance of raw materials, and the infrastructure of transportation, communication, utility, and other services—are limited, particularly in the short run. Yet as we all know there are numerous claims on these resources. Each special interest group assumes that its claim is somehow unique and deserves satisfaction. When we total all of the worthwhile claims, we find that they far exceed our ability as a Nation to satisfy them particularly in the unrealistically short time frames that are sometimes expected. Obviously hard choices must be made.

In trying to respond to the claims before it, governments at all levels attempt to satisfy as many claims as possible. That is a natural response to the desire to attract future electoral support. However, this response has resulted in the increasing intervention of government at all levels into our economic system and into our individual affairs. In my judgment, the efficiency of our economic system has been unnecessarily distorted by bureaucratic infringements and by stop-and-go policies which have produced an atmosphere of instability.

The growth in government spending (Federal, State and local) has far exceeded the rate of expansion of the economy. Total government spending averaged about 35 percent of our GNP in 1975, compared with 27 percent in 1960 and 21 percent in 1950 (see Chart 1). In 1975, 1 out of 6 workers was a government employee; in 1950 this ratio was only 1 out of 10. In absolute terms, total government spending at all levels—Federal, State and local—has gone from $61 billion in 1950 to $136 billion in 1960 and to $525 billion in 1975 (see Table 1). Increasingly, a greater portion of our ability to produce goods and services is being taken over by government. Each new inroad has implications for the efficiency of the private sector, to which we must look for productivity gains and resulting increases in the total amount of goods and services produced.

I believe that the balance has tipped too far in the direction of bigger and bigger government at the relative expense of the private sector. The American people are beginning to resent this growth, for many of them know that ultimately it must be paid for directly with their taxes and/or indirectly by accelerating inflation.

We must redress this imbalance and restore to the American people greater discretion over personal spending decisions. They are usually able to decide what is best for them and, within limits, competitive markets are able to respond to these desires in the most efficient and responsive manner. I am not talking about a reduction in the absolute levle of government expenditures. What I am advocating is a slowdown in the upward momentum of government spending that began to accelerate in the mid-1960's so that the relative portion of resource allocation decisions made by the private sector increases. In this way, the overall efficiency of our economic system can increase and we can brnig about higher economic growth.

It cannot be emphasized often enough that the true wealth of a Nation is in its ability to produce goods and services. Improvements in this ability come mainly from the private sector. We can debate how the total pie should be divided, but we should not lose sight of the fact that we are no better off as a Nation unless the pie continues to increase in real terms. To do so and realize a durable prosperity, we should restore incentives to the private sector by tipping the scales toward a somewhat greater relative growth of the private sector.

However, government spending is only one part of the picture. Resource allocation also is affected by the myriad of regulations the private sector faces. Regulatory agencies have come to exercise direct control over transportation, energy, communications and the securities market—industries that account for almost 10 per cent of the value of everything made and sold—and to exercise indirect control over much of the rest of our private economy. Business activities have become more controlled in areas of environmental protection, job safety, consumer requirements, hiring practices and information reporting and much more.

To be sure, many of these regulations are necessary and important in safeguarding the public interest. For example, regulations to prevent monopolistic pricing, to assure product safety, to provide reasonable and effective standards for environmental protection and worker safety, to make possible fair employment and other things of this sort are improtant to us all. However, too many regulations are overlapping, inefficiently administered with long delays, or obsolete. Others are actually anti-competitive. Regulators regulate with a frenzy and in so doing hamper the basic efficiency of competitive markets.

An underlying problem is that many regulations have never been subjected to a true cost-benefit type of analysis. The benefits are always cited, but very seldom are they documented by evidence showing that the regulation proposed is really going to make a difference. In other words, is there going to be a measurable and significant benefit which will exceed the combined cost of administering the regulations and the costs resulting from reduced efficiency of the U.S. economic system—costs which ultimately must be borne by the consumer? In cases where the benefits are less than the total costs, we should consider changing or eliminating the government regulations and administrative actions that have caused the problems. Many regulations designed to cope with yesterday's problems are obsolete today. Frequently these regulations impede innovation by creating barriers to entry which preserve the status quo and limit competition. Other regulations simply are ineffectively administered creating needless red tape and delays.

In those relatively few areas where there is an identifiable need to safeguard the public interest, Government regulation and administrative direction should be used but normally economic decisions should be left to the marketplace. By eliminating unnecessary regulations and streamlining others, the negative impact of government actions that restrain the economic decision making ability of the private sector would be reduced. The consumer would benefit in being able to purchase the product or service at a lower price and/or with less inconvenience than would otherwise be the case. The reform of government regulation is a principal goal of the Administration and many members of Congress as well. I know of no issue that has the agreement of so many people—from liberals to conservatives, from business to labor. Yet the special interest groups are vociferous and tenacious. Witness the reactions of airline and trucking executives to the President's reform proposals for these industries. We should all recognize that we have an enormous stake in restoring competition to the marketplace.

Turning next to the question of economic stabilization, there is certainly an important role to be played by fiscal and monetary policies in evening out extreme moves in the economy. There have unquestionably been times, however, when such moves and policies have been counter productive. For example, additional government stimulus frequently takes effect at times when the total productive capacity of the economy cannot absorb the increased demand for goods and services. The result is inflation, dislocations in the economy, and, eventually, unemployment. Increased government spending programs have proven to be a cumbersome tool for short-term economic stabilization purposes. There usually is a considerable lag between the time a need is identified. or a claim is made by a special interest group, and the time there is a specific response by Congress to the proposal. Then there is another time lag before the expenditures actually occur and begin to spread throughout the economic system. At the time a proposal was initially considered there may have been underutilization of resources in the economy, but by the time the program actually comes on stream resources are often fully employed so that the additional government spending leads to greater inflation.

If there were some way that old programs could be phased down or eliminated during a period of rapid economic expansion, fiscal policy might be more effective as a tool for stabilization purposes. However, experience has shown that this is not the case and that programs initiated in a period of economic slack tend to become a permanent part of the budget. It is extremely difficult to reduce or eliminate even the obviously ineffective or obsolete programs; to scale down existing programs for countercyclical purposes has been, for all practical purposes, impossible. This is particularly true when the sizable outlays of the many State and local governments are added to the total.

This implies that we must avoid abrupt and excessive changes in government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets, in the markets for capital goods, and in financial markets.

In addition to government expenditures, I am concerned with the size of the chronic Federal deficits, particularly the negative impact on financial markets and capital formation. The rise in Federal expenditures has exceeded the growth in revenues resulting in Federal budget deficits in sixteen out of the last seventeen years. The traditional view of the Government's role in the business cycle was that deficits would be recorded in periods of economic slack, but that surpluses would occur in periods of high economic activity. As a result, savings would be available to the private sector for the capital formation necessary to sustain the economic advance in real terms. This has not occurred in recent years. We not only have had deficits in periods of economic boom but even larger deficits in periods when there is less than full utilization of our resources.

These deficits, of course, need to be financed and such financing in periods of prosperity harm the economy in a number of ways. Over the past ten years, the Federal Government will have borrowed in the capital markets a total of nearly one-third of a trillion dollars on a net basis. The national debt now is climbing at a rate of more than $1 billion a week. During the last ten years, the interest on the debt has more than tripled to almost $38 billion in the current fiscal year and will go to $45 billion in FY 1977, (Interest is now the third largest Federal budget item, after income maintenance and defense.) As annual interest payments grow, fiscal flexibility is constrained. This "uncontrollable" outlay puts pressure on the total budget, which in turn means that programs must be displaced or tax reductions foregone.

Moreover, the deficits place the U.S. Treasury in a position of competing with private investors. The recent avalanche of Treasury securities has created distortions in the traditional patterns of funds being raised by various sectors in the capital markets as well as in the sheer magnitude of total funds raised (see Table 2). In my judgment, this has contributed to making our financial markets less efficient in recent years in channeling the savings of society to investment opportunities. As a result, capital formation is impeded.

Furthermore, deficits cumulate over time. Total Federal debt has increased from $329.5 billion at the end of Fiscal Year 1966, to an estimated $633.9 billion at the end of FY 1976—a rise of 92 percent in only 10 years time. Over the last ten years the average maturity of the debt has declined from 5 years, 3 months to 2 years, 5 months. What this means is that the U.S. Treasury must be a more frequent visitor in financial markets simply to roll over outstanding securities let alone raising funds for current deficits. In this fiscal year, 1976 the U.S. Treasury will absorb over 70% of all moneys in the securities markets; government at all levels will absorb over 80%. This percent must be sharply reduced as the economic advance continues or else some private areas will have to go without.

The problem becomes far more critical as the recovery progresses and the financing needs of the private sector intensify. If deficits remain large, the Treasury, by being first in the credit line, will always get its needs financed but in so doing will make it difficult for companies with less than prime financial ratings to obtain the financial resources they need at acceptable interest rates.

This problem of "crowding out" does not imply a dollar-for-dollar displacement of Treasury for private borrowing, but rather describes strains in the financial markets. These strains result in certain private borrowers not being satisfied and in the financial markets as a whole being less efficient in their function of channeling savings in our society to investment opportunities.

Another aspect of the crowding out problem is the secular deterioration I see in the financial structure of U.S. businesses. Over the past decade there has been a strong trend towards a much more leveraged corporate balance sheet. Debt has roughly tripled; liquid assets have declined relative to liabilities; the debt-equity ratio has about doubled; and the average maturity of debt has shrunk. Just as the Treasury is a more frequent visitor to credit markets, so too will many companies, and if there is a competition for funds, it is quite clear that the less than prime rated company will be the loser. Continuing heavy Treasury borrowings will eventually cause difficulties for these companies, small businesses and potential home owenrs. (In the Appendix, crowding out is discussed in greater detail.)

The size of the deficit also affects the rate of capital formation in the private sector, and this is a matter of great concern. As the recovery progresses, private capital investment must rise to sustain the recovery. In the longer run, the need for increased capital formation has been carefully documented by the Treasury, by numerous outside studise, and most recently, in Chapter 1 of the Economic Report of the President. If we are to meet our goals for increased employment and productivity in a noninflationary environment as well as our environmental, safety and energy goals, we must have an increase in the rate of national savings and private direct investment relative to the total GNP. More specifically, we must increase the percentage of business fixed investment from the average figures of 10.3 percent of our gross national product the last decade to approximately 11½ percent over the next decade. In another sense, total investment, including residential construction, must increase from approximately 14½ percent to 16 percent.

The achievement of our capital formation goals depends on the necessary expenditures being financed in the private sector. In turn, the adequacy of capital flows depends on the savings of society being less and less used to finance Federal expenditures and more and more focused on capital formation. This is the only way we can sustain a durable recovery over the long run and bring down the level of inflation. If the private sector is unable to finance capital formation because of the huge demands on savings by the Federal Government and because of the resulting inefficiencies introduced in financial markets, the boom-and recession sequence of the last decade will be repeated. Therefore, it is imperative that we reduce the Federal deficit and work toward a budget surplus as the recovery progresses.

Excessive monetary stimulus must also be avoided to prevent renewed inflationary pressures and uncertainty. No one wants to see an explosion of the money supply. On the other hand, it is important that the monetary growth be adequate to support the increase in nominal GNP necessary to sustain the recovery. With the surge in the economy in the last half of 1975, velocity increased dramatically; that is, the turnover of the money stock rose indicating people and business used money more efficiently. This growth rate in velocity is not sustainable over the longer run, but still the average rate of growth of velocity may well be higher than in years gone by. If this occurs, the money supply need not grow at as fast a rate to sustain a given level of nominal GNP as it would need to do if there were only a modest growth in velocity. Given the fact that monetary growth in 1975 was moderate, the Federal Reserve has considerable flexibility in managing monetary growth in the months ahead and still be within its target range on a cumulative basis. Given the anticipated velocity increase and this flexibility in near-term policies, the Federal Reserve's target range of 5 to 7½ percent for growth in the money supply is consistent with the sustained recovery we anticipate for 1976. However, over the longer run, this range is not compatible with bringing down the level of inflation. Therefore, the monetary targets will need to be reduced in the future as the recovery proceeds.

For both fiscal and monetary policies, the problem of instability is compounded by the present inflation psychology that permeates our society. All too readily the economy will move to a higher level of prices, but only grudgingly will it move to lower prices despite slack demand. This inflation psychology has been building for a decade and its unwinding will not be easy. The achievement of economic growth without accelerating inflation could be upset by fiscal and monetary policies that are, or even appear to be, overly stimulative.

In addition, such excesses will lead to bottlenecks developing in certain key industries well before the economy as a whole reaches full employment. This occurred in 1973 in such industries as chemicals, steel, paper and fertilizers.

The dislocations caused by bottlenecks send inflationary tremors throughout the economy and lead to inefficiencies which ultimately can curtail a recovery in real terms.

I believe that by excessively concentrating on short-term economic stabilization goals rather than on the long-term allocation of resources, stop-go fiscal and monetary policies in the past have been a disruptive influence which has accentuated the business cycle. Too often fiscal policies and, to a lesser extent, monetary policies have lagged economic developments so that when the stimulus or restraint arrives the business cycle has changed. As a result, these policies accentuate rather than dampen the ups and downs in the economy—just the opposite of the intended purposes of these changes.

We must act wisely and responsibly in bringing stability to our economy. The excesses of the past are not easily undone. Excessive spending, excessive credit creation, excessive stimulation all may provide a short-term palliative, but before long additional inflation and production bottlenecks set in and economic declines. The stop-and-go policies of the past fifteen years have led to an instability which now is deeply rooted in our society. We can undo this problem only through a moderate and steady economic recovery which restores confidence in the prospect for longer run prosperity in a noninflationary environment.

There can be confusion about what is necessary to deal with a current problem and the effect of that action on future fiscal flexibility. Too often we in government are prone to make decisions without proper consideration of the cumulative impact of those decisions on the future. To deal with this problem, I am proposing that government accounting be placed on an accrual basis where unfunded liabilities are fully recognized. This would thwart the natural tendency for those at all levels of government to want to claim revenues too early and expenditures too late, thereby postponing the day of reckoning. We have had recent examples of the sharp and painful adjustments that must occur to a local government when things are continually swept under the rug until eventually the rug will cover no more. With each sweeping, future fiscal flexibility is curtailed one more notch. Eventually a government has no flexibility to deal with current problems. The same thing occurs for the Federal government, except the rug can be stretched for a while because, after all, the Federal government prints money.

The Treasury has been publishing accrual statements for certain individual agencies since 1956 and we now plan to do this on a consolidated basis for the Federal government as a whole. Our target date for the first of these publications—for the Fiscal Year ending September 30, 1977—is early in 1978. I would emphasize that the initial publication will focus on significant accruals that have a major impact on the overall financial condition and operating results of the Federal government. The first set of statements are likely to be accompanied by extensive qualifications. As the reporting process and statement preparation procedures are improved, however, these qualifications will diminish.

Not only will the reader obtain a consolidated financial view of the Federal government but an idea of the magnitude of all liabilities, whether they be funded or unfunded and whether they be due for payment in the near future or the distant future. In these consolidated statements, revenues will be recognized only when they are earned and sure to be collected and expenditures will be recognized no later than the time the liability to pay them is firmly established. We believe that this will bring more responsible accounting to government. Fnancial problems will surface long before a crisis is imminent, thereby reducing unpleasant surprises. I believe this will permit more reasoned judgments on decisions which impact the future fiscal flexibility of our nation. Our children should not bear the albatross of paying for the excesses of this generation, while their government is unable to cope with problems because it lacks fiscal flexibility.

I realize that there has been concern with the cost of installing elaborate accrual accounting systems in agencies where the need is not clearly established. I want to assure you that I am not advocating a slavish application of textbook accounting to every agency and appropriation without regard to benefits. All Federal agencies have accrual accounting of some sort. What we intend to do is supplement the data we already have with some missing pieces of major proportions, and by major I mean in terms of governmentwide magnitudes, not individual appropriations.

I also want to say that I am not proposing a change in the basis for calculating the official budget surplus or deficit, or in the manner of justifying appropriations. There are some who advocate accrual accounting for both of those purposes, but I do not want to let the controversy over those applications interfere with my objective of giving the American people a clear business-like disclosure of the overall financial condition of their Government.

III. SUMMARY

This country has developed the most efficient and prosperous economic system the world has ever known. Over the past fifteen years the U.S. economy has increased the real output of goods and services by 60 percent; the real income of the average American has increased by over 50 percent; the number of Americans living in families with incomes below the poverty level has declined from 20.7 to 10.2 percent (1974) of the population; and 20 million new jobs have been created. Unfortunately, that impressive performance was marred by: (1) a sharp increase in inflation beginning in the mid-1960's; (2) continued unemployment in excess of 5 percent throughout the first half of the 1960's and again in the 1970's, and a sizable GNP "gap" between actual and potential output during those same time frames; and (3) occasional disruption of international trade and investment. While we clearly are justified in having a great deal of pride in our economic system, there also are sufficient reasons to have concern about the future pattern of economic progress.

Throughout much of this period the concept that the government must continuously intervene to stabilize the U.S. economy has dominated policy decisions. The repeated use of fiscal and monetary stimulus too often has turned out to be counter-productive because of the lagged impact of such actions. The "temporary" programs created to respond to current problems have frequently become a permanent government activity with the result that fiscal flexibility and control have been continuously eroded.

This is not to say that governments do not have an important role in promoting economic development. The Federal budget has become a major factor in determining the allocation of national resources. In addition, the Federal Government has an important role in providing temporary assistance to moderate the negative impact of economic recessions. During the 1974–75 recession public employment programs were expanded, unemployment insurance coverage was liberalized, various transfer payments were increased and considerable personal and corporate income tax relief was provided. Federal spending increased dramatically—up approximately 40 percent from FY 1974 to FY 1976—and part of this increase was the responsiveness of existing programs to economic slack. Government policies clearly have a major impact on the total economy, particularly during periods of recession.

The debate over the proper role of the government in the total economy will continue. But there is an even more fundamental issue involving the total size and growth of government spending which has led to chronic deficits and periodic disruption of the entire economy. Merely ranking priorities within the Federal budget is not enough. We must expand the analysis to evaluate total government outlays as they relate to the priorities of the entire economy. I emphasized the need for considering the combined private and public demand for goods and services in my testimony before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee on April 3, 1975.

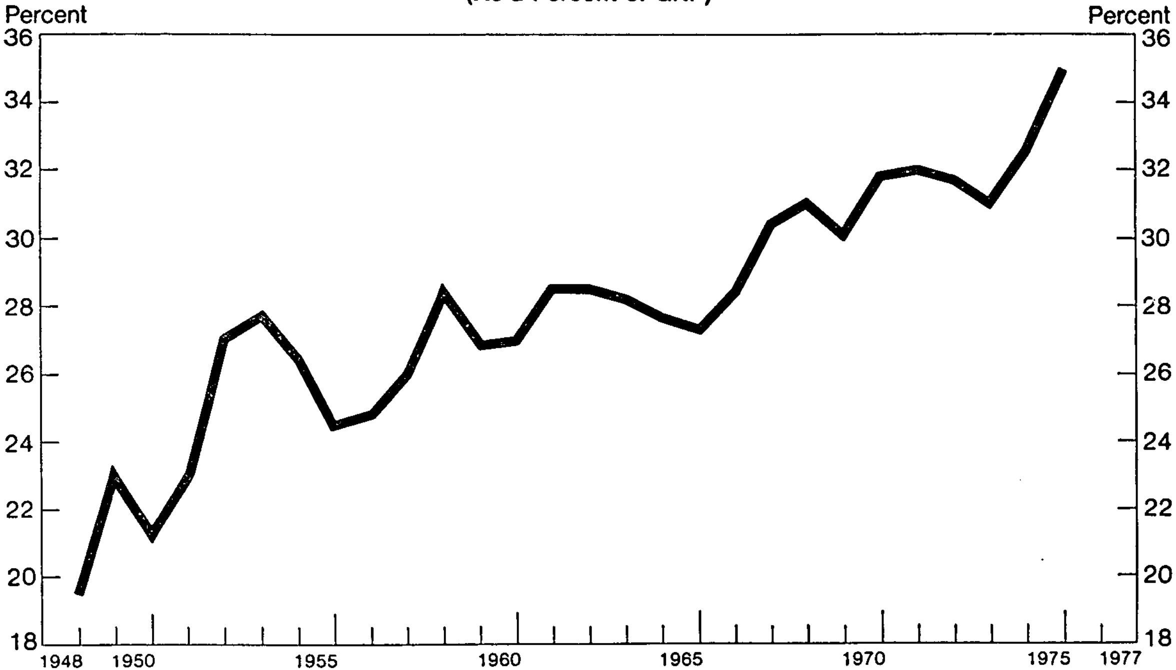
The second basic requirement is to lengthen the time horizon of policy planning. There is a natural tendency to concentrate too much on short-run needs without adequate consideration for the cumulative impact of decisions into the future. This joint is particularly important at this time because of the short-term benefits claimed for rapidly stimulating the economy with the slack that still remains at this stage of the recovery. However, because of the painful inflation recently experienced there must be greater concern about the reactions in the private sector to actual and potential government policies. Employees are anxious to restore their real wage gains and business wants to restore profit margins which have been eroded by inflation. If the real growth in the economy is accelerated too rapidly, both real and perceived inflation pressures could quickly escalate because of concerns about the future. Another repetition of inflation and recession would result in even more unemployment and lost output. Lower rates of unemployment and inflation are obviously the desired goal, but we must consider the prospects over the next few years not the next few months. A mix of policies designed to provide temporary relief at the expense of higher rates of inflation and unemployment in future years is inappropriate.

It is particularly important to consider the longer-run government spending trends. The amount of adjustment in any specific Federal budget may appear to be relatively limited because of the legislative decisions of the past. However, decisions to better control Federal spending today will have major significance on the levels of outlays in 1978, 1979 and beyond as existing programs continue to expand. It will never be easy to make these fundamental shifts and there is a tendency to wait for a more "convenient" time to begin the painful process of regaining fiscal control, but I am convinced that the longer we permit the existing trends to continue the more difficult the ultimate correction process will be. To come to grips with this issue we have designed a responsible mix of economic policies that will bring about durable, lasting economic prosperity which will benefit our nation with sustainable and increasing employment.

Thank you.

Chart 1

TOTAL GOVERNMENT EXPENDITURES
(As a Percent of GNP)

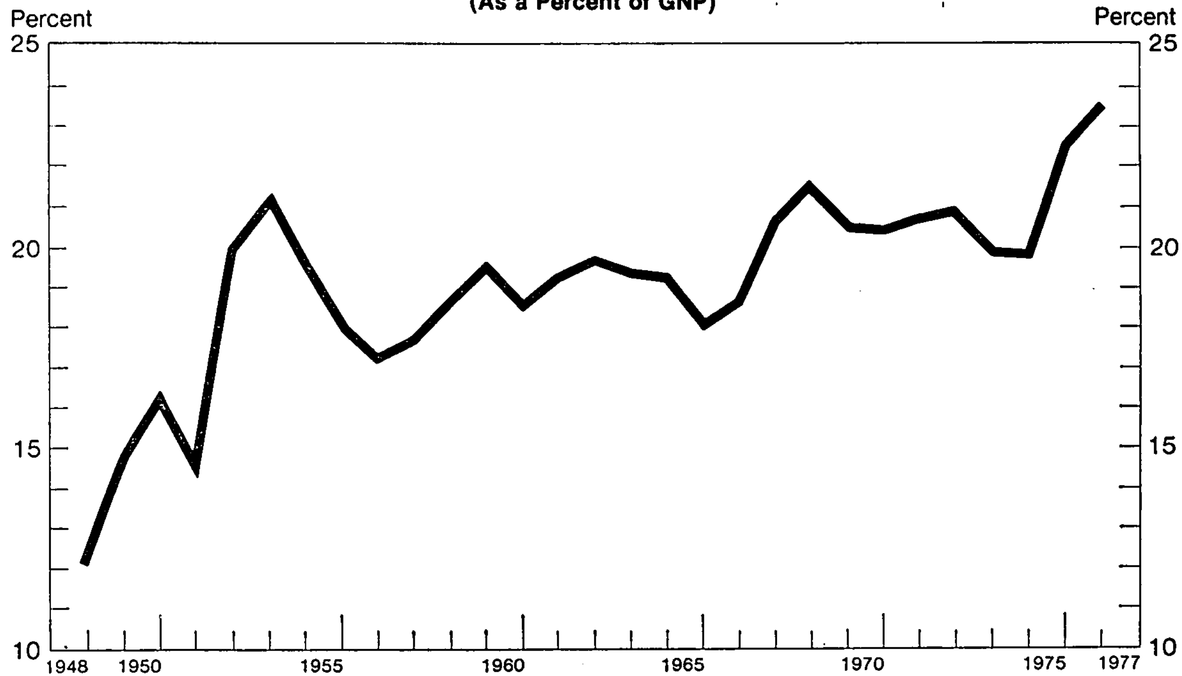


Source: Department of Commerce

CHART 2

FEDERAL BUDGET OUTLAYS

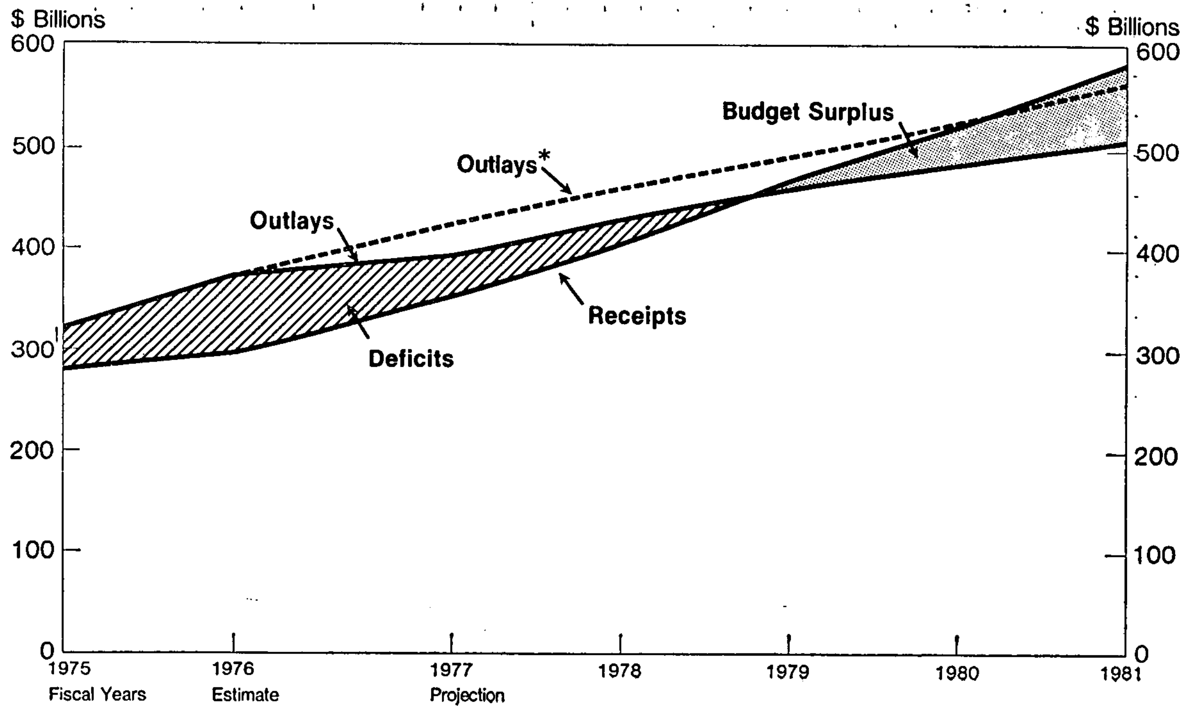
(As a Percent of GNP)



Source: OMB and Department of Commerce

CHART 3

THE FISCAL OUTLOOK TO 1981



* Current Services—no restraint.

TABLE 1.—TOTAL GOVERNMENT EXPENDITURES

[Dollars in billions]

Calendar year	Federal	State and local	Grants in aid	Total	Gross national product	Percent of Gross National product: Federal	State and local	Total
1948	$34.9	$17.6	$2.0	$50.5	$259.1	12.7	6.8	19.5
1949	41.3	20.2	2.2	59.3	258.0	15.2	7.8	23.0
1950	40.8	22.5	2.3	61.0	286.2	13.4	7.9	21.3
1951	57.8	23.9	2.5	79.2	330.2	16.7	7.2	24.0
1952	71.1	25.5	2.6	93.9	347.2	19.7	7.3	27.0
1953	77.1	27.3	2.8	101.6	366.1	20.3	7.5	27.7
1954	69.8	30.2	2.9	97.0	366.3	18.2	8.2	26.5
1955	68.1	32.9	3.1	98.0	399.3	16.3	8.2	24.5
1956	71.9	35.9	3.3	104.5	420.7	16.3	8.5	24.8
1957	79.6	39.8	4.2	115.3	442.8	17.0	9.0	26.0
1958	88.9	44.3	5.6	127.6	448.9	18.6	9.9	28.4
1959	91.0	46.9	6.8	131.0	486.5	17.3	9.6	26.9
1960	93.1	49.8	6.5	136.4	506.0	17.1	9.8	27.0
1961	101.9	54.4	7.2	149.1	523.3	18.1	10.4	28.5
1962	110.4	58.0	8.0	160.5	563.8	18.2	10.3	28.5
1963	114.2	62.8	9.1	167.8	594.7	17.7	10.6	28.2
1964	118.2	68.5	10.4	176.3	635.7	16.9	10.8	27.7
1965	123.8	75.1	11.1	187.8	688.1	16.4	10.9	27.3
1966	143.6	84.3	14.4	213.6	753.0	17.2	11.2	28.4
1967	163.7	94.7	15.9	242.4	796.3	18.6	11.9	30.4
1968	180.6	106.9	18.6	268.9	868.5	18.7	12.3	31.0
1969	188.4	117.6	20.3	285.6	935.5	18.0	12.6	30.5
1970	204.2	132.2	24.4	311.9	982.4	18.3	13.5	31.8
1971	220.6	148.9	29.0	340.5	1,063.4	18.0	14.0	32.0
1972	244.7	163.7	37.5	370.9	1,171.1	17.7	14.0	31.7
1973	264.8	180.9	40.6	405.1	1,306.3	17.2	13.8	31.0
1974	300.1	201.3	43.9	457.5	1,406.9	18.2	14.3	32.5
1975	356.9	222.4	54.2	525.1	1,499.0	20.2	14.8	35.0

Note: Federal grants-in-aid to State and local governments are reflected in Federal and State and local expenditures. Total Government expenditures have been adjusted to eliminate this duplication. The ratio of Federal expenditures to gross national product excludes grants-in-aid.

Jan. 28, 1976.

TABLE 2.—NET FUNDS RAISED IN THE SECURITIES MARKETS BY MAJOR SECTOR

[Dollars in billions]

Fiscal year	U.S. Treasury [1]	Federal and sponsored agencies [2]	Total Federal sector	State and local [3]	Corporate and foreign bonds [4]	Total securities	Federal sector as a percent of total	Government sector as percent of total [5]
1960	$0.8	$1.6	$2.4	$5.7	$4.9	$13.0	18.6	62.4
1961	2.0	–.2	1.8	4.9	6.3	13.0	14.0	51.8
1962	8.8	2.2	10.9	6.0	5.7	22.6	48.4	74.7
1963	6.4	1.0	7.4	5.5	6.2	19.2	38.7	67.5
1964	2.7	1.5	4.2	5.2	6.4	15.8	26.5	59.6
1965	3.1	2.2	5.3	6.9	7.9	20.1	26.3	60.6
1966	–1.0	6.8	5.8	7.3	10.9	24.0	24.1	54.5
1967	–.6	2.7	2.1	6.0	13.0	21.1	9.8	38.5
1968	18.2	5.6	23.8	7.2	16.4	47.4	50.3	65.5
1969	–1.9	5.8	3.9	12.0	15.9	31.8	12.2	50.0
1970	6.8	8.2	15.0	9.7	16.8	41.5	36.2	59.4
1971	20.5	2.8	23.3	15.0	27.5	65.8	35.3	58.2
1972	19.6	8.7	28.3	15.6	21.7	65.6	43.1	66.9
1973	18.5	14.4	32.9	12.6	15.4	60.9	53.9	74.7
1974	2.1	21.3	23.4	17.0	17.4	57.7	40.5	69.9
1975	51.9	15.8	67.7	16.8	33.5	117.9	57.4	71.6
1976	[6] 87.5	14.3	101.8	14.0	25.1	140.9	72.2	82.2

[1] Net increase in marketable and nonmarketable bills, notes and bonds. (Includes Federal financing bank.)
[2] Increase in bills, notes, and bonds of budget and sponsored agencies. Includes GNMA pass-throughs.
[3] Increase in notes, bonds, and Government loans.
[4] Increase in bonds and notes with original maturities of more than 1 yr.
[5] Includes State and local as part of Government sector.
[6] Estimate.

Note.—Office of the Secretary of the Treasury, Office of Debt Analysis, Jan. 8, 1976.

Source: Fiscal years 1960–75 data based on Federal Reserve flow-of funds accounts (which show net changes in outstandings).

TABLE 3.—UNIFIED FEDERAL BUDGET SURPLUS OR DEFICIT IN RELATION TO GROSS NATIONAL PRODUCT 1954–1977

Fiscal year	Budget surplus (+) or deficit (−) (in billions of dollars)	Budget surplus (+) or deficit (−) as percent of gross national product	
		Annual	3-yr moving average (centered)
1954	−1.2	−0.3	
1955	−3.0	−.8	−0
1956	+4.1	1.0	0.3
1957	+3.2	.7	.3
1958	−2.9	−.7	−.9
1959	−12.9	−2.7	−1.1
1960	+.3	.1	−1.1
1961	−3.4	−.7	−.6
1962	−7.1	−1.3	−.9
1963	−4.8	−.8	−1.0
1964	−5.9	−1.0	−.7
1965	−1.6	−.2	−.6
1966	−3.8	−.5	−.6
1967	−8.7	−1.1	−1.5
1968	−25.2	−3.0	−1.2
1969	+3.2	.4	−1.0
1970	−2.8	−.3	−.7
1971	−23.0	−2.3	−1.6
1972	−23.2	−2.1	−1.9
1973	−14.3	−1.2	−1.2
1974	−3.5	−.3	−1.5
1975	−43.6	−3.0	−2.7
1976e	−76.0	−4.8	−3.4
1977e	−43.0	−2.3	

Appendix A

Crowding Out—Setting the Record Straight

There clearly exists some misunderstanding about the meaning and significance of the so-called phenomenon of "crowding out." In essence, there is the idea that since financial collapse has not yet occurred, then the whole issue is misleading. This is wrong. What has occurred is a focussing of attention on short-run improvements in financial markets (associated primarily with the worst recession since the 1930's) and an ignoring of what happens longer-term as the economy moves back toward fuller capacity under conditions of repeated huge sized government budget deficits.

No matter how viewed, the inescapable fact is that with reasonably full use of capacity, more resources claimed by the government *must* mean less for the private sector. Huge deficits which take the lion share of credit flows will eventually push out the weaker private areas—specifically potential home owners, small businesses and even larger companies who do not have a superior credit rating. This is turn will hurt real growth, deprive our workers of adequate productive tools, frustrate the achievement of our longer-term economic needs, and further misallocate our scarce resources. (This was pointed out repeatedly in prior testimony, e.g., January 25, 1975, before the House Ways and Means Committee.)

1. Interest Rates

Interest rates have declined over the past year or so as would be expected during a recession. High-grade bond rates have fallen from a peak of about 10.5% in mid-1974 to around 8.5% today. Yet this drop cannot be taken as sufficient evidence that credit is ample and more importantly that credit will remain ample to support a lasting business recovery. This loss of long-term funds is still very high historically. (Such interest rates ranged between 2%-6% from 1865–1965—a period containing serious wars, depressions, financial panics, business booms and other assorted economic extremes.) The combination of sustained high Federal government financing, of a growing demand for private financing as the expansion proceeds and of a Federal Reserve policy which must eventually moderate in generosity (to avoid rekindling inflation) points to a level of interest rates and availability of funds for private areas which are not consistent with our long-run needs. Total government borrowings this fiscal year will absorb a record 82% of funds available in the securities market; this percent eventually must be sharply reduced or else some private areas will have to go without.

2. AVAILABILITY OF CREDIT

Funds are more readily available to more sectors of the economy today, but again this too reflects the cyclical slack in the economy and not the longer-run secular forces at work here. In the first quarter of 1975 about 5% of all new bond issues were Baa-rated or less. By the fourth quarter, it was almost 10%. (This is still below rates close to 20% at times in 1971 and 1972 however.) More lesser-rated companies are able to finance today. Unfortunately, a lot of these bonds are for shorter duration—5-7 year maturity as opposed to 20-30 year maturity which was the norm not too long ago. This will raise problems in the future since the companies will have to refinance more frequently (referred to as the "rollover" problem in point 4 below). The most important issue immediately ahead is whether such lesser rated companies, will continue to find the necessary funds to sustain the economic advance. When credit markets eventually tighten (as is inevitable), problems of credit availability will occur and their severity will be directly proportional to the relative borrowings of the government.

3. FINANCING OF DEFICIT

The relative "ease" with which the Federal government financed the deficit in 1975 should not be viewed as a normal state of affairs. The fact is that private needs for credit were low because of the recession but as the recovery gains momentum this year, private credit needs will rise. For example, total short-run business borrowing declined in 1975 by about $14 billion; this year it is expected to rise by about $20 billion which is a swing of almost $35 billion. What this means is that there will be a much higher need for total credit in 1976 than in 1975 and eventually some private areas will be squeezed. This is why it is imperative to take steps now to limit the rise in Federal government spending (up almost 40% in just two years time). Not only is future flexibility lost if this cannot be accomplished but the deficit will remain huge and some private areas will not be financed.

4. FINANCIAL STRUCTURE

Over the past decade there has been a strong trend towards a much more leveraged and brittle structure of corporate balance sheets. Debt has roughly tripled, liquid assets have declined relative to liabilities, and the debt-equity ratio has about doubled. Sustained high Federal budget deficits will eventually create pressures in financial markets that will cause difficulties for lesser-rated companines (in terms of debt rollover) let alone leave sufficient credit for expansion needs.

5. CAPITAL FORMATION

Several studies clearly point to a much heavier need for investment over the next several years if there are to be enough jobs for a growing labor force, a healthier environment for our people and a higher degree of energy self sufficiency in the United States. (The share of business investment in GNP must increase from an average of 10.4% over the past 10 years to 12.0% for the rest of this decade—an historically unprecedented change.) Sustained high Federal budget deficits will automatically frustrate the fulfillment of those capital needs by depriving many, many private areas of needed financing to build the new factories and buy the advanced machinery. The real dimension of crowding out becomes much more persuasive and severe the further ahead we look.

CONCLUSION

Crowding out is a genuine problem whose major economic impacts will occur ahead if something is not done about excessive Federal budget deficits caused by too rapid a rise in government spending. The serious nature of this issue should not be masked because of the impacts of a recession. If steps are not taken to exercise better fiscal control, some areas in the private sector will go without needed financing; capital formation will be less than desired; and our serious unemployment and inflation problems will be that much further from a satisfactory resolution. The following excerpts from Professor Paul McCracken's article on the January 8 editorial page of the Wall Street Journal is a well articulated discussion of budget deficits and the phenomenon of "crowding out":

"There is here, however, a more substantive problem. It is the failure of conventional fiscal policy wisdom to face the full implications of the fact that an increase in the federal deficit, from accelerated spending or more tax reduction, must be financed. And the added funds that the Treasury must then borrow are funds not then available to others in the market for financing. . . .

"Markets have, of course, substantial capacity for accommodating to changes in demands, and effects on other borrowers of swings in budget deficits of modest proportions will not be large. When, however, the U.S. government had to raise funds at the rate of $81 billion per year in the first half of 1975, after a $5 billion pace a year earlier, the 22% decline in money for home and commercial mortgages during that period can hardly be assumed to have been an entirely unrelated development.

"The question was never whether a large deficit would cause a disintegration of financial markets, or a collapse of capitalism, or some other catastrophe of draconian proportions, though some have pointed to the absence of such cosmic disaster as evidence that the "crowding out" theory was wrong. The point is the quite common sense one that in financial markets where demands for funds are active, and this is apt to characterize 1976, other claimants for funds will get less than if the large Treasury requirements were not present in the market. The financing "oop" of fiscal policy must be closed.

"This all carriers with it some implication for budget strategy in 1976. Within the limits of fiscal discipline that the political process can muster in a quadrennial year, the Congress and the President can continue efforts toward regaining better control of spending without having to worry about the net adverse effect of this fiscal restraint on the economy. Dollars not borrowed by the Treasury will be put to work by other claimants in the money and capital markets. And housing would be a major beneficiary of the easier financial markets that would result. The basic 1976 trend for interest rates, in fact, is more in the hands of those who manage the budget than of the Federal Reserve."

Representative LONG. I am sure a few of the members of the committee have some questions they would like to ask you.

Congresswoman Heckler.

Representative HECKLER. Thank you, Congressman Long.

Well, Mr. Secretary, as always I enjoyed your testimony. You are one of my favorite members of the Cabinet. However, I have to say that in view of the fact that we have two committee meetings this morning, I am beginning to feel inundated in a sea of words. I would not want you to have to report to the Commission on Paperwork. With a 21-page prepared statement, sir, isn't it possible to make your points and then reserve the rhetoric for your responses to the answers?

Secretary SIMON. Let me explain. Quite often I deliberately do that, Congresswoman Heckler, I have had seven testimonies or will have by tomorrow, during the last 5 business days. We have drafted this document. My staff does all the basic work and I do all the rewrite work. We work together. I would hate to tell you how many hours we spent on this. I have a basic pessimism, knowing the amount of time you have to spend on so many general matters as it relates to all the various areas you are trying to cover, that if I didn't make some of the very strong points I make here and make them verbally, after all this work, that you would not have the time and many would not have the inclination to pore through something that one could honestly say is pretty boring stuff, because economics is a dismal science. I do have very strong feelings about how we got here and how we are going to get out. I have spent a great deal of time attempting to make important points about why our policies are what they are and what they are designed to do. That is why I read it. I know it is tough. I tried to summarize and most of the time I do.

As I said, this big document has been the mother document, if you will, for all my other testimonies on the economy and our economic policy. I felt that if I could get the majority of the people on this important committee just to catch a few of the points I was trying to make—and you might not agree with me—but I thought at least you would have an idea generally of what we are doing.

Representative HECKLER. I think many of the points are well taken, but noting your ability to handle questions, I think the rhetoric could also have been fully covered in your responses. Nonetheless, since I hope to get to another committee this morning as well, I feel perhaps somewhat pressed for time today. Well, that point has been made.

One of my great concerns here is this question of the social security tax. Having many senior citizens in my district, I wondered whether or not you or any of your staff members have made comparisons or studies showing the net effects of your proposed social security rate combined with the proposed tax cut for lower- and middle-income-level families?

In other words, is there going to be a net increase, a net benefit, to the lower income level family with the social security changes proposed by the President?

Secretary SIMON. We are in the process of doing an economic analysis by income group, which we will supply for the record when it is completed.

[The following tables were subsequently supplied for the record:]

PROPOSED TAX CHANGES—SINGLE PERSON WITH ITEMIZED DEDUCTIONS OF 16 PCT OF ADJUSTED GROSS INCOME [1]

Adjusted gross income	Tax liabilities				Tax changes 1975–77		
	1974 law	1975 law	Proposed		Income tax only	Social security [2]	Income tax and social security
			1976	1977			
$2,000	0	0	0	0	0	+$6	+$6
$3,000	$138	$62	$31	$24	−$38	+9	−29
$4,000	302	221	176	155	−66	+12	−54
$5,000	490	404	334	307	−97	+15	−82
$6,000	681	594	501	469	−125	+18	−107
$7,000	889	796	677	641	−155	+21	−134
$8,000	1,100	1,007	864	823	−184	+24	−160
$10,000	1,506	1,476	1,278	1,227	−249	+30	−219
$15,000	2,589	2,599	2,358	2,307	−252	+98	−154
$20,000	3,847	3,817	3,609	3,553	−264	[3] +190	−74
$30,000	6,970	6,940	6,722	6,655	−285	[3] +190	−95
$50,000	15,078	15,048	14,811	14,725	−323	[3] +190	−133

[1] Based on a single person without dependents, under 65. If standard deduction exceeds itemized deduction, uses standard deduction.

[2] Employee's share of FICA contributions only. Includes effects of proposed increase of rate from 5.85 pct to 6.15 pct, effective Jan. 1, 1977. Also, it is projected that the ceiling on taxable wages will rise to $16,500 in 1977. The 1975 level was $14,100.

[3] Increases for households at these income levels are at a maximum because, aside from the general rate increase they are affected by the fact that additional wages will be subject to tax.

Note.—Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 9, 1976.

PROPOSED TAX CHANGES—MARRIED COUPLE—1 EARNER WITH ITEMIZED DEDUCTIONS OF 16 PCT OF ADJUSTED GROSS INCOME[1]

Adjusted gross income	Tax liabilities				Tax changes 1975–77		
	1974 law	1975 law	Proposed 1976	Proposed 1977	Income tax only	Social security[2]	Income tax and social security
$2,000	0	0	0	0	0	+$6	+$6
$3,000	$28	0	0	0	0	+9	+9
$4,000	170	$24	0	0	−$24	+12	−12
$5,000	322	170	$88	$60	−110	+15	−95
$6,000	484	326	233	190	−136	+18	−118
$7,000	658	492	387	335	−157	+21	−136
$8,000	848	674	542	485	−189	+24	−165
$10,000	1,171	1,054	872	800	−254	+30	−224
$15,000	2,062	2,002	1,827	1,750	−252	+98	−154
$20,000	3,085	3,025	2,842	2,780	−245	[3] +190	−55
$30,000	5,564	5,504	5,358	5,328	−176	[3] +190	+14
$50,000	12,380	12,320	12,140	12,080	−240	[3] +190	−50

[1] Based on a married couple with no dependents, both under 65, whose income consists entirely of the salary of 1 spouse. If standard deduction exceeds itemized deduction, family uses standard deduction.

[2] Employee's share of FICA contributions only. Includes effects of proposed increase of rate from 5.85 pct to 6.15 pct, effective Jan. 1, 1977. Also, it is projected that the ceiling on taxable wages will rise to $16,500 in 1977. The 1975 level was $14,100.

[3] Increases for households at these income levels are at a maximum because, aside from the general rate increase, they are affected by the fact that additional wages will be subject to tax.

Note.—Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 9, 1976.

PROPOSED TAX CHANGES—MARRIED COUPLE—2 EARNERS WITH ITEMIZED DEDUCTIONS OF 16 PCT OF ADJUSTED GROSS INCOME[1]

Adjusted gross income	Tax liabilities				Tax changes 1975–77		
	1974 law	1975 law	Proposed 1976	Proposed 1977	Income tax only	Social security[2]	Income tax and social security
$2,000	0	0	0	0	0	+$6	+$6
$3,000	$28	0	0	0	0	+9	+9
$4,000	170	$24	0	0	−24	+12	−12
$5,000	322	170	$88	$60	−110	+15	−95
$6,000	484	326	233	190	−136	+18	−118
$7,000	658	492	387	335	−157	+21	−136
$8,000	848	674	542	485	−189	+24	−165
$10,000	1,171	1,054	872	800	−254	+30	−224
$15,000	2,062	2,002	1,827	1,750	−252	+45	−207
$20,000	3,085	3,025	2,842	2,780	−245	+60	−185
$30,000	5,564	5,504	5,358	5,328	−176	+195	+19
$50,000	12,380	12,320	12,140	12,080	−240	+380[3]	+140

[1] Based on a married couple with no dependents, both under 65, whose income consists of the salaries of both spouses. evenly divided. If standard deduction exceeds itemized deduction, family uses standard deduction.

[2] Employee's share of FICA contributions only. Includes effects of proposed increase of rate from 5.85 pct to 6.15 pct, effective Jan. 1, 1977. Also, it is projected that the ceiling on taxable wages will rise to $16,500 in 1977. The 1975 level was $14,100.

[3] Increases for households at these income levels are at a maximum because, aside from the general rate increase, they are affected by the fact that additional wages will be subject to tax.

Note.—Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 9, 1976.

PROPOSED TAX CHANGES—FAMILY OF 4—1 EARNER WITH ITEMIZED DEDUCTIONS OF 16 PCT OF ADJUSTED GROSS INCOME [1]

Adjusted gross income	Tax liabilities				Tax changes 1975–77		
	1974 law	1975 law	Proposed		Income tax only	Social security [3]	Income tax and social security
			1976	1977			
$2,000	0	0	0	0	0	+$6	+$6
$3,000	0	0	0	0	0	+9	+9
$4,000	0	0	0	0	0	+12	+12
$5,000	$98	0	0	0	0	+15	+15
$6,000	245	$35	0	0	−$35	+18	−17
$7,000	402	186	$89	$60	−126	+21	−105
$8,000	569	347	236	190	−157	+24	−133
$10,000	886	709	555	485	−224	+30	−194
$15,000	1,732	1,612	1,446	1,325	−287	+98	−189
$20,000	2,710	2,590	2,405	2,280	−310	[4] +190	−120
$30,000	5,084	4,964	4,781	4,648	−316	[4] +190	−126
$50,000	11,690	11,570	11,345	11,180	−390	[4] +190	−200

[1] Based on a married couple with 2 dependents, both under 65, whose income consists entirely of the salary of 1 spouse. If standard deduction exceeds itemized deduction, family uses standard deduction.
[2] Does not include earned income credit; with credit, figures would be as follows:

Adjusted gross income	Tax liabilities				Tax change 1975–77		
	1974 law	1975 law	Proposed		Income tax change only	Social security	Income tax and social security
			1976	1977			
$2,000	0	−$200	−$100	0	+$200	+$6	+$206
$3,000	0	−300	−150	0	+300	+9	+309
$4,000	0	−400	−200	0	+400	+12	+412
$5,000	$98	−300	−150	0	+300	+15	+315
$6,000	245	−165	−100	0	+165	+18	+183
$7,000	402	+86	+39	$60	−26	+21	−5

[3] Employee's share of FICA contributions only. Includes effects of proposed rate increase from 5.85 pct to 6.15 pct effective Jan. 1, 1977. Also, it is projected that the ceiling on taxable wages will rise to $16,500 in 1977. The 1975 level was $14,100.
[4] Increases for households at these income levels are at a maximum because, aside from the general rate increase, they are affected by the fact that additional wages will be subject to tax.

Note.—Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 9, 1976.

PROPOSED TAX CHANGES—FAMILY OF 4—2 EARNERS WITH ITEMIZED DEDUCTIONS OF 16 PCT OF ADJUSTED GROSS INCOME [1]

Adjusted gross income	Tax liabilities [2] 1974 law	1975 law	Proposed 1976	Proposed 1977	Tax changes 1975–77 Income tax only	Social security	Income tax and social security
$2,000	0	0	0	0	0	+$6	+$6
$3,000	0	0	0	0	0	+9	+9
$4,000	0	0	0	0	0	+12	+12
$5,000	$98	0	0	0	0	+15	+15
$6,000	245	$35	0	0	−$35	+18	−17
$7,000	402	186	$89	$60	−126	+21	−105
$8,000	569	347	236	190	−157	+24	−133
$10,000	886	709	555	485	−224	+30	−194
$15,000	1,732	1,612	1,446	1,325	−287	+45	−242
$20,000	2,710	2,590	2,405	2,280	−310	+60	−250
$30,000	5,084	4,964	4,781	4,648	−316	+195	−121
$50,000	11,690	11,570	11,345	11,180	−390	[4] +380	−10

[1] Based on a married couple with 2 dependents, both under 65, whose income consists of the salaries of both spouses, evenly divided. If standard deduction exceeds itemized deduction, family uses standard deduction.
[2] Does not include earned income credit; with credit, figures would be as follows:

Adjusted gross income	Tax liabilities 1974 law	1975 law	Proposed 1976	Proposed 1977	Tax change 1975–77 Income tax change only	Social security	Income tax and social security
$2,000	0	−$200	−$100	0	+$200	+$6	+$206
$3,000	0	−300	−150	0	+300	+9	+309
$4,000	0	−400	−200	0	+400	+12	+412
$5,000	$98	−300	−150	0	+300	+15	+315
$6,000	245	−165	−100	0	+165	+18	+183
$7,000	402	+86	+39	60	−26	+21	−5

[3] Employee's share of FICA contributions only. Includes effects of proposed rate nicrease from 5.85 pct to 6.15 pct; effective Jan. 1, 1977. Also, it is projected that the ceiling on taxable wages will rise to $16,500 in 1977. The 1975 level was $14,100.
[4] Increases for households at these income levels are at a maximum because, aside from the general rate increase, they are affected by the fact that additional wages will be subject to tax.

Note.—Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 9, 1976.

Secretary SIMON. You know people tend to link this arithmetically and it is the right thing to do. If I raise social security taxes and propose a cut in general taxes at the same time, the question is there an offset and what is the offset. There is a slight net plus obviously.

But, really it is two separate points. We have economic policy. Part of our economic policy relates to a cut in Government spending and a reduction in taxes simultaneously. That is going to be stimulative because the budget is still stimulative; and, of course, a tax reduction does add stimulus to the economy.

But No. 2, and importantly as it relates to social security, this is not fiscal or economic policy. The President has proposed an increase in social security taxes on the employer and employee to attempt to take care of the fiscal integrity of the social security trust fund of the social security system. This isn't the final answer let me assure you of this. All we have done with this is subtract A from B. In other words, we have bought some time in raising these taxes. It is just going to postpone the day when the social security trust fund is going to run out but we have to design a permanent solution to this.

Hearings have started this week on how we should fund the social security system, and I hear the familiar cry for general revenues. I frankly am absolutely appalled by this because in my judgment general revenues should never—and never is a long time—in any circumstance be relied upon to finance the social security system. Social security is a purchased insurance program and not a welfare program. The financing of it has to preserve this vital characteristic.

Where are these general revenues? This just guarantees massive debts as far as the eye can see if we ever get pulled into that trap. So let's buy this time and then design the system that is permanently going to be financed and not all of a sudden come to another crisis, as we so often do in government, and then make bad decisions under pressure.

Representative HECKLER. As you probably know, Mr. Secretary, there are over 100 cosponsors on the House side of the bill to reform the funding of social security on a one-third employer, one-third employee, and one-third general revenue basis. Now have you done or are you presently doing some studies as to what the impact on the Treasury would be of that proposal because it is not an academic idea. It is gathering momentum on the House side.

Secretary SIMON. Well, is is always easy to go to the Treasury Department and use their general revenues. The fact that we have no general surplus revenues in the Treasury today doesn't seem to bother anybody in the Government. We are not talking about surplus revenues; we are talking about deficits to finance the social security system. The social security system was based on an earned right principle. Now, if you want to dismiss the earned right principle and turn the system into a welfare program, that is up to Congress. I suggest the terrible temptation of continually raising benefits, as has been done in the past, will continue in the future and end up providing misery to the very people we are trying to help; namely, the retirees and all the rest on fixed incomes through the insidious and cruel tax of inflation.

And that one-third share doesn't fool me either. Maybe it will start at one-third but it will not end up that way. It will grow.

Representative HECKLER. Nonetheless, I think it would be important for the Congress to have some facts and analysis of what the impact would be.

Secretary SIMON. Oh, I assure you when I'm called to testify, which I assume will be right after David Matthews, I will have a response to this that will be slightly negative.

Representative HECKLER. One of the problems that I see on the question of social security is the fact that there seems to be some controversy about the urgency of the crisis. The JEC staff estimated that given the economic assumptions of the budget, the surplus and the trust fund, although declining, is estimated to be $23 billion in 1981 under current law.

Secretary SIMON. Well now, can I stop you there and ask——

Representative HECKLER. If I might just ask a question?

Secretary SIMON. OK.

Representative HECKLER. Why should the Congress thus embark on changes which would increase the surplus to $68 billion in 1981?

Secretary SIMON. Right now I think my numbers are accurate but I don't have the social security stuff with me—our trust fund is about $44 billion. In 1981 it is projected at $23 billion, that is only 2 months—that is 2 months' reserve.

Now, if we have another recession—and we are going to have another recession someday—that 2 months will be depleted extremely rapidly. And that is what I am talking about the crisis when it occurs.

I don't think, Congresswoman Heckler, you would disagree with me, or any other of the people that are making studies like this, that the trust fund is going to run out. We may disagree on the day. Whether it is 1985 or 1986 or 1981 in my mind isn't terribly important. The actual date just lends to the urgency of doing something about it now.

But then we must also look at the longer run. We must look at a time when we are going to have more people retired. We must also consider the assumptions people are making on the fertility rate in the future and its impact on the system. In other words, we must look at how many people are going to be working in our economy to support these retirees, to fulfill these promises that we continue to make to the people. We must also look at what the real earnings increase is going to be. And I would hope that all of these questions are going to be asked very searchingly by the Members of this Congress because I think we have real problems as we look ahead 25 and 50 years. I know what folly that is, Representative Heckler, suggesting we look ahead like that into the long term because we seldom do.

Representative HECKLER. I understand my time is up, Mr. Secretary, but I will say that young people in my district are now questioning whether they should contribute to the social security fund, because of the fear of having the fund absolutely bankrupt by the time they would be able to draw benefits. That fear is growing in acceptance to the point where there is almost an attitude of panic about this question.

Secretary SIMON. Well, I have had young people ask me that question, Congresswoman Heckler, and I tell them I believe that, as far as social security and the future is concerned, that we will act with uncharacteristic wisdom and put the system on a sound financial basis in the future.

Representative HECKLER. Thank you.

Representative LONG. Thank you very much. Senator Proxmire.

Senator PROXMIRE. Mr. Secretary, we welcome your statement. I am glad you got some strong documentation here—where you say "total government spending averaged about 35 percent of our GNP in 1975, compared with 27 percent in 1960 and 21 percent in 1950." And then you document that with charts and you point out the enormous increase in personnel working for the Federal Government.

Secretary SIMON. And State and local governments, too.

Senator PROXMIRE. Yes, the State and local increase has been the most spectacular and one of the biggest reasons for this great increase that you point to. It is good to have this brought up to date. The figures I have seen go back to 1930 where, of course, the increase is even more spectacular. I think at that time, 10 percent of our GNP was Government and now it is 35. The difficulty is the momentum.

Now, I think this is very sound. I am glad you are hitting away at it. The problem I have here, however, is that if the administration is going to take the position that we have to hold down the increases in Federal spending—and I think it is a sound position—then it seems to me they should come forward with a program to encourage the private sector to expand and to expand vigorously. Just yesterday, the Chairman of the Federal Reserve Board said he was going to lower his monetary goals to 4½ percent. And of course in the last 6 months, the increase in the monetary supply has been low. It is true that interest rates have gone down, but it seems to me that if we are going to have the Federal Government follow a policy of eliminating jobs, or of at least not providing jobs for people who are out of work, then the only way you can make this work realistically is to have a program that really enables the private sector to take off in an effective way. We must have a housing program, a monetary program, as well as tax incentives. I don't see that in the administration's agenda, and I don't see that in your statement, although, as I say, it is a very good statement and a very responsible statement. But, I think your statement indicates we are going to idle along at an unacceptable pace. You know as well as I do, if that happens, two things are likely to result: One is that this Congress is going to increase spending sharply and override the Presidential vetoes; and the second thing is we are going to have a President in 1977 who is not going to fool around and we are really going to have a Federal spending takeoff.

Secretary SIMON. Let me comment on that. Of course, that is where the debate is, namely, are we doing enough and what is enough? And I really think that we have provided an extensive stimulus already. Again, when we look back to where we were a year ago, we see that. We had Federal outlays, which have been very stimulative. Federal outlays have grown 40 percent in the last 2 fiscal years.

Senator PROXMIRE. That is exactly the wrong course and you should agree.

Secretary SIMON. Oh, I surely do.

Senator PROXMIRE. You are the main spokesman on that.

Secretary SIMON. Yes.

Senator PROXMIRE. I am talking about the other side, though. Where is that?

Secretary SIMON. All right, let's talk for a moment about the tax proposals as far as stimulating investment. We have $8 billion for stimulating investment and $20 billion for individuals. That is $28 billion for capital formation and stimulating the economy. We have proposed a permanent investment tax credit at 10 percent. Our utility proposals would assist building in this critical area, and also put people in the construction industry back to work. But, as to the foundation of the tax proposals that we made, in my opinion the most dramatic was the integration of corporate and personal taxes. Most other industrial countries in the world are already doing that and it is time for us to catch up. If we could enact those programs, Senator Proxmire, in my opinion, we would have a private sector that indeed would be stimulated sufficiently to take care of our goals in the future.

Senator PROXMIRE. Well, I appreciate the confidence——

Secretary SIMON. Also, I am a believer in markets. And I must admit, and maybe you will take some exception to this, markets are really not markets; they are not a Federal force; they are people.

There are millions of individual people making decisions and deciding that things are going to be better or things are going to be worse. When you take a look at the recent performance, both in the interest rate sector as well as the stock market and the ability of companies to finance in the equity sector, which has been nonexistent for such a long period of time, there is growing confidence—and I read an article which I must admittedly agree with, and I read it yesterday in one of the newspapers—that the investors now believe that we are not going to, or beginning to believe, that we are not going to overstimulate; that we are going to have a moderate recovery that is going to be lasting; and that we are not going to make the mistakes we made in the last 10 years twice. That gives me some confidence in believing we have the right mix of economic policies, but I can see where there is cause for disagreement. Because, boy, I agree with you—you know, as Irving Kristol said, the beginning of wisdom is to know that the future is unknowable.

Senator PROXMIRE. You see, the best tax incentive programs you can conceive are not going to get any really vigorous expansion in plant and equipment unless the market is there, unless it is there. You can eliminate the corporation income tax and you are still not going to get an increase in business investment in plant and equipment unless they are convinced that they are going to have an expansion in sales. I don't see that in the administration's program.

Secretary SIMON. Well, of course——

Senator PROXMIRE. You say you are going to get a reasonable expansion in housing. We got that from Mr. Lynn, who estimated 1.75 million housing starts by the end of the year. That is very optimistic. The experts that appeared before our committee don't go that high. And even if they got that high, it would be pitifully inadequate. Our goal is for 2.6 million housing starts a year. So that is far short of what we ought to have.

Housing is an area where we can have 2 man-years of work for every housing start. We need 1 million additional housing starts now. We need that in the private sector. A very, very modest investment on the part of the Federal Government can start this moving in a big way, but there is no program to do it.

Secretary SIMON. You know, when you say there is no program——

Senator PROXMIRE. There isn't a program to do that.

Secretary SIMON. In fiscal year 1976, farm and residential credits supplied by the Federal Government will be about $36 billion of mortgage credit. That is a lot of——

Senator PROXMIRE. What do you mean supplied by the Federal Government?

Secretary SIMON. Well, farm credit and mortgage credit, FHA, GNMA, FNMA, VA, Home Loan, and all of the other programs.

Senator PROXMIRE. Oh, sure, there is insurance, but these aren't programs to get over the tough stubborn fact that when the typical family goes out to borrow money so they can buy a home, their mortgage rate is 9 percent, plus.

Secretary SIMON. I agree with you.

Senator PROXMIRE. And that is what stops them. If the mortgage rate was 7 percent, they would buy that home and put two people to work for a year. You multiply that by 1 million, and you've got a big part of the recession solved, and you have it in the private sector.

Secretary SIMON. I would say there are other factors. I agree that a mortgage today at 9 percent is a deterrent to housing. If it was at 5 percent, it would be $100 a month less in payments. But also take a look at what happens as a result of inflation for the past 10 years, really, in the cost of an average house, which is over $40,000 in the United States today. The cost of land has skyrocketed. That is why in attacking inflation——

Senator PROXMIRE. Well, there are all kinds of things. What I am saying is here is something we can do something about. We passed legislation in the House and Senate—the President vetoed it. That legislation would have brought the interest rates down.

Now, let me ask you about one other area. I am concerned about your priorities, too. I don't think the budget we are given by the Ford administration is going to put people to work as effectively as another budget might. In the military area, for instance, the papers reported this morning, the New York Times reported there was a memorandum from the Office of Management and Budget that there is a $3 billion of "cut insurance" in the military budget. In other words, $3 billion higher than they felt it really had to be. In addition to that, the President overruled the Office of Budget and Management to the tune of $2.7 billion in restoring funds that the Office of Management and Budget cut. Add those together, and that is almost $6 billion here.

Secretary SIMON. He is the boss.

Senator PROXMIRE. Well, he may be the boss, yes, that is right. But, it suggests that the Office of Management and Budget, which was looking for an efficient way to provide the defense we need, and the "cut insurance" together adds up to a concentration in the military area, which (1) is inflationary because you don't produce the economic goods this way; and (2) is a very expensive way to provide jobs. The average job in the military is about $17,000 for a job, compared to a little more than half that in other areas and far, far less than that in housing.

Secretary SIMON. I don't think there is the water this year——

Senator PROXMIRE. This is the first time we had "cut insurance" in writing. In the past, we have speculated on this and it has been denied they had "cut insurance." This time, we have a memorandum in the newspapers.

Secretary SIMON. It is?

Senator PROXMIRE. Sure, the New York Times disclosed it this morning. They tell us there is $3 billion of water in there.

Secretary SIMON. I wasn't aware of that. Of course, I must admit I get a lot of information out of the New York Times and the Wall Street Journal and things like that. As I always said, the ship of state is the only ship that leaks from the top.

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

Representative LONG. Senator Taft.

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

First, I have an opening statement, which I won't go into, but which I would like to put in the record at this point.

Representative LONG. Without objection, so ordered.

[The opening statement of Senator Taft follows:]

OPENING STATEMENT OF HON. ROBERT TAFT, JR.

One of the major issues to emerge from our hearings on the Economic Report of the President is the controversy over the proper short run economic policy to be followed over the next few months. Do we increase the amount of stimulation to try to drive unemployment down faster, or will this worsen inflation unacceptably and put us back in a boom-or-bust cycle? Can we lower unemployment more swiftly and surely by means of government jobs or through the private sector?

When the Council of Economic Advisors testified here last week, it was their contention that it was at least twice as expensive in terms of tax expenditure to put a person to work with a federal program rather than by lowering taxes enough to stimulate private investment. Furthermore, the Council declared that 80% of the public jobs created by such programs ended up merely replacing one public employee with yet another, for a very small net gain in employment.

This testimony is a serious indictment of the public sector programs we have been funding with billions of dollars. I believe that the Council, or the Treasury, or some other part of the executive branch, owes us a study of these questions that can provide us with hard figures and explanations. Those who favor public jobs are just not going to take the Council's word on the matter. They must have evidence if they are to change their views.

Those of us who favor the private sector also need to see such a study. We need it to prove our case, and I would urge the Secretary of the Treasury to review the testimony of the Council, to discuss this matter with them, and to get such a study under way as soon as possible.

I should like to say a few words about the contention that public jobs can fight inflation by utilizing excess capacity and raising supply. This idea runs counter to the established theory that there is a trade-off in the short run between inflation and unemployment. Unfortunately, there is a grain of truth here that has resulted in a good deal of confusion about this matter.

It is true that an increase in aggregate supply in the economy should tend to lower prices, at least on a oneshot basis. However, we are faced with deficient aggregate demand for the output. We could stimulate demand by cutting taxes or by increasing government spending. The Council prefers the former. The latter has pitfalls.

If the government buys goods and services that the public values and would have freely chosen, then the public experiences an increase in living standards. If the public does not value the added output, then resources have been wasted.

What is worse, some people on the Hill are talking as if public jobs could lower the general price level. This is impossible. If we want the price of automobiles to fall, we must do something to increase the efficiency of the industry, so that costs will fall, output and hiring will expand, and the consumer will buy the product at the lower price. This can only be done through investment and the stimulation of production of automobiles. It makes a great deal of difference, from the point of view of increased supply, whether or not it is an increase in the supply of something useful, something the consumer wants, and something the consumer has been reluctant to buy because of the price. It does not fight inflation to hire someone to push paper, or to do something else that does not produce the goods that the consumer wants to buy. The anti-inflation theory only makes sense if people return to work in those private industries which have economies of scale, or if the expansion of private industry occurs because of investment and lower costs of production. These goals can be achieved by tax cuts for business and individuals far faster than through government hiring, which only takes people out of the productive sectors of the economy, and gives us a supply problem for the future.

In short, we can stimulate real output by increasing the rewards for production, encouraging efficiency through investment, and raising consumer demand for the products, all through tax cuts. Or we can put people into jobs the consumer did not create, rather than trying to put them in the productive sector, and, in this roundabout and inefficient way, try to force an increase in demand at two to ten times the tax expenditure of the simple tax cut.

I think that, if we look at this problem from the consumer's and taxpayer's viewpoint, our choice is clear.

Senator TAFT. Mr. Secretary, under the financing plan for the proposed plan for the IMF trust fund, less developed countries will obtain a proportional share of the one-sixth of the IMF gold, which is to be sold to raise money for the trust fund. The developed nations will be the only ones to turn over their gold to accomplish the sale for the trust fund——

Secretary SIMON. The who, Senator? I didn't hear that.

Senator TAFT. The developed countries. Are the OPEC countries to be classified as developed or less developed for the purpose of this transaction? The OPEC countries have recently reduced their promised amount of foreign aid to Third World countries. Has the proposed trust fund caused them to shift this burden to the IMF?

Secretary SIMON. I am going to have to check on that question on the countries, and the distribution of gold. But, I would speculate, but only speculate, that the OPEC nations will be treated in the same way as the United States. It is under discussion, I am told.

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

The matter is still under discussion, but the objective is to have OPEC treated as if it is part of the economically developed countries for this particular transaction.

Senator TAFT. Would they sell back to the Fund?

Secretary SIMON. They would do the same thing as the United States would do.

Senator TAFT. In other words, sell back to the Fund?

Secretary SIMON. That is the U.S. position and that you can be sure of.

Senator TAFT. Thank you. How do you answer the argument at the present time in the early stages of an economic recovery, Mr. Secretary, it hardly behooves us to recommend a budget that represents a cutback in real spending?

Secretary SIMON. Well, sometimes we look only at the short run and not at the long run for the cumulative effect of actions that have been taken in the past. When I look at a budget that was originally going to grow almost 15 percent in 1977 over 1976, without any action towards new programs; when I look at a budget that has grown 40 percent in the last 2 fiscal years; when I look at a monetary policy that has been stimulative and will continue to support an expansion in our economy, I think that a reduction in the growth of spending is indeed called for before we renew the inflationary excesses, Senator Taft.

Senator TAFT. What interest rates levels do you believe are consistent with continued economic recovery, and what interest rates are implied in the budget's provision for Federal deficits?

Secretary SIMON. Well, the average interest rate of the United States Treasury today is 6.55 percent. We never try to guess, if you will, what interest rates will be during the course of the year. So we always set what interest rates actually are in the various sectors of the market today, and then make judgments as to where the various financing is going to tak place in what maturity sectors, and that is how we get our interest rate judgments, and they have been fairly accurate in the past. And of course, the interest rates, as you know, are a function of the supply and demand for money and most importantly of the level of inflation.

Senator TAFT. Are you saying, then, that you don't expect, the budget doesn't project, any change in average interest rates? Is that it?

Secretary SIMON. Again, we never felt it was our role, in our budget, to give our forecast on what the interest rate might be month-by-month each year, as we are financing our debt.

Senator TAFT. In the preparation of the budget, was any consideration given to having a larger budget than the one that was recommended? Specifically, do you or other officers in the executive branch attempt to predict the consequences of a budget that at least represented no fall off in real spending levels?

Secretary SIMON. Yes, we started that exercise last summer, Senator Taft, in attempting to identify what indeed spending might be and what would be the resulting impact on inflation and the economy with continued spending based on our judgments of GNP and continued economic recovery and the rest. And the decision was arrived at, after much debate, and announced by the President really in October of what we are going to try to do as far as cutting back spending in fiscal 1977 by the $28 billion, in which much of the work had been done—well, most of the work on the economic side, but the specifics all hadn't been designed yet, because all of the agencies were still in the process of doing that.

And it is at that level where, Senator, in our judgment, we believed we could have a sustainable, durable, and lasting recovery.

Senator TAFT. Have you, or anybody in the Treasury, anybody in your tax analysis staff, made any comparison or studies showing the net effect of the proposed social security rate and base increases, combined with the proposed tax cuts for lower and midincome families? In other words, will there be a net benefit or a net detriment to these lower-income families?

Secretary SIMON. Well, simply speaking, there would be a net benefit—and that is overall. But we are in the process of doing this now, by income class, which we will supply to this committee just as soon as it is finished.

Senator TAFT. Well, there seems to be some controversy as to the urgency of the crisis in the social security trust fund, which makes the proposed rate increases necessary. The Joint Economic Committee staff estimated that, given the economic assumptions in the budget, the surplus in the trust fund—although declining—is estimated to be $23 billion in 1981 under the current law. Would you explain why you believe this action should be undertaken now?

Secretary SIMON. I responded, Senator Taft, before you came in, to Mrs. Heckler. I think Mrs. Heckler asked me that question, and I went into it in some great detail.

Senator TAFT. You don't need to repeat it, then.

Secretary SIMON. I said that $23 billion is only 2 months reserve in 1981, and if we do, indeed, have a recession sometime in the future, that the fund would be very quickly depleted. Nobody disagrees, either you reconomists or ours, that the trust fund is going to run out. Whether it is 1985 or 1987 or 1981 to me is immaterial. We have to get that remedied right now.

Senator TAFT. There have been a number of calls for an increase in public service jobs to help bring the rate of unemployment down quickly. Can you advise what is Okun's Law and what relevance does it have to this situation?

Secretary SIMON. Well, as a rough guide, 3 percent extra growth in real GNP drops the unemployment rate by 1 percent. And of course, stimulation to achieve that, would, in our judgment, be highly inflationary. Our judgment on public service jobs is that they have been not terribly efficient. They have been a good deal more costly than simply providing assistance for the unemployed now. Also, assistance gives people the ability to continue to look for work in the private sector, which today still provides five out of every six jobs in this country. That is the area that must be reinvigorated, with the incentives that I spoke about to Senator Proxmire in our overall economic policies.

Senator TAFT. When the Council of Economic Advisers testified here last week, it was their contention that it was at least twice as expensive in terms of tax expenditures to put a person to work in a Federal program, rather than lowering taxes enough to stimulate private investment. Furthermore, it declared 80 percent of the public jobs created by such a program ended up merely by replacing one public employee for another, with a very small net gain in employment. This would seem to me to be a very serious indictment of public service programs, which have been funded with billions of dollars. Do you think that the Treasury or the Council or some other part of the executive branch should make a study of these questions that can provide us with figures and explanations?

Secretary SIMON. Let us try to do that in a comprehensive way, but understanding at the same time, Senator, that it is very difficult. We have numerous examples in the CETA program and others where we are willing to provide the public service jobs where people get laid off by State and local governments and that there is a replacement there. But, it is very hard to quantify how much, exactly how much that does occur. People are reluctant to talk about it. Therefore, it is difficult to analyze.

Senator TAFT. All I could say about it is, this is going to be an argument in the Congress. And those who favor public jobs aren't going to just take the Council's word, or the Treasury's word on the matter. And I think we need some evidence, and we need a study of some kind put together.

Secretary SIMON. I am told the Labor Department has such a study underway right now. So, we will get a copy of that to you.

Senator TAFT. Would that be coordinated with the Treasury?

Secretary SIMON. With the Economic Policy Board, it would be, yes.

Senator TAFT. Thank you very much. I think my time has expired.

Chairman HUMPHREY [presiding]. I have a question I would like to ask.

Mr. Secretary, you talk a great deal in your current statement and also in the past about the dangers of crowding out in the money markets; that is, that large government borrowing demands might take the available credit away from private borrowers, thereby hampering the recovery of the private economy. You have mentioned this particularly as it related to 1976 when the economy would be recovering rather than in 1975 when the private demands for funds was weak.

My question, or observation that I put to you is this. In looking through current economic publications, I seem to find that there isn't too strong a private demand. So, I ask, where is the strong private demand for the funds which you and others have been anticipating for 1976?

Secretary SIMON. Well, that is——

Chairman HUMPHREY. Let me just continue a minute. Bank loans to business have been declining.

Secretary SIMON. Yes.

Chairman HUMPHREY. The money supply is not growing or, if it is, very little, not because the Fed doesn't want it to grow; but because there is no demand for funds and because banks are following very cautious lending policies. Now, the layman's type of business publication—and I mention Business Week—but also others, points this out week after week. The Commerce Department survey of business investment plans indicates very modest growth of business investment in 1976 and an actual decline in real terms.

Now, this would seem to indicate that demand for private funds may turn out to be less than was generally assumed. So, my question is: Do we face the crowding out problem in 1976, or do we face, in fact, a problem of weak demand in the private sector for funds? Thus far the evidence seems to me to be weak demand.

Secretary SIMON. Let me first of all thank you, Mr. Chairman, for being the first one who has portrayed accurately what I was saying a year ago.

Chairman HUMPHREY. Can I just say here, on February 9, Business Week said: "The Fed is sending out signals but the banks aren't getting out the money." It says: "The big loan demand stand-off." This is a feature article, pointing out that even when the banks are shopping around sort of door-to-door, they are just not placing the money.

Secretary SIMON. Let me comment a couple of seconds on this before you have to run. What I said a year ago was that the danger of crowding out was going to occur next year and beyond when the economic recovery was well underway, when private demands started to go up and that indeed there then was going to be a competition for funds; Mr. Chairman, what I would like to do is ask you, if you could, on the way back to your other hearing, to read this. I wrote a three-page document which was attached to my testimony, and it is called "Crowding Out: Setting the Record Straight." It talks about what the danger is.

Chairman HUMPHREY. I saw that.

Secretary SIMON. It talks about the danger of financing deficits and it talks about the interest rates. And yet's look back last year, when we talked about financing in the marketplace. I was forecasting that corporate borrowing was going to be a record. And I was even low as to what the ultimate corporate borrowing was. Do we call interest rates that declined from 10 to 8¾ percent in the severest recession in a generation as having declined? Yes, I guess they technically have. Well, but relative to what? Starting with an economic expansion of 8¾ percent interest rates is too high. There is no doubt about that.

Also, take a look at the Baa, at the lower rated corporations, and how they fared in 1975. The first 6 months of last year, Baa's were about 5 percent of the market, versus a traditional 20 percent. They go to 10 percent at the end of the year, but were still well below prior levels. So there was a slight problem.

The real problem, however, exists in the future, as this three-page paper points out, if something isn't done about about our Federal deficits. And Beryl Sprinkel wrote a good article, which I would like to put in the record, if I might. This was in the Chicago Tribune on February 2, 1976.

Chairman HUMPHREY. The article will be included in the hearing record.

[The article follows:]

[From the February 2, 1976, issue of the Chicago Tribune]

FISCAL STIMULUS NOT ISSUE IN DEFICIT SPENDING DEBATE

(By Beryl W. Sprinkel)

President Ford's budget projects outlays of $394.2 billion in fiscal 1977 and a deficit of $43 billion, which include the effect of a further $10 billion tax reduction. Despite the fact the projected expenditure level is 5.5 per cent above this year, it represents a relatively tight budget.

Merely financing program now under way would yield expenditures of $420 billion—more than $25 billion above the President's plan.

Furthermore, the Joint Economic Committee of Congress, chaired by Sen. Hubert H. Humphrey [D., Minn.], recently called for more fiscal stimulus, including an additional 10 per cent tax cut and spending of $10 billion more than the $430 billion needed to sustain present programs.

Two budget issues will be heatedly debated over the months ahead: First, should the federal government play a larger or smaller role in the economy, relative to the private sector? And second, do we need even larger deficits to stimulate the economy?

Presently, federal, state, and local spending account for about 40 per cent of national income. Furthermore, the trend has accelerated in recent years.

For example, from 1970 to 1975 the expansion in government outlays was equal to 55 per cent of the increase in national income. This means that for each additional dollar of income, 55 cents was allocated to government programs.

No wonder the public is becoming concerned about the growing burden of higher spending and higher taxes! Furthermore, the government is increasingly pre-empting the market incentive system by telling its citizens what they can do and what they may consume.

There is mounting evidence many of our costly government programs are not achieving their stated objectives, and, in fact, frequently are exacerbating problems.

Citizen and legislative awareness is reflected in the Congressional Budget and Impoundment Control Act of 1974, which is fully effective this year. This act forces Congress to impose a ceiling on overall government expenditures before considering the funding of existing and proposed programs.

The spending constraints will force an ordering of legislative priorities. High taxes dull incentives to save, invest, and produce, and hence make it more difficult to finance the growth needed to provide jobs and higher incomes in future years. Taxes can be lowered only by reducing expenditures at the government level.

The preferred relative size of government versus the private sector is a legitimate are for debate. However, we cannot continue recent rates of growth in public spending without seriously handicapping the health and prosperity of the private sector, which still employs five out of six of the nation's workers.

Some argue that, irrespective of the private versus public sector argument, we nonetheless need a more stimulative budget policy to hasten the return to higher employment.

This view follows conventional Keynesian analysis, which contends the larger the actual or full employment budget deficit, the greater the stimulus and, hence, the larger the subsequent rise in spending, national income, and employment.

But is this view correct? Budget deficits created by spending increases or tax cuts must be financed. There are only two ways this can be done.

If the deficit is financed by absorbing savings otherwise available for housing or other forms of capital investment, the stimulus of higher federal spending and-or tax cuts is offset by restraint on private investment. There is no reason to believe a net stimulus will occur under these conditions, but there is a presumption private investment will be retarded.

Alternatively, the resulting deficit may be financed with new money created by the Federal Reserve System. In this case there will be no short-run squeeze on private investment, but, with current deficits, an enormous increase in the money supply would occur. This would raise employment in the short run but would undoubtedly lead to accelerating inflation by 1977.

Furthermore, if a somewhat greater expansion in the money supply is desirable—and I believe it is—it can be readily achieved without incurring large federal deficits.

Therefore, larger federal deficits either create a squeeze on private capital formation, or, if financed mostly by newly created money, provide a short-run stimulus at the cost of higher inflation in the future.

If moderately greater growth in the money stock is needed, it can be achieved without larger deficits. It therefore does not follow that a larger deficit is needed to stimulate the economy.

This is a false issue, even though the familiar drumbeat has already begun. Deficits provide stimulus only if financed by new money.

Unfortunately, many who prefer larger government spending programs attempt to justify their position by arguing the need for a greater stimulus. These are separate issues and should remain so.

If American voters ever decide, as many have, that government is too large and should be retrenched, they need not accept larger budgets and deficits because of the perceived desirability of greater stimulus.

Compared with the alternative of increasing monetary growth by Federal Reserve action, fiscal policy is an inefficient tool for providing a short-run economic stimulus. The size of government should be debated on its merits or demerits, not on the false issue of needed fiscal stimulus.

Since 1976 is an election year, legitimate fears exist that excessive money will be created and federal spending on voter services will soar. Yet, up to the present, the newly proposed budget is restrained, and monetary growth has been below Federal Reserve targets.

But the year has just begun. Emphasis on bold, new budget programs, larger budget deficits, and sharply higher monetary growth could again trigger the go-stop policy thrusts of the past decade. Let us hope political manipulation of our national finances is avoided in this Bicentennial year.

Secretary SIMON. Mr. Sprinkel talks about the traditional Keynesian analysis. You have heard Arthur Burns say, on many occasions, we are no longer living in the Keynesian world, which responds to the policies as in the past. But, it is a fact that deficits are going to be financed in one of two ways, Mr. Chairman. One is to take money from the private sector. It is pretty simple in periods of high activity, or even moderate—and we are not there yet, but we are on our way there—that money we take in the Government is money that will not be spent in the private sector for private investment. There is no doubt about that.

The second way it can be financed is if the Federal Reserve prints the money. Now, that is a stimulus to the economy. There is no doubt about that. And that would keep interest rates, at least for a short period of time, a little lower than they might be, but we all know what would happen——

Chairman HUMPHREY. I think you left out something very important. The best way to finance the deficits is to get the country going so you don't have the deficits.

Secretary SIMON. I agree with you, except for what happened in the last few years.

Chairman HUMPHREY. But the point is, you've got yourself dug into quicksand. You keep singing the same song, but you never get us out of the sand.

Secretary SIMON. But the point is, if you really believe the best way is to balance the budget, how come we have done it only once in 17 years?

Chairman HUMPHREY. Well, we have had deficits, but nothing on the horrendous scale that we have been enjoying these last few years. I submit to you, when you have a policy as nonproductive as the one you have been pursuing, you might want to reexamine it, Mr. Secretary. After all, if you keep taking the same old medicine and you continue to be sick, go get a nw doctor or at least get a new prescription. Here you've got deficits that you say we ought to finance. My suggestion is maybe it is important to have a greater money supply so you get out of deficit. These deficits are not due just to wasteful Government expenditure. In part, I suppose, it has been a pattern of our life, but they are due to high unemployment and recession. There is $40 billion in this current budget that is related to social costs, and unemployment compensation costs. Now, if you can cut that in half, you've got your deficit cut in half.

Secretary SIMON. May I say——

Chairman HUMPHREY. No, wait a minute. You talk about crowding out. Now when is this going to happen?

Secretary SIMON. As this memorandum says—which I again hope you read—as we work our way back to capacity. And I will also suggest along with what I just finished saying, Mr. Chairman, that it has already happened to some extent. Paul McCracken talked about this in an article recently. It has already happened, to a lesser degree. And the more that economic activity increases, the more it will occur.

Chairman HUMPHREY. But it didn't crowd out.

Secretary SIMON. And you can tell me——

Chairman HUMPHREY. There was a lot of borrowing in the third and fourth quarters that wasn't crowded out.

Secretary SIMON. Yes, but borrowing by whom?

Chairman HUMPHREY. Interest rates have been coming down, haven't they?

Secretary SIMON. I don't call 10 to 8½ percent per se as coming down.

Chairman HUMPHREY. Well, I wish you had been as concerned about those high rates a year ago.

Secretary SIMON. I warned about them exactly at that time.

Chairman HUMPHREY. Well, warned about them, but what have you done about them?

Secretary SIMON. What do you want to do about interest rates?

Chairman HUMPHREY. Well, one thing is to make available a supply of money so you get your interest rates down.

Secretary SIMON. If we make available an excessive supply of money, you are eventually going to have even higher interest rates.

Chairman HUMPHREY. I think they were kept up, Mr. Secretary, as a considered determined policy, as a part of a way to slow down this economy at a time when it was already slowing down. That is my personal judgment. I think there is a lot of evidence that supports it. But, you have argued the crowding out theory. It is a good theory, but when is the crowding out going to start?

Secretary SIMON. The period of real crowding out, as I say, comes when the real economic activity picks up and as it increases in the future. And regardless of what some academic economists whisper in your ear, they never understood anything about finance or anything about financial implications of it to begin with.

Chairman HUMPHREY. May I say that as your interest rates have come down so has your money supply gone down.

Secretary SIMON. Well, as I say——

Chairman HUMPHREY. And there hasn't been any crowding out.

Secretary SIMON. I discussed the phenomena of M_1 earlier with you on the velocity and the problem of seasonal adjustments.

Chairman HUMPHREY. But my question, Mr. Secretary, I can buy the theory of crowding out. I understand the so-called logic of the crowding out. But, the theory in economics is one thing, and the practice of economic life is another thing.

Secretary SIMON. I am not a theorist, but——

Chairman HUMPHREY. Has it started? It hasn't started yet, has it?

Secretary SIMON. I am not a theorist and I am not an economist either.

Chairman HUMPHREY. Well, let me ask, has it started yet?

Secretary SIMON. There has been evidence of crowding out in the market during the first 6 months of last year.

Chairman HUMPHREY. Well, what about——

Secretary SIMON. Again—well, let me finish, please. As Paul McCracken stated in the Wall Street Journal, we see——

Chairman HUMPHREY. That doesn't make anything true.

Secretary SIMON. No, but I am giving you statistics. Is it a coincidence that when the Federal Treasury was financing on an annual rate of $81 billion versus $5 billion a year before, that money for housing and home mortgages declined 22 percent? I think that obviously there is a competition there; there is a competition that made the Baa corporations not able to go into the long-term sector. Those that could borrow were financing in the short-term and intermediate sector, which did very little to redress their balance sheets. But the real problem is not in 1975 and it is not going to be in the early months of 1976.

Chairman HUMPHREY. Well, when is it?

Secretary SIMON. I can't say it will be June 11th at 12 noon.

Chairman HUMPHREY. No, I didn't say that. But what year do you think it is going to be?

Secretary SIMON. I think toward the end of this year and into next year, directly related to the facts of our deficits.

Chairman HUMPHREY. Well, now, isn't the projected deficit to be less this year?

Secretary SIMON. Yes, we certainly hope it is going to be.

Chairman HUMPHREY. All right. And if we have recovery of any degree, it will be even less than the current projection?

Secretary SIMON. Well, based on our projections, it will be $43 billion.

Chairman HUMPHREY. Well, that is about $30 billion less than last year.

Secretary SIMON. $30 billion less than the fiscal——

Chairman HUMPHREY. Yes, than the current fiscal year.

Secretary SIMON. Right.

Chairman HUMPHREY. All right, but what makes you think there is going to be more crowding out when the deficit is less and the recovery has some of its own momentum?

Secretary SIMON. Because private demands are going to grow.

Chairman HUMPHREY. The private demands are going to grow. That is true. But, my goodness, there is a great deal of difference already in the projected deficit of the last year as compared to the projected deficit for next year.

Secretary SIMON. There is also another very important point. Economists us the symbol, "net new money raised in the marketplace." And I have always had some great problem with the net new money raised because of the massive debt rollovers that we have in the Treasury Department now. We used to have what we called quarterly refundings. But I have been filling up the financing slots at such a rapid pace, I think we can look forward to the day when we are going to have almost weekly refundings.

Chairman HUMPHREY. Here is the story that the average citizen gets. Look here at what Business Week says: "Bank loans to business have been slowing. So banks are buying more Treasury bills. Interest rates are continuing to slip and the money supply is flattening out."

Now, all the talk that we heard a year ago from you and others was that we were going to be in this terrible crowding out crunch. It hasn't happened. Now you are pushing it up another year.

Secretary SIMON. Wait a minute. No, sir; you go back and look at the printed words in my testimony, Mr. Chairman, which said it is going to occur in 1976 and beyond as the economic activity rises. When you talk about what has happened to business loan demand, of course business loan demand is off. No. 1, take a look at the largest inventory reduction in our history. So, obviously, there has been a paydown. But, with consumer spending and retail sales as they are right now, you can reasonably expect a pickup in the months ahead.

Chairman HUMPHREY. OK. We do not disagree on the theoretical dangers of the theoretical problem of crowding out. I don't disagree with that. What I am trying to say, and I think the evidence thus far supports my contention, is that at a time of 8 percent unemployment, at a time of less than adequate use of our plant capacity the possibilities of crowding out, as a constraining force of the money available to private industry does not seem to be documented by the current facts. Now, you are making a prediction. And what you are really saying is that at the end of calendar 1976——

Secretary SIMON. These are judgments as to when it will happen.

Chairman HUMPHREY. At the end of calendar year 1976, there is going to be a very serious problem of crowding out. I would like to ask you to do this—and I will cease and desist: Does the Treasury prepare estimates of supply and demand for funds, broken down by a major category, usually called sources and uses of funds? Could you make those available to us?

Secretary SIMON. I certainly will.

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

TOTAL FUNDS RAISED IN U.S. CREDIT MARKETS, CALENDAR YEARS[1]

[In billions of dollars]

	1972 (actual)	1973 (actual)	1974 (actual)	1975 (estimated)	1976 (projected)
Long-term funds:					
Mortgages:					
Home	40.7	41.7	30.2	38.5	50.7
Multifamily	10.4	8.5	7.8	5.0	6.5
Commercial	15.1	17.3	11.6	4.9	8.8
Farm	2.6	4.4	4.9	4.4	5.8
Total mortgages	68.8	71.9	54.5	52.8	71.8
Corporate securities:[2]					
Bonds	20.2	12.5	23.4	36.2	25.5
Stocks	13.6	9.6	4.6	9.1	13.0
Total corporate securities	33.8	22.1	28.0	45.3	38.5
Total long-term funds	102.6	94.0	82.5	98.1	110.3
Government securities:					
U.S. Government	13.9	7.7	11.8	84.2	86.6
Federal agencies	9.7	21.6	21.5	9.7	20.8
State and local governments	14.7	14.0	18.1	16.7	13.5
Total Government Securities	38.3	43.3	51.5	110.6	120.9
Short-term funds:[3]					
Business credit:					
Open market paper	1.6	8.3	16.7	−1.7	4.2
Bank loans	22.0	42.4	34.4	−18.6	11.2
U.S. Government loans	.3	1.2	2.1	−.1	1.9
Federal agencies loans	.8	8.5	9.3	−2.4	4.2
Financial companies loans to business	2.8	2.9	3.5	1.3	1.2
Security RP's	1.7	3.3	−3.1	2.9	1.5
Total business credit	29.2	66.6	62.9	−18.6	24.2
Consumer credit	19.2	22.9	9.6	5.2	16.5
Security credit	8.9	−8.2	−4.6	−.7	2.0
Foreign loans:					
Banks	3.7	7.9	7.6	.3	.5
U.S. Government	1.8	1.7	1.6	3.0	2.6
Total foreign loans	5.5	9.6	9.2	3.3	3.1
Other loans:					
Banks	2.8	1.8	−2.5	.7	1.1
U.S. Government	.7	.6	.9	1.2	1.3
Policy loans	.9	2.2	2.7	1.5	1.6
Total other loans	4.4	4.6	1.1	3.4	4.0
Total short-term funds	67.2	95.5	78.2	−7.4	49.8
Total funds raised	208.1	232.8	212.4	201.3	281.0

[1] Based on the economic assumptions used in the budget for 1976 and 1977.
[2] Including foreign securities.
[3] Including bank term loans and long-term Federal credits.

Note.—Office of the Secretary of the Treasury, Office of Debt Analysis, Jan. 23, 1976.

TOTAL FUNDS SUPPLIED IN U.S. CREDIT MARKETS, CALENDAR YEARS[1]

[In billions of dollars]

	1972 (actual)	1973 (actual)	1974 (actual)	1975 (estimated)	1976 (projected)
Savings Institutions:					
Contractual-type:					
Life insurance companies	13.8	15.7	16.1	16.1	17.5
Private pension funds	6.6	7.3	8.2	12.9	14.9
State and local retirement funds	7.8	9.2	12.3	11.5	14.2
Fire and casualty insurance companies	6.7	5.0	4.0	5.8	5.2
Total	34.9	37.2	40.6	46.2	51.8
Deposit type:					
Savings and loan associations	36.4	27.1	21.0	42.5	46.2
Mutual savings banks	10.4	5.4	3.4	11.7	12.0
Credit unions	3.1	2.9	2.7	5.5	6.3
Total	49.9	35.4	27.1	59.6	64.5
Other:					
Investment companies	−1.8	−2.5	.9	1.4	1.2
REITs	4.9	4.5	.9	−3.7	−2.5
Total	3.1	2.0	1.8	−2.3	−1.3
Total savings institutions	87.9	74.6	69.5	103.5	115.0
Banking:					
Federal Reserve banks	0.3	9.2	6.2	6.8	11.1
Commercial banks	75.4	83.3	62.2	23.1	63.6
Total banking	75.7	92.5	68.4	29.9	74.7
Business:					
Nonfinancial corporations	2.6	7.9	8.1	14.6	15.3
Finance companies	10.7	10.2	4.0	−1.1	2.0
Securities brokers and dealers	4.3	−3.5	−1.0	−2.3	2.0
Nonfarm noncorporate businesses	1.1	1.3	.9	1.2	1.6
Total business	18.7	15.9	12.0	12.4	22.9
Government:					
Federal Government	2.6	3.0	7.4	11.5	10.7
Federal agencies	7.0	20.3	24.1	12.3	19.5
State and local governments	3.6	.4	.3	1.9	−.7
Total governments	13.2	23.7	31.8	25.7	29.5
Foreign	10.8	3.5	12.0	11.2	14.4
Households (residual)	1.8	22.6	18.7	18.6	24.5
Total funds supplied	208.1	23.28	212.4	201.3	281.0

[1] Based on the economic assumptions used in the budget for 1976 and 1977 and on 6.3 pct increase in M1 and 9½ pct increase in M2 both years.

Note.—Office of the Secretary of the Treasury, Office of Debt Analysis, Jan. 23, 1976.

Chairman HUMPHREY. I think that will be helpful to us in terms of resolving what is a legitimate difference of views as to where we are going. I don't want my remarks interpreted as that private capital should not have the sources available to it for its expansion. I believe in investment. I know that capital formation is important. But nothing is worse to the economy than capital that is dormant and unused. Dormant capital is really like unemployment; when you've got unused labor and unused capital, you've got two depressents on the economy. I must confess that I was really shaken when I read in the February 9, issue of Business Week, which says:

The Federal Reserve and the Nation's big commercial banks now have a dilemma in common. The Fed insists it wants to stimulate the money supply and promote economic recovery by getting banks to loan more money to busi-

ness. The banks are busily looking for loan customers, but are unwilling to cut prices or shade their new, tougher credit standards to get it. The problem is that the very businessmen who normally rely on bank money insist they really do not need much of it today, producing what economist Leonard Santow calls a mismatch. And according to Santow, the banks do not want to lend to companies that need the money and the companies that the banks want to lend to do not need the money.

What is new? That is exactly what has been going on. That is what the whole ball game is all about. The people who don't need the money can get it; the people that need the money, the guy that is struggling for his life, they say "Well, you can't meet my credit standards." This is what has gone on in this country for several years, and this is why there are bankruptcies and this is why the housing industry is in trouble.

General Motors doesn't have to worry. They have a line of credit. But the little stores really have to worry, because they don't have that line of credit. This is what we have been arguing about in regard to the prime rate, which is about as meaningful to the average citizen as blowing bubbles in a sand storm. It doesn't mean a thing. What is important is the going rate.

So, I am just kind of an old-fashioned practical kind of guy, out from the woods that takes a look at what happens to the fellow out there who wants to borrow some money. And the people who want to borrow can't get it; and the people that don't need it, they say, "Hey, would you like to have a nice big platter-full of loans?"

Secretary SIMON. Thank you for confirming my theory of crowding out.

Chairman HUMPHREY. There is no crowding out.

Secretary SIMON. That is exactly what it is. You are crowded out by the high interest rates in the marketplace, by the flight to quality, by the inability to borrow by the lesser corporations. General Motors and the rest of them can get it.

Chairman HUMPHREY. There is a lot of money lying around. You and the Fed should get the banks and tell them they'd better start using it. Because when this capital is not used, it is unemployed. Like unemployed workers, unemployed capital is a curse on an economy that depends on the marketplace. If I know anything about economics, I know that.

What is our problem today? If our problem is Government policy, then maybe we should get working to change the rules. Whatever it is, there is capital waiting there and it isn't being used. It is not being crowded out. It isn't being used. That is my judgment, anyway.

Secretary SIMON. You have good judgment.

Chairman HUMPHREY. All right. Congressman Long.

Representative LONG. Yes, I do have two short questions. One is a request for the record, Mr. Secretary, but before I get to that, let me ask this. In the President's budget for this year, the proposition that business in high unemployment areas, which, if I recall correctly, was 7 percent or more——

Secretary SIMON. Yes, sir.

Representative LONG [continuing]. Be allowed to depreciate new investments in plant and equipment at a faster than normal rate. On the face of it, it appears to be a very attractive type of situation, and one generally I would favor.

The budget estimates of the cost to the Treasury of this tax write-off would be about $300 million for fiscal year 1977.

Secretary SIMON. $369 and eventually $1 billion.

Representative LONG. You say $369 and $1 billion?

Secretary SIMON. In four years.

Representative LONG. And, as I say, on the face of it, such a program looks very good. But, if we look at the capacity utilization across the entire spectrum of the economy, we begin to get to a little bit of a different picture. It is somewhere about 75 percent, at least to the best of my knowledge. Maybe it is a little more than that, or maybe a little bit less than that. And I wondered if, in coming forth with that proposal, if you all had any evidence that areas of high unemployment are closer to fully utilizing the existing capacity of plant and equipment than is the rest of the economy? Because I strongly suspect that what it really is, is that they have a lower utilization than you do in the economy at large. And I wonder if, in view of that, if this is really a wise policy?

Secretary SIMON. I have no knowledge of any study that has ever been done or, indeed, Congressman Long, could be done that could quantify present capacity in hundreds of thousands of companies that exist. I will say one thing, though, and this is pretty generally agreed to, that at best the government's capacity numbers are suspect. Back in 1971, when we were pulling out of the recession, everybody was talking about 4 or 5 years and then we would get back to full utilization again. And full utilization means different things to different industries. And normal full utilization is about 85 percent—and again, our numbers are somewhat suspect—but we found that we got back to full capacity again in 1973 and 1974. And the bottlenecks, Mr. Chairman, which you correctly referred to, appeared very early in some of our basic industries. And this is what is in danger of happening again. When certain basic industries reach the peak before others, the price pressures become apparent in some of our great basic commodities.

Representative LONG. But the point you are making runs all the way across the business spectrum, Mr. Secretary, and unless there is some justification for showing that the capacity is used to a greater extent than 75 percent, or at least equal to what the national average is, it seems to me that the basis of the recommendation that we have given in these high unemployment areas, well, is at the very minimum, Mr. Secretary, suspect.

Secretary SIMON. No. If we know within reason—and again this is suspect—that we have approximately 72 or 73 percent capacity utilization in our economy and we have an unemployment rate unacceptably at an 8.3-percent level. We know also that the construction industry is probably one of the most severely impacted in the area of unemployment. So if we talk about building plants and expanding existing plants today, it has a twofold benefit: It puts the construction industries back to work in the initial stages, if you will; and it starts plant expansion and new plant building before we move back to full capacity again. Hopefully, this transfers activity that would have occurred next year and the year after into this year when there is a slack in the economy and when there is high unemployment.

Representative LONG. Doesn't it follow, Mr. Secretary, that if you've got an area where they are not even using their existing capacity, you are not going to get that because they are not going to build additional capacity?

Secretary SIMON. No, sir. If I am a businessman and I take a look at my order book and I take a look at what I consider to be the demand in the future, and I remember back to 1973 and what I was operating at then, and if I am making a decision whether to expand my plant now or wait a couple of years and see what happens, I take a look at what the outlook is now. I take a look at inflation and, if I wait a couple of years, it is going to cost me 8 percent or 7 percent or 6 percent additional, I assume, I take a look at the fact the materials are going to go up in price and the wages are going to go up, certainly. So, I weigh all of these things. And just because I am operating at below capacity now doesn't mean I am not going to start a new plant or expand the existing one because probably it is going to take me a couple of years to finish that expansion. And by that time, I expect I will be at full capacity, and then I will be able to produce more goods and services. So, I don't think——

Representative LONG. Let me try another tactic, then. What did you come up with in the way of figures as to the number of jobs this might create. Did you come up with a projection in that regard?

Secretary SIMON. We did, when we were figuring our revenue estimates at $300, $600 and $900 billion. But each project would employ different amounts of labor, so that is a highly judgmental number, just like our revenue estimates are judgmental, too.

Representative LONG. I don't argue with the need for long-range planning on the part of business and looking at where your market is going to be 3 or 4 years from now and what your capacity is going to be. But, it seems to me to be very elementary that if you are in an area that has high unemployment, that is logical that that means you are even at a lower rate of use of capacity than you are in the country at large, and that consequently you are again dealing with one where the need for capital investment to build your capacity is less than it could be in the country at large. And while most of the area I represent would fall into this category and I well recognize that, it still doesn't seem to me to have been a well thought out proposal.

Secretary SIMON. Well, we discussed it at great length. And of course, this is designed for the near term, to take care of the unemployment that exists today for providing incentives, if you will, to get the needed expansion certainly in industries that would be expanded in the future.

You know, the point is that maybe it won't work. Nobody knows whether it will work or not. But, if it does not work, it is not going to cost us anything.

Representative LONG. But, let's go back to this question whether at the time you were making this decision to come up with this recommendation, whether it would be judgmental as to the number of jobs that would be created?

Secretary SIMON. I will get the judgments we used on the number of jobs, Congressman.

Representative LONG. Could you come up with that figure?

Secretary SIMON. Fine.

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

The primary effect of the proposal to allow accelerated depreciation deductions in areas of high unemployment is to accelerate the timing of investment outlays. Some projects will be started and completed earlier than previously planned so as to take advantage of the tax incentive allowed under the proposal. Unfortunately, because of the temporary nature of this proposal and the absence of similar precedents in the past, any quantitative forecasts are conjectural at best. We know that the direction of change will be positive. However, too many other factors affect employment to isolate the impact of this proposal on the magnitude of jobs provided, holding all other things constant.

Representative LONG. Finally, let me ask you one other thing to present for the record. We are doing here, as you know, some in depth analysis of this whole question of the social security trust fund. And it has been difficult for me, at least, to determine from the budget the status of the trust funds in a way that I can understand readily. As best I can, in fiscal year 1975, the trust fund receipts exceeded outlays by about $4 billion in round figures. And in fiscal year 1976, the outlays under that fund reversed the thing. Now, the outlays are going to exceed the receipts by about $2 billion.

It seems to me that this is directly related to the high unemployment that exists. The unemployment rate will probably average over 8 percent, or somewhere right around 8 percent, in fiscal year 1976, and——

Secretary SIMON. Let me respond for the record, because I want to get the numbers for you, which will answer the first part of your question.

Representative LONG. That is what I was going to ask you to do. I really wasn't going to ask you to comment off the top of your head. We need the figures.

Secretary SIMON. Let me give you what has happened in the last 5 years as far as receipts and outlays and what we expect to happen in the future under various assumptions on the depletion of the trust fund; because I don't as I said to the Chairman before, I don't think anybody disagrees that the trust fund is going to be depleted in the future, whether it be 1987 or 1985 or 1981. I think we can have a difference of opinion on our assumptions, but the fact remains the trust fund would be depleted certainly in the 1980's. And I will supply these numbers for you, Congressman Long.

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

The following table provides actual receipt and outlay data for the Social Security trust funds for Fiscal Years 1971 through 1975. Also provided in the table are estimates for Fiscal Year 1976, the transition quarter, and Fiscal Year 1977. The estimates are contained in the President's 1977 Budget and are consistent with unemployment rates of 7.7% in Calendar Year 1976 and 6.9% in Calendar Year 1977.

The 1976 Annual Report to the Congress of the Board of Trustees of the Social Security Trust Funds is currently being prepared and we expect that this report will provide estimates under a variety of economic assumptions. The report is due by April 1, 1976.

FEDERAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE TRUST FUNDS, RECEIPTS AND OUTLAYS, FISCAL YEARS 1971-77

[Dollars in millions]

	Fiscal year 1971	1972	1973	1974	1975	[1] 1976	Transition quarter	[1] 1977
Receipts:								
Social insurance taxes and contributions	$35,845	$39,907	$46,084	$53,925	$62,458	$66,465	$17,917	$76,912
Interest on Federal securities	1,942	2,107	2,283	2,518	2,808	2,837	692	2,654
Federal payment as employer for employee retirement	640	657	695	764	916	963	255	1,054
Other (mainly receipts of special Federal payments)	466	537	524	496	4	517		717
Proposed legislation								3,482
Total receipts	38,892	43,207	49,585	57,703	66,671	70,782	18,864	84,819
Outlays:								
Benefit payments	34,482	38,587	47,332	54,007	62,469	71,386	19,581	82,166
Payments to other trust funds	626	749	802	931	1,010	1,083		1,289
Administrative expenses and other	765	822	956	929	1,179	1,298	353	1,393
Proposed legislation							−12	−826
Total outlays	35,874	40,157	49,090	55,867	64,658	73,707	19,922	84,022
Surplus or deficit (1)	3,018	3,050	495	1,836	2,018	−2,985	−1,058	797

[1] As estimated in 1977 budget document.

Note.—Date: Feb. 11, 1976.

Representative LONG. One of the assumptions I would like for you people to consider and project in that is full employment, sir, as to what it would be under the variable factors——

Secretary SIMON. Absolutely.

Representative LONG [continuing]. Of unemployment that exists.

Secretary SIMON. Yes, as I said again to the chairman, full employment today would help. But all it would do is postpone the ultimate depletion of the trust fund and not provide a permanent, if you will, solution.

Representative LONG. That statement scares me, Mr. Secretary. It gets me back to something that we had the biggest hassle here the other day with Mr. Greenspan about that I ever heard. It just seems to me as though it is an absolute lack of concern for people as human beings to say that we have been at work now, and that they are going to become entitled to social security because of the fact they are at work now, but that is going to create a problem for us down the road—to say that, Mr. Secretary, scares the hell out of me.

Secretary SIMON. I was not relating this to unemployment. I am talking about the revenue impact of having the high unemployment or the revenue impact of having the present unemployment rate we have now. It is immaterial. The social security trust fund is going to be depleted gradually over the years and we have to direct ourselves to the permanent financing solution. I wasn't relating it to high unemployment or low unemployment. I was making a financial statement.

Representative LONG. Well, I don't argue with your financial statement with you, but I am making a social and political human being statement that it seems to me it is directly related to the number of people that are covered by——

Secretary SIMON. I mean, we would love to have full employment and we want to get there as fast as we safely can, Mr. Long.

Representative LONG. In order to save your time and everyone's time, Mr. Secretary, let me ask our staff to get together with yours with respect to these projections on this issue.

Secretary SIMON. Absolutely.

Representative LONG. It could be helpful to us and there are three or four things we would like to have in this regard, if we could.

Mr. JONES. That is on the social security?

Representative LONG. On the social security and also on the health insurance trust fund. The two are, as you well know, related.

Chairman HUMPHREY. Yes; in looking over the social security financing, it seems to me you have to lay down certain options and alternatives, such as the full employment figures and what they would give to you in terms of receipts and outlays, such as certain possible increases in the wage base.

Secretary SIMON. The wage base, if you increase the wage base, what that does is automatically increase the benefits in the future approximately 25 or 30 years from now——

Chairman HUMPHREY. No, it doesn't automatically do it. Your benefits have to be determined by law.

Secretary SIMON. Yes, but the formula presently, as explained to me, increases the benefits in the future as we increase the wage rates.

Chairman HUMPHREY. Yes, that is the decoupling provision. Well, I think the time is at hand to take a very good solid look at our social security trust fund and also how they are invested and in what kind of securities they are invested.

Secretary SIMON. They are invested in the finest securities in the world.

Chairman HUMPHREY. Yes, Government securities, but also at what rates of interest on those securities? Some of them are invested at rather low rates of interest.

Secretary SIMON. I think you will find the social security trust fund is managed just like all of our trust funds, Mr. Chairman, at the market rate of securities.

Chairman HUMPHREY. That is right. I have been told the trust funds have been invested in rather low-yield securities.

Secretary SIMON. Well, some of them were bought 20 years ago, or 10 years ago, when interest rates were lower than they are today.

Chairman HUMPHREY. Yes, well you can be helpful to us in that also. The other point I want to make, and again these are all projections of your revenue estimates—and by the way, revenue estimate errors have been made by many Treasury Secretaries.

Secretary SIMON. Not many; all. And I would suggest that every Treasury Secretary in the future does——

Chairman HUMPHREY. Well, it is still an estimate. That is my point. We understand that.

Do you consider these revenue estimates on the conservative side or on the more generous side?

Secretary SIMON. I would say that these estimates are our best estimates, if you will.

Chairman HUMPHREY. The last time you had some estimates on off-shore oil that were way off.

Secretary SIMON. Excuse me, that is on the expenditure side of the budget. That is a negative expenditure.

Chairman HUMPHREY. Well, that always confuses me.

Secretary SIMON. It always confuses me, too.

Chairman HUMPHREY. I don't think anybody really understands that.

Secretary SIMON. Well, that is the way we keep our books and I don't understand that either.

Chairman HUMPHREY. If you can clear that up, Mr. Secretary, you and I will be better friends.

Well, you have been here a long time. Let me thank you for your extensive statement. We have some disagreements. I personally feel that the emphasis in our budget, which also relates to fiscal policy and monetary policy is not adequate in terms of getting at the problems of unemployment. And I am not using the word "unemployment" relating only to unemployed manpower; as I said a while ago, unemployed resources, unemployed capacity or unused capacity, unused capital, are also important. But these are differences that men of good will hold. I just think that there is a willingness to permit the recovery to come at a slower pace than I believe is desirable.

Secretary SIMON. That is the difference.

Chairman HUMPHREY. Yes, that is it.

Secretary SIMON. And that is where honest men, Mr. Chairman——

Chairman HUMPHREY. That is the difference.

Secretary SIMON. Well, honest man can differ.

Chairman HUMPHREY. I never impugn anybody's motives who comes before us. That is the last thing I need to do. I know you people are concerned about the country, just as I am.

Secretary SIMON. Sure.

Chairman HUMPHREY. Our concern is sometimes expressed differently. I was very upset the other day, to be honest about it, about the job's program, which I know is not in your neck of the woods. I was darned upset when I listened to the Council of Economic Advisors tell us what we couldn't do. I wanted to hear what we could do. I worked with a fellow sometime ago who said, "If you have a fellow around telling you what you can't do all the time, you ought to find somebody who can tell you what you can do."

Secretary SIMON. I used to tell the story about my house counsel at Solomon Bros. I would come in and I would say, "Good morning." And he would say, "No."

Chairman HUMPHREY. Yes, that is right. And so what I am trying to get is——

Secretary SIMON. Is somebody who will go and find a way to do it.

Chairman HUMPHREY. Yes, let's do it. Now, you've got the Humphrey philosophy.

Secretary SIMON. And I will add, do it safely.

Chairman HUMPHREY. Well, the problem is, Mr. Secretary, that I want to be safe, but being safe is sometimes moving fast enough so that you don't get run over, you know. [Laughter].

Chairman HUMPHREY. With that friendly note, we can recess.

[Whereupon, at 12 noon, the committee recessed, to reconvene at 10 a.m., Thursday, February 5, 1976.]

THE 1976 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 5, 1976

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

The committee met, pursuant to notice, at 10:15 a.m., in room 318, Russell Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey and Javits; and Representatives Moorhead and Heckler.

Also present: Loughlin F. McHugh and George R. Tyler professional staff members; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and M. Catherine Miller, minority economist.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Gentlemen, you are very patient. You will find that the work of the Congress at this time is a classic example of what we call nonplanned activity. Most of our colleagues find themselves today in the Senate on a piece of legislation or in another committee.

We welcome here four distinguished private economists and I think we will save a good deal of time if I just let you get right at it. I will give my opening statement at this point.

This morning it is my pleasure to welcome four distinguished private economists who have been invited to discuss the economic outlook with us.

Previous sessions in this series of hearings have been limited to official administration spokesmen. Their counsel to us can be summed up in the phrase: "do nothing." They agree that it would be nice to bring unemployment down faster than they project. They agree that it would be nice to have less inflation. Mr. Greenspan spoke, very sincerely and eloquently. Yet neither he, nor any of our administration witnesses, had any suggestions for doing much about it.

The administration fears that any strong action to promote faster recovery would touch off a boom which would lead in turn to bust. My own feeling is that the administration is having the wrong nightmare. In the first place, with as much unutilized labor and capital as is presently available, I fail to see why a boom would be such a bad thing. In the second place the possibilities of a boom occurring are, to put it mildly, remote. The dangers of overstimulating the economy seem to me to be quite minimal, indeed, virtually nonexistent Dr. Burns has just lowered his targets for monetary growth. No danger of overstimulus from that quarter. The President has recommended a highly restrictive budget. Congress may enlarge it somewhat, but I see no indication that Congress is leaning toward excessive spending which would overstimulate the economy. Quite the contrary.

My own nightmare is a different one. My fear is that the recovery is weak and fragile, weaker than we have recognized or admitted. In my nightmares we allow a sluggish pattern of economic performance to continue, unemployment to remain high, above 8 percent, inflation to persist at 6 or 7 percent. This is the danger against which we must guard, as I see it.

Having been advised by the administration to do nothing about anything. I look forward with interest to the statements we will hear this morning. Will the academic and the financial community also advise us to do nothing? Or will you present us with some policy options, which we can consider as alternatives to the present passive stance of the administration? Needless to say, I am hoping that we will hear some alternatives proposed. I do not think my hopes will be disappointed.

I have expressed on other occasions my own fear that the recovery, which is much heralded in these days, is weak and fragile. I tend to believe, even though I am a born optimist, that it may be slightly weaker than we have recognized or admitted, particularly when we see a sluggish pattern of economic performance continuing with unemployment remaining high, and inflation persisting at 6 or 7 percent. These obviously are warning signs for us.

We are privileged to have four economists with us this morning as our witnesses: Mr. Gardner Ackley, Professor of Economics at the University of Michigan and I need not point out you are the former chairman of the Council of Economic Advisers, and that of course, makes you a special witness. We also have Mr. Glenn Burress, of the University of Texas. We have Robert Nathan, who is appearing here this morning as Chairman of the Council on National Priorities and Resources.

Finally, we have Robert Parks, of the Advest Institutional Advisory Service in New York. I ask each of you to proceed alphabetically.

So, Mr. Ackley, why don't you start.

STATEMENT OF GARDNER ACKLEY, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. Ackley. Thank you, Mr. Chairman. It is always an honor and a pleasure too to appear before this distinguished committee particularly so, Mr. Chairman, under your gavel.

I understand that this morning's session is to deal with the outlook for the economy——

Chairman Humphrey. Correct.

Mr. Ackley. In relationship to economic policy, and I am going to confine my discussion pretty largely to that, I do have a prepared statement, which I assume will be put in the record——

Chairman Humphrey. Of course. Your prepared statement as well as any other material you present will be printed in full in the record.

Mr. Ackley. Fine, thank you. I will read just a few paragraphs of it to save time. For those who have a copy before them, I will summarize several pages, which indicate that, in my view, at least, the Council is basically more optimistic about the outlook for the economy, given the fiscal policies which are recommended in the President's budget, his tax proposals.

Chairman HUMPHREY. When you say the Council, you mean the Council of Economic Advisers?

Mr. ACKLEY. The Council of Economic Advisers.

Chairman HUMPHREY. Yes.

Mr. ACKLEY. My own view is that if we accept the fiscal assumptions that are built into the President's economic programs, the rise in gross national product in 1976 would be somewhat lower, the unemployment rate rather higher than the Council has forecast. Now, I don't want to exaggerate the difference, at least as far as 1976 is concerned. Most of the forecasts that are made by economists these days are in the same ballpark as the CEA forecasts. We all foresee a gradual recovery, sufficient slowly to reduce the unemployment rate in 1976 and early 1977. Almost no one sees an incipient boom nor an early slide into a recession. While neither possibility can ever be absolutely excluded, I don't believe that we ought to worry about either one occurring this year.

Likewise, the prevailing opinion is clearly that there will be a continued moderation in the inflation rate in 1976 and into 1977; moderation at least by the standards of recent years. The principal problems, Mr. Chairman, that I have with the Council's forecasts are not so much for 1976 as they are for 1977 and beyond.

The Economic Report tells us very little about the Council's reasoning concerning 1977. Nevertheless, we can infer from what is said in the report that the relatively optimistic forecast for 1977, with a growth rate of real GNP of 5.7 percent, can only depend on the assumption of a truly spectacular boom in business investment.

Chairman HUMPHREY. Now, there isn't much indication that that is going to take place, is there?

Mr. ACKLEY. I have some doubts about the Council's forecasts for 1976 in this respect: It seems to me this perhaps is the area in which the Council's forecast is appreciably more optimistic than most others. with an 8 percent growth in business investment in 1976 over 1975. But in order to justify, in order to validate a forecast of 5.7 percent growth in real GNP in 1977, my statement traces out the reasoning by which I have to conclude that this must rest on a further substantial acceleration of business fixed investment in 1977. And I just don't see the basis for that. Indeed, I'm not sure I see the basis for the 8 percent forecast for 1976.

The conclusion of all of this is that only a fiscal policy which either would allow some appreciable growth in real Government expenditures or which involved tax rates and transfer payments designed to afford a faster growth of consumer spending could provide reasonable assurance that steady recovery will continue through 1977 at a rate fast enough to keep the unemployment rate headed downward. There is another way to summarize this conclusion. As the official estimates of the budget show, the Federal "full-employment" budget surplus is expected to increase by $19 billion between fiscal years 1976 and 1977. As one tries to interpolate the quarterly or half-year pattern of this surplus, my guess is the decline from early 1976 to 1977 would be considerably sharper than this. The change in the full employment surplus is not a perfect measure of the economic impact of the budget. As we all know though, it is the best simple measurement we have.

Some decline in full employment deficit is surely appropriate as the cumulative forces of recovery replace the cumulative forces of recession. And as the economy approaches full employment, we should plan to move into a full employment surplus.

But a turnaround as fast and drastic as now proposed, Mr. Chairman, could very well thwart the recovery: Either slow it down to a point that no further employment would occur in the unemployment rate or at some point, Mr. Chairman, trip off a new recession.

There was one final point I wanted to make, Mr. Chairman, even though it may not properly be on today's agenda because it deals not with the outlook but the appropriate goals for public policy. My point is simply that even if the Council's forecasts could be counted on as correct, I would personally not find acceptable the state of affairs which it describes. To me, the human, social, and political costs of prolonged unemployment at the rates forecast by the Council are simply intolerable. Even if the President's proposed fiscal policy were sufficiently stimulative to support the recovery forecast it would still be too restrictive a policy.

Now the Council and the President say they, too, regret long continued high unemployment, but there is really no choice. They say that any effort to speed the recovery beyond the cautious rate which they forecast would be self-defeating. They say it would merely reignite inflation, and this would so frighten people that real private spending would dry up as fast as government spending or disposable income increased. This is a newly popular doctrine recently defined by Arthur Burns, and now it has been seized upon by the White House to defend its cautious policies.

One can imagine that such an outcome might possibly occur. But simply because it can be imagined doesn't make it plausible or probable. As a matter of fact, a statement of this document, as though it were a proven fact or as though there had even been any extensive theoretical or empirical analysis to support it, is in my view simply fraudulent economics.

My own view, for what it is worth, is that a somewhat more stimulative fiscal policy and a consequent somewhat faster recovery toward tolerable levels of production and unemployment would involve, over the next year and a half, negligible costs in terms of increased inflation.

In my view the effects of a more visible progress toward resolving our dismal economic problems would strengthen rather than weaken business and consumer confidence and willingness to spend.

Perhaps I could ask to have put in the record some comments I recently made on this subject at the Michigan outlook conference.

Chairman HUMPHREY. Without objection this will be done at the end of your commentary.

Mr. ACKLEY. Thank you. Those of us who support a less austere fiscal policy are not proposing any "quick-fix" or "make-work" government jobs. We are proposing a continued public incentive which will support mainly a faster growth in private jobs, for the production of useful goods and services which the private sector, enjoying more rapidly rising real incomes, would purchase either for consumption or investment for planned future increases of production.

The administration's view seems to me to be that if we merely assure the availability of enough idle resources which could be used for private investment and provide some extra financial incentives, private investment will automatically expand to fill whatever gap there is. After what business has been through in recent years, I suggest that a somewhat stronger and more sustained growth in markets is necessary to assure that private investment will enjoy the strong and durable recovery which we all want.

Chairman HUMPHREY. Mr. Ackley, we appreciate your statement. Your prepared statement and the text of the speech referred to will be included in the hearing record.

I know Senator Javits has made some notes, and I have. We will come back and quiz you a bit on a couple of your observations. Thank you.

[The prepared statement of Mr. Ackley, together with the speech referred to follow:]

PREPARED STATEMENT OF GARDNER ACKLEY

I understand that this morning's session of the Hearings is to be devoted primarily to the economic outlook, and its relationship to government economic policies. In this brief initial statement, I shall therefore confine my attention to these matters, with special reference to their discussion in the Economic Report of the President and the accompanying Annual Report of the Council of Economic Advisers.

Living as I now do in the distant province of Michigan, I received neither the 1977 Budget nor the 1976 Economic Report in time to have prepared my own full-fledged, independent forecast of GNP and the inflation rate on a basis consistent with the fiscal policies proposed in those documents. For me to have done so would, in any case, have been almost impossible this year because of the extensive revisions concurrently made in our national accounting system and in the data for recent years, the details of which are still not generally available outside of Washington. Thus, while I can and will comment on the Council's forecast, I cannot provide a detailed alternative forecast, constructed "from scratch," and reflecting the President's proposed policies, as the Council's forecast presumably does.

Essentially, we can summarize the Council's forecast in terms of three crucial figures: the growth rate of real GNP; the level of unemployment; and the rate of inflation. Between calendar years 1975 and 1976, real GNP is expected to grow by 6.2%, slowing only to 5.7% in 1977. As a consequence, the unemployment rate is seen to decline from 8.5% in 1975, to 7.7% this year, and to 6.9% in 1977. Inflation (as measured by the GNP deflator) is forecast at 5.9% in 1976, rising to 6.2% in 1977. (I have not found the 1977 forecasts in the Economic Report, but they appear on page 25 of the Budget.)

My own latest forecast, made last December, saw a growth of real GNP of 6.0% from 1975 to 1976, an unemployment rate of 7.9% for this year, and a 6.4% rise in the GNP deflator. The differences from the Council's forecasts for 1976 are relatively minor, though on all counts, I was slightly less optimistic. Although I do not systematically collect the forecasts of others, my impression is that most other forecasters have also been somewhat less optimistic than the Council. That is certainly the case for the forecasts most recently reported to the American Statistical Association or to Philadelphia columnist J. A. Livingston.

This seems to be true as well for the forecasts produced by the large macroeconometric models. For example, the most recent forecast of my colleagues at the University of Michigan, Professors S. Hymans and H. Shapiro, using the Michigan Econometric Model, calls for a 5.9% increase in real GNP in 1976 (compared with the Council's 6.2%), slowing to a 5.0% rate in the first half of 1977. Unemployment in the Michigan forecast falls gradually to 7.2% in the second quarter of 1977, 0.2% above the apparent Council forecast for that quarter. The year-over-year inflation rate for 1976 is forecast by the Michigan Model at 5.9% in the GNP deflator—exactly the same as CEA's—with the Michigan inflation rate falling in 1977 as the CEA's rises slightly. I understand that the still more recent forecast of the Wharton Model is not very different from these figures, and thus also less optimistic—at least on GNP and unemployment—than the Council.

Now, an important problem in interpreting comparisons like these I have just made arises from the fact that any respectable forecast has to be based upon its author's best assumptions regarding government fiscal policy; and in making their recent forecasts, the various forecasters may have assumed either a less or a more stimulative fiscal policy than the President now proposes. For example, I know that my own forecast assumed an appreciably larger FY 1977 budget than the President has proposed, and somewhat different tax assumptions.

The detailed fiscal assumptions of the Michigan Model forecast include a FY 1976 budget total identical to the Council's, but a FY 1977 budget about $13 billion higher than CEA's—and, in both years, distinctly richer in purchases of goods and services, where it counts the most. On the other hand, after July 1, 1976, the Michigan assumption was probably for somewhat higher tax rates than the President has proposed. My hunch is that the Michigan forecast, if altered to insert the President's budget and tax recommendations, would still remain appreciably below the Council's. But until the model is refitted to the new GNP data, and rerun using the President's proposed budget and tax rates, it is impossible to make any definitive comparison.

I think that I have seen both Otto Eckstein and Arthur Okun (whom I regard as among the very best forecasters in the business) quoted as saying that their own latest forecasts were quite close to the Council's but assumed a more stimulative fiscal policy.

Thus, I believe that the Council is somewhat more optimistic about the outlook than most forecasters outside the government—myself included. Given the same fiscal assumptions, most of us would put the percentage gain in real GNP in 1976 a bit lower, and the unemployment rate a bit higher, than has the Council. On the other hand, I don't want to exaggerate the difference—at least so far as 1976 is concerned. Most of our forecasts are in the same ball park as the Councils: we foresee a gradual recovery, sufficient slowly to reduce the unemployment rate in 1976 and into early 1977. Almost no one sees an incipient boom, nor an early slide into a new recession. While neither possibility can ever be absolutely excluded, I don't believe that we should worry about either one occurring this year. Likewise, the prevailing opinion is clearly that there will be continued moderation in the inflation rate in 1976 and into 1977—"moderation" at least by the standards of recent years. That is also my view.

The primary problems which I personally have with the Council's forecast are not so much for 1976, as they are for 1977 and beyond. The Economic Report gives very few hints about the Council's reasoning concerning 1977. But we can draw some clear inferences. One is that the Council expects the rate of expansion of real final demand to be appreciably higher in 1977 than in 1976. This follows directly from two statements in the Report: first, that almost 1½ percentage points of the 6.2% real GNP growth from 1975 to 1976 reflects the swing in inventory accumulation, which implies a projected growth of real final demand in 1976 of about 4.7 or 4.8%; second, the Council says that, after mid-1976, the growth of final demand and of inventories will be approximately equal (which seems plausible enough). Since the growth of real GNP is forecase by the Council at 5.7% from 1976 to 1977, this implies a forecast of growth of final demand in 1977 also close to 5.7%—a full percentage point greater than its projected 1975-to-1976 expansion of final demand.

The only basis I can see for such a forecast is a truly spectacular expected boom in business investment. Certainly, the expansion of no other significant component of real final demand can be expected to accelerate between 1976 and 1977. Surely not real residential construction, after the 30 percent expansion forecast by the Council for 1976. The Council also explicitly assumes the same less-than-3%-a-year growth of real State and local government purchases in both 1976 and 1977. Real Federal government purchases are expected to rise only 1% in 1976, and surely by no more than that in 1977. And whatever happens to net exports cannot make a great deal of difference.

This leaves only consumer purchases and business fixed investment. This year—i.e., between 1975 and 1976—the Council expects real consumer purchases to rise by 6%, nearly as fast as real GNP. This is supposed to occur despite a projected growth of only 5% in real disposable income (even with the 1976 tax cuts); it stems, rather, from an assumed drop of about 1 percentage point in the saving rate. I do not find that unreasonable.

For 1977, however, the rise in disposable income relative to the rise in GNP will probably slow down further than in 1976, since, after 1976, further net tax reduction is trivial or even nonexistent; moreover, the growth of transfer payments must decelerate materially in 1977 under the President's plans. The only way in which real consumption could again in 1977 grow even nearly as fast as real GNP would be for a further sharp decline to occur in the saving rate. While this cannot be excluded, I doubt that we have any reason to count on it.

This leaves a sharp acceleration in the growth of business fixed investment as the only remaining source for the Council's projection of a faster growth of real final demand in 1977 than in 1976. But is that really plausible?

Many economists will be somewhat skeptical about the Council's forecast of an 8% growth of real business fixed investment between 1975 and 1976. (This is probably the main respect in which the Council's forecast for 1976 is stronger than others'.) Surely, so strong a growth is not suggested by recent surveys of investment intentions, by the recent behavior of durable-goods orders and nonresidential construction contracts, nor by current and expected rates of capacity utilization. On the other hand, the first year of recovery always brings a surge of corporate profits, which has already begun; moreover, corporate tax rates are to be reduced and other incentives to investment are proposed, which add to corporate profits and cash flow. Some short lead-time investment items, that were merely deferred during the recession, may be quickly reinstated once it is clearly over. Further, as Table 1 on page 26 of the Council's Report shows, rather high rates of growth of real fixed investment are typical of the first full year of recovery from previous recessions.

The table which appears below reproduces in column (B) the data for first-year growth rates of business fixed investment found in the Council's table. (I have changed the column headings somewhat in an attempt to make the table a little easier to understand.) Clearly the Council's 7.9% growth for 1976 does not appear out of line with past experience.

However, in column (C) I have added the growth rates of business fixed investment in the second year of each recovery (which would correspond to 1977). In only one previous recovery (that following the 1970 trough) was there acceleration of growth in the second year of recovery, and that from a low first-year rate. In order to support the Council's optimism regarding both 1976 and 1977. I have shown that a substantial acceleration from the high 7.9% first-year growth rate of business investment is required. I see nothing in the proposed policies, nor in previous cyclical experience, to expect it.

My conclusion is that onily a fiscal policy which either allows some appreciable growth in real government purchases, and/or which involves tax rates and transfer payments designed to support a faster growth of consumer spending, can provide reasonable assurance that steady recovery will continue through 1977, at a rate fast enough to keep the unemployment rate headed downward.

There is another, and simpler, way to summarize this conclusion. As the official estimates in the Budget show, the Federal "full-employment" budget surplus is expected to increase by $19 billion between fiscal years 1976 and 1977, from a deficit of $16 billion in the former year to a surplus of $3 billion in the latter year. If one tries to interpolate the quarterly or half-year pattern of this surplus, my guess is that the decline from early 1976 through 1977 would be considerably sharper. The change in the full-employment surplus is not a perfect measure of the economic impact of the budget; but it is the best simple measure that we have.

GROWTH RATES OF REAL BUSINESS FIXED INVESTMENT IN RECOVERY PERIODS, 1955–77

Quarter of cyclical trough	Annual growth rate of real business fixed investment from half year following cyclical trough (percent)	
	To corresponding period 1 yr later	From corresponding period 1 yr later to 2 yrs later
(A)	(B)	(C)
1954–III	15.3	1.7
1958–II	10.8	4.4
1961–I	9.8	3.2
1970–IV	6.0	13.9
1975–II	[1] 7.9	?

[1] CEA forecast.

Surely, some decline in the full-employment deficit is appropriate as the cumulative forces of recovery replace the cumulative forces of recession. And, as the economy approaches full employment, we should plan to move into a full-employment surplus. But a turn-around as fast and as drastic as now proposed could well abort the recovery—either slow it down to the point that no further improvement would occur in the unemployment rate, or, at some point, trip off a new recession.

There is one final point which I must make—even though it may not properly be part of today's agenda, for it deals not with the outlook but with the appropriate goals for public policy.

My point is this: even if the Council's forecast could be counted upon as correct, I personnally would not find acceptable the state of affairs which it describes. To me, the human, social, and political costs of prolonged unemployment at the rates forecast by the Council are simply intolerable. Even if the President's proposed fiscal policy were sufficiently stimulative to support the Council's recovery forecast, it would still be too restrictive a policy.

Of course, the Council—and the President—say that they greatly regret long-continued high unemployment. But there is really no choice. Any effort to speed recovery beyond the cautious rate which they forecast would be self-defeating: it would merely reignite inflation; and this would so frighten people that real private spending would dry up as fast as government spending or disposable income increased.

This is a newly popular doctrine, recently pioneered by Arthur Burns, and now seized on by the White House to defend its cautious policies. One can imagine that such an outcome might conceivably occur. But because it can be imagined does not make it probable, or even plausible. Its matter-of-fact statement, as though it were a proven fact—or as though there had even been any extensive theoretical or empirical analysis to support it—is simply fraudulent economics. My own view is that a somewhat more stimulative fiscal policy and a consequent somewhat faster recovery toward tolerable levels of production and unemployment would involve—over the next year and a half—negligible costs in increased inflation. And, in my view, the effects of more visible progress toward resolving our dismal economic problems would strengthen rather than weaken business and consumer confidence, and willingness to spend. Perhaps I could ask at this point to have put in the record some comments I recently made on this and related subjects at the recent Michigan Economic Outlook Conference.

Those of us who support a less austere fiscal policy are not proposing a "quick-fix" of "make-work government jobs." We are proposing a continuing public stimulus which will support mainly a faster growth of private jobs—in the production of useful goods and services which the private sector, enjoying more rapidly rising incomes, would purchase either for consumption or for investment to expand future production.

The Administration view seems to be that if we merely assure the availability of enough idle resources which could be used for private investment, and provide some extra financial incentives, private investment will automatically expand to fill the gap. After what business has been through in recent years, I suggest that a somewhat stronger and more sustained growth of markets is necessary to assure that private investment will enjoy the strong and durable recovery which we all want.

[Speech before the 26th Annual Economic Outlook Conference, University of Michigan, December 12, 1975]

Some Observations on the 1976 Outlook and Its Implications

(By Gardner Ackley)

The forecast presented earlier by Professors Hymans and Shapiro, based on the Michigan Econometric Model, envisages an expansion of real GNP over the next year rather more sluggish than has been typical of earlier postwar recoveries. Although I might offer a few specific comments regarding certain aspects of this forecast, they would not, on balance, contribute to a distinctly different view of the overall outlook for GNP expansion. Nor do I disagree with the general order of magnitude of the inflation forecast, although I might prefer to describe it by a range of 4 to 8 percent rather than any single value.

However, since I do not have a substantially different view of the general character of the outlook, it is probably more useful if I use my time for some rather more personal comments on what I see as some implications of this outlook for economic policy.

The Michigan Model forecast calls for an unemployment rate a year from now of 7.6 percent. The most optimistic serious forecast I have seen gets the rate down to 7¼ percent by then, and government spokesmen mention 7 percent as their year-end expectation. No matter. Any one of these would involve an unemployment rate which after 1½ years of recovery still exceeded the highest quarterly unemployment rate experienced at any time since 1941.

The fact that we are facing so miserable an economic prospect means only one thing to me—that our recent and current national economic policy must be judged a failure. And I see no significant prospect of coherent political leadership—in either party—nor of public support, for any major change of policy which might significantly alter the outlook for continuing massive unemployment. Rather, most of us seem to be contemplating with relative complacency the prospect that millions of our fellow citizens—able and anxious to provide for their own livelihoods, and, incidentally, contribute to the prosperity of the rest of us—will continue for some time to bear economic deprivation and/or the psychological wounds of demeaning handouts.

If, as some glibly assert, it will be 1980 before the unemployment rate gets down even to 5 percent, several million of the young workers who will enter the labor force in this half-decade will bear permanent psychological scars. Add these to the scars remaining from Vietnam, and one can well worry about the future social and political stability and coherence of our nation. I may add that a prolonged period of slack economy and slow growth also offer little promise of generating the vast investment for future growth that is being so widely called for today.

One common response to the evident bankruptcy of our national economic policy is for us to tell each other that things are really not so bad. It's just that the standards we have previously been using for judging our economic performance were unrealistic. One recent form which this takes is to say that we really shouldn't look at unemployment as a percentage of the labor force, but at employment as a percentage of the adult population. This latter rate has declined very little during the recession. What this view tells us is that we should ignore the fact that demographic, economic, and social changes now place a larger fraction of our population in the position of being capable and desirous of contributing to their own and their families' support. Send the wives, freed from drudgery by the products of modern industry, and wanting jobs, back to their kitchens and nurseries; tell the high school graduates and drop-outs, who say that they want jobs, to relax and enjoy life on the street corners: after all, the percentage of the adult population at work today equals the average percentage over the entire period since 1948, and that should be good enough.

I happen to disagree rather substantially with some of Arthur Burns' views on economic policy; but I admire him (among other reasons) because he, at least, is not willing to accept the prospect of continued unprecedented unemployment. Although he rejects more stimulative fiscal and monetary policies, he does continue to state that the appropriate and urgent target of public policy is to eliminate all involuntary unemployment, even to the point of making government the employer of last resort—although with a Constitutional Amendment (yes, really!) to assure that the pay for such jobs would never become attractive.

A perhaps more widespread response to the prospect that massive unemployment will continue for some time is not to say that this really doesn't matter, but rather that—because of inflation—we obviously cannot afford to use the standard tools of stimulative monetary and fiscal policy on which we once thought we could rely to achieve and maintain full employment. This response raises many complex issues both of economic analysis and of policy, which I shall not be able to develop fully here, although I regard them as among the most vital questions which face our society in the 1970's. But let me very briefly summarize my own views on the relationship between unemployment and inflation, and their implications for today's economic policies.

First, anyone who is familiar with my views knows that I have never accepted the opinion, widely held in the 1960's, that all that is necessary to avoid inflation is to manage aggregate demand in such fashion that it never crowds too close to the aggregate productive capacity of our economy: i.e., so to apply fiscal and monetary policies that the unemployment rate never goes or long stays below some minimum safe level—which once was thought to be 4 percent, and maybe translates to 5 percent today, given the present composition of our labor force. Avoiding excessive pressure on productive resources is not, in my view, a sufficient condition for avoiding inflation—although it surely is a necessary one. And I never believed the obverse of the standard position either—namely, that a rate of unemployment even considerably higher than the minimum safe rate will quickly or effectively eliminate or even sharply reduce an inflation already in being. I have always stressed the view that inflation, however initiated, acquires a life of its own, which is highly resistant to deflationary demand-management policies. Surely, the experience of 1969–71, and even more so, that of 1973–75, provide strong evidence in support of this position.

My analysis thus denies that acceptance of the costs of high unemployment will, sooner or later, buy us victory over inflation. While I do not reject the possibility of some very modest tradeoff between unemployment and inflation at rates of unemployment above the minimum safe level, this tradeoff seems to me so slight at current levels of unemployment that I do not see how anyone with any conscience at all can accept its present terms.

I recognize, of course, that our recent experience with inflation has been very traumatic for everyone. Even so, we need to assess the costs of inflation rationally. Too many accept without examination the view that inflation is so damaging that no price is too high to reduce it. But economists are trained to reject all such absolute judgments. Looking realistically at the costs of inflation, certainly of inflation in the 4 to 8 percent range, I find them far less than the costs of continued massive unemployment. I conclude, therefore, that we should alter our fiscal and monetary policies in such a way as to reduce the latter substantially in return for a possible slight increase in the former.

However, if others conclude that the costs of the slight extra inflation that might be the byproduct of a substantial reduction of unemployment are even more intolerable than the costs of that unemployment, then they surely must consider the possibility of supplementing more expansionary demand management policies by other policies which would permit us to reduce simultaneously the costs of both inflation and unemployment. I refer, of course, to the whole range of possible policies from direct controls through incomes policies, across the whole gamut of manpower and public employment policies, and through a long list of pro-competitive policies designed to increase the flexibility of wages and prices, and their stabilization through free-market competition. Again, it is to the credit of Arthur Burns that he continues to remind us of these other options.

But we are not facing up to these choices; we sit helplessly paralyzed by the memory of the double-digit inflation of 1974, failing to recognize that its causes were almost entirely independent of the level of employment or unemployment.

I have reserved for last a very recent view—most forcefully expressed by Arthur Burns—that even if we wanted to use them, monetary and fiscal policies no longer will work to reduce unemployment because they create self-defeating expectations. Any move toward greater fiscal or monetary stimulus, he says, in today's climate creates expectations of further inflation which will depress business and consumer spending by as much as the stimulus tends to increase them.

One cannot deny the possibility that Burns could be correct. Surely, I believe that attitudes and expectations do significantly influence spending decisions; and that such attitudes are influenced by perceptions of public economic policies. However, I would immediately add that, if Chairman Burns were correct, the acute public sensitivity which he fears must in part be blamed on those government officials who regularly and indiscriminately attack what they choose to call the "crazy government spending" and the "horrendous deficits" generated by the very government they serve; and, as well, on the monetarists in my profession who cry inflation whenever the weekly rate of increase of the money exceeds their private norms.

If the Burns proposition were correct, it should have prevented the tax rebates of last May from creating a surge of consumer spending—but it didn't. We need, of course, to look for unusual residuals or displacements in the consumption and investment equations of standard econometric models at times when economic policy changes were announced; and to study, as well, the evidence from psychological survey data. But until it is proved otherwise, I cannot believe that the bulk of the public pay that much attention to specific policy changes. People may be (and apparently are) depressed by the general posture of recent and current government economic policy—as I am, although perhaps for different reasons—and this might affect their spending decisions. But I strongly doubt that there is any built-in, self-defeating offset to specific moves which the government might make—and in my opinion should make—to reduce unemployment more rapidly than the forecasts for 1976 and 1977 now project.

Chairman HUMPHREY. Now, let's proceed to Mr. Nathan.

STATEMENT OF ROBERT R. NATHAN, CHAIRMAN, COUNCIL ON NATIONAL PRIORITIES AND RESOURCES

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

Recognizing that my prepared statement as formally presented will be placed in the record. I would like to summarize.

Chairman HUMPHREY. Yes, at this time, if you please.

Mr. NATHAN. First of all, I agree with Gardner Ackley that the figures and the policies don't seem to fit very well and the only way that the growth rates, as modest as I regard them, as set forth in the Economic Report, Mr. Chairman, will be achieved, will be a rise in private plant equipment expenditures and other private outlays which are not in the cards now and which in my judgment are not likely to be achieved because of the cautious fiscal policies that are implicit in the picture. So that in many ways I think that, that which is assumed, is made more unlikely by the very policies which are being pursued.

Second, I think the most serious problem of all stems from the continued philosophy of pursuing the forces of inflation through unemployment. On that score I think we should give to Allen Greenspan and to the President and the Budget Bureau a mark of "A" for being fairly forthright in this respect, that is, to let unemployment be the answer to inflation. I think it may deserve an "A" in terms of being reaonably explicit; but I think it deserves a "D-minus" in terms of what it does for the country. Because every element in this very, fine tuning that one reads page by page and paragraph by paragraph in the Economic Report keeps saying over and over and over again that we ought to have some recovery but not much. In other words, it should be very slow, because otherwise we are likely to have inflation.

And I believe in looking at the outlook, Mr. Chairman, we ought to take a hard look at this picture. And let me start by saying in my judgment inflation continues to be a very serious problem. And I don't think we ought to put it under the rug and ignore inflation; but I don't think the answer lies in fighting inflation with unemployment.

Now, let me just deal with the policies which in my judgment, Mr. Chairman, and members of the committee will influence what the outlook is in 1976 and 1977. An outlook doesn't mean anything unless there is implicit in that outlook policy assumptions that are spelled out. If we do follow the program that is set forth by the President in the budget and in the Economic Report and in his statement to the Congress it is quite clear that what we are going to have is a very soft and what I regard as a sick economy for some years to come. I believe there is just as much likelihood of worsening inflation, assuming nothing directly is done about inflation, by this kind of a soft economy and soft recovery as there is by a more vigorous, but not excessive, recovery.

Basically, the inflation we have had has not been attributable to excess demand. And if we are going to try to fight inflation by keeping demand constrained or held way down, there is a serious doubt whether we are going to solve the problem of inflation.

As far as the budget itself is concerned, I would like to state that this budget truly has limited fiscal stimulation especially starting in the middle of 1976. If one were to achieve the cut in expenditures that the President is proposing, this would be a very deterring element in terms of future recovery prospects.

On the other hand, the suggestion there would be substantial further tax cuts to match the $28 billion expenditure cut, is greatly exaggerated, because the amount of tax cuts that will continue, if there is no further change, will be sizable. And proposed further cuts will be relatively insignificant. So what the Ford program is to really take an awful lot of the stimulation out of the Federal fiscal picture by pursuing the President's restructive policy on the expenditure side and slight expansionist efforts through further tax cuts which are going to be very, very small.

In other words, the "add-on" in terms of stimulation from the tax side of the picture is going to be quite small starting in the middle of 1976 but the reduction associated with the expenditure side, Mr. Chairman, is going to be very sizable. And this I think would make the last half of 1976 rather dubious in terms of economic outlook but into 1977 it would raise very, very serious doubts in my mind. I say that because I just don't think private investment and private spending will just bounce up unless there is some basic reason for it.

Now, let me just turn to what the policy approaches ought to be. In my judgment, when you have 8.3 percent unemployment, when the GNP gap in the last quarter of 1975 in current prices was $214 billion, I think that the administration's failure to be deeply concerned about any sizable increase in the gross national product much in excess of normal growth, Mr. Chairman, represents a degree of failure of the economy or of the marketplace that we ought to face up to. And I think this resort to slow growth is a key element in the picture of a wrong attack in inflation.

It is not that we don't have needs: We have desperate needs in the public and private sectors. We have desperate needs in the environmental field and in water supplies, in recreation, certainly in energy, certainly in transit, certainly in our urban problems. And to say we should ignore those needs, Mr. Chairman, in my judgment is a regretable waste of the potentials in this country and of failure to fulfill our objectives of high levels of unemployment and production.

Now, what did the President say in Michigan the other day? He said that we don't want to have the public jobs. Now, I admit a lot of public jobs will not be as productive as private jobs. But the alternative is not now public or private jobs.

As you see in the President's own budget, Mr. Chairman, there will be either some public jobs or no jobs at all for a lot of these people. That is the alternative. And I think that what we must do is move toward private jobs and incentives and stimulate aggregate demands to provide all kinds of jobs.

Now, let me turn to a couple of figures and then deal a moment with inflation. What we have in the present budget and the foreseeable budgets are huge deficits. But these deficits by and large are not expansionist deficits. These deficits by and large are recession deficits. Except for the tax cut last year and the automatic increase and extension of unemployment compensation, Mr. Chairman, by and large the deficits we are suffering are of unprecedented peace time magnitudes and are practically wholly attributable to recessions. I repeat, these are not spending deficits; they are recession deficits. And I think it is important to know this because the over simplistic explanations that come forth that our inflation is all attributable to deficit financing, Mr. Chairman, loses its entire validity when one looks at the figures.

Let me just note, Mr. Chairman, that from 1946 to 1968, for 22 years, our national debt went up $100 billion. From 1969 through this year, we see a rise in Federal debt of $275 billion.

In other words, in 7 years we are going to have $275 billion versus $100 billion in 22 earlier years. Now, I know they are different dollars, but this big increase in the debt has been primarily a result of low economic activity primarily associated with the two recessions. And I am convinced that if we can take aggressive expansionist fiscal ventures now, that will get us back to full employment more promptly and therefore we will have less of a rise in the national debt and less of the huge deficits.

Having said this and having argued for expansion, I want to emphasize, Mr. Chairman and members of the committee, that I am not talking about ignoring the inflation problem. As a matter of fact, I want to say I think inflation is one of the gravest malignant problems that faces this country. What it does to the poor, what it does to the fixed income groups, what it does to industry, what it does in the international sphere, what it does in the state and local governments, what it does to the public utilities, and housing are really tragic and drastic. But the sad part of it is that we are not making great progress toward price stability. Few people realize that in recent months the rate of inflation in this country is the worst in any peace time period of the history in America, except for 1973–74. Had it not been for a softening in farm prices, we wouldn't have gained as much ground on inflation as we have. And I don't see the soft economy as being the only solution. And we ought to move on this. We ought to understand where our marketplace is not functioning effectively. I would urge we set up another Temporary National Economic Committee and find out where the strengths and weaknesses are and find out what we ought to do to have a more vigorous dynamic competitive economy.

I am in favor of getting rid of the recession, which holds up the price level and I am also in favor of pursuing an analysis and understanding as to why prices rise in the face of a very soft demand. I understand that costs have gone up, but people have been able to get away with price increase after price increase when capacity utilization is down 50, 60, or 70 percent. We ought to understand more about that. I think we have to attack inflation directly. This is a long subject. And I am not talking about across-the-board controls or freezes. But when we have the President of the United States not saying one single word of criticism, despite huge increases in prices, then I think we have some real problems. Maybe jawboning alone won't do it and maybe guidelines won't do it alone. But a combination of efforts to make the market function more effective and direct intervention will permit us to move toward price stability without letting the economy go to pot.

Chairman HUMPHREY. I thought the Council of Economic Advisers' report was very negligent and derelict in this matter.

Mr. NATHAN. Totally.

Chairman HUMPHREY. It just sort of referred to the rates inflation and indicated that it was better than it was and that they hoped it would level off. But there is really no substantive discussion of the causes except insofar as deficit financing is concerned. There is a fixation on deficit financing and deficit financing causing inflation.

Senator JAVITS. Well, Mr. Nathan, I would like to add one other dimension to this while you are all speaking. And that is that the productivity—and that is that the fact is that wages and salaries have grown way ahead of the game too. And in a sense they cause even more economic dislocation because it is such a very big factor in consumption. So I hope the liberal economists like yourself will discuss or emphasize the administered price structure instead of the administered labor structure.

Mr. NATHAN. I think you have to look at the administered costs and you have to look at the whole picture to see why it is that we have to resign ourselves to these kinds of levels of unemployment and idle resources. And the reason why, Mr. Chairman, you don't find it in the economic report is because they feel the only way to handle inflation is a soft economy. I have given you a chart, which I passed around, which indicates the nature of the gap of the gross national product. And I just want to say if we pursue the policies here—and then I will finish up—if we pursue the proposed policies by the administration, it will be 1978 before the gap in the GNP is down to where it was at the worst time in the past—and this refers to the last 20 years—the worst time and not the best. In other words, until 1978 we will have a gap—a loss of GNP in actual relative to potential—that will be bigger proportionately than at any time in the depth of any recession in the last 20 years.

If you look at the President's projections and the budget projections—the chart and table—you will find that back in 1958 during that recession, Mr. Chairman, the gap in the gross national product approached nearly 8 percent.

Chairman HUMPHREY. Yes.

Mr. NATHAN. And then in 1960–61, in that recession it was a little over 7 percent. But, it was over 14 percent in the second quarter of 1975. And in the fourth quarter it was about 12½ percent. But we will not get down to 8 percent or below 8 percent until 1979.

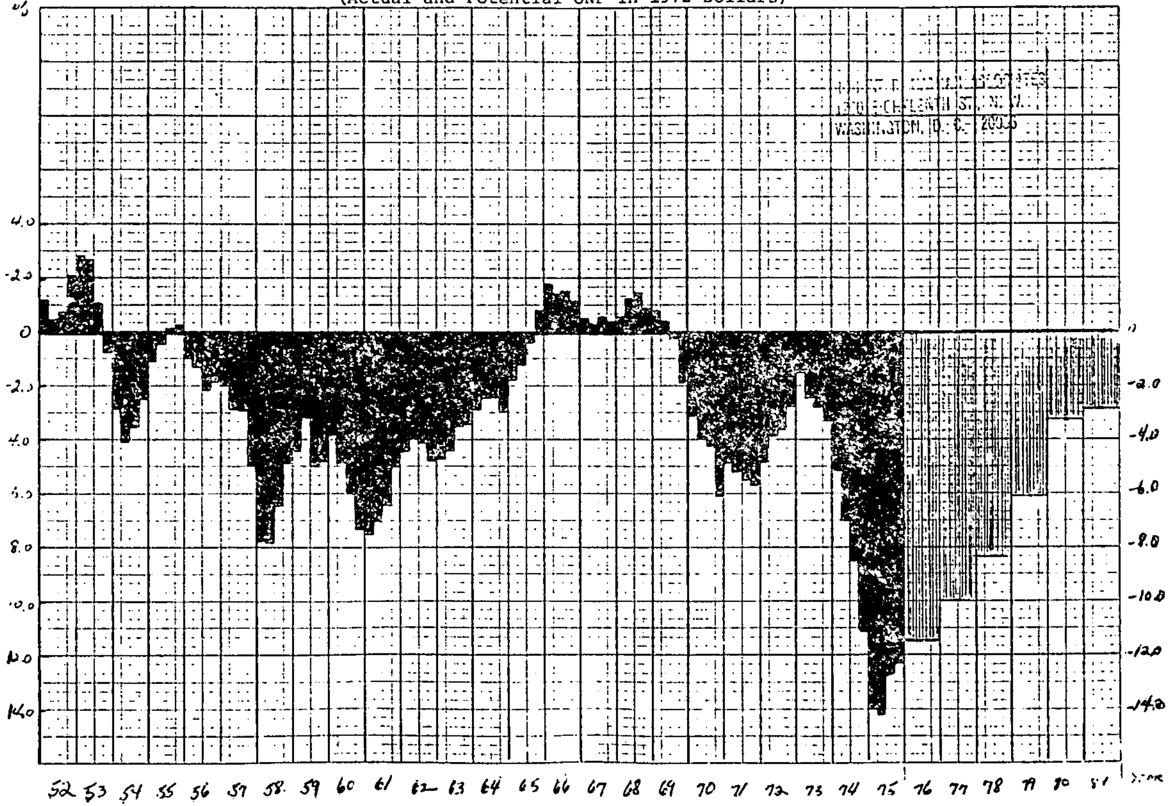
Chairman HUMPHREY. I see your point.

Mr. NATHAN. And all I am saying is never in the past quarter of a century in a recession were we as low as 8 percent. Now, we are resigning ourselves to having the worse situations for 3 more years. I just think this reflects a negative, defeatist, mismanagement policy that we can't afford to go on with.

Chairman HUMPHREY. Thank you very much. It is very revealing testimony.

[The chart and table referred to, together with Mr. Nathan's prepared statement follow:]

PERCENTAGE DEVIATIONS OF ACTUAL GNP FROM POTENTIAL GNP
1952-75 QUARTERLY AND PROJECTION 1976-81, YEARLY
(Actual and Potential GNP in 1972 Dollars)



ACTUAL AND POTENTIAL GROSS NATIONAL PRODUCT

[Billions of 1972 dollars; seasonally adjusted annual rate]

Period	Actual gross national product	Potential gross national product	Gross national product gap (potential less actual)	Gross national product as percent of potential gross national product
1952:				
I	591.3	584.6	−6.7	−1.15
II	592.1	589.6	−2.5	−.42
III	598.3	594.7	−3.6	−.61
IV	612.5	599.9	−12.6	−2.10
Year	598.5	592.2	−6.3	−1.06
1953:				
I	622.2	605.1	−17.1	−2.83
II	626.2	610.3	−15.9	−2.61
III	622.4	615.6	−6.8	−1.10
IV	616.4	620.9	4.5	.72
Year	621.8	613.0	−8.8	−1.44
1954:				
I	608.1	626.2	18.1	2.89
II	605.6	631.6	26.0	4.12
III	614.4	637.1	22.7	3.56
IV	626.1	642.6	16.5	2.57
Year	613.7	634.4	20.7	3.26
1955:				
I	641.1	648.1	7.0	1.08
II	650.8	653.7	2.9	.44
III	660.3	659.4	−.9	−.14
IV	667.0	665.1	−1.9	−.29
Year	654.8	656.6	1.8	.27
1956:				
I	664.1	670.9	6.8	1.01
II	667.5	676.6	9.1	1.34
III	667.9	682.5	14.6	2.14
IV	675.7	688.5	12.7	1.84
Year	668.8	679.6	10.8	1.59
1957:				
I	680.4	694.3	13.9	2.00
II	680.9	700.3	19.4	2.77
III	685.6	706.4	20.8	2.94
IV	676.7	712.5	35.8	5.02
Year	680.9	703.4	22.5	3.20
1958:				
I	663.4	718.6	55.2	7.68
II	668.2	724.8	56.6	7.81
III	684.4	731.1	46.7	6.39
IV	702.1	737.4	35.3	4.79
Year	679.5	728.0	48.5	6.66
1959:				
I	710.7	743.8	33.1	4.45
II	726.3	750.2	23.9	3.19
III	718.6	756.7	38.1	5.04
IV	726.2	763.2	37.0	4.85
Year	720.4	753.5	33.1	4.39
1960:				
I	740.7	769.8	29.1	3.78
II	738.9	776.5	37.6	4.84
III	735.7	783.2	47.5	6.06
IV	731.9	789.9	58.0	7.34
Year	736.8	779.9	43.1	5.53

ACTUAL AND POTENTIAL GROSS NATIONAL PRODUCT—Continued

[Billions of 1972 dollars; seasonally adjusted annual rate]

Period	Actual gross national product	Potential gross national product	Gross national product gap (potential less actual)	Gross national product as percent of potential gross national product
1961:				
I	736.6	796.7	60.1	7.54
II	749.0	803.6	54.6	6.79
III	758.7	810.6	51.9	6.40
IV	776.9	817.6	40.7	4.98
Year	755.3	807.1	51.8	6.42
1962:				
I	788.1	824.6	36.5	4.43
II	798.3	831.8	33.5	4.03
III	804.3	839.0	34.7	4.14
IV	805.8	846.2	40.4	4.77
Year	799.1	835.4	36.3	4.35
1963:				
I	813.5	854.0	40.5	4.74
II	823.7	861.9	38.2	4.43
III	838.8	869.9	31.1	3.58
IV	846.9	877.9	31.0	3.53
Year	830.7	865.9	35.2	4.07
1964:				
I	861.1	886.0	24.9	2.81
II	872.0	894.2	22.2	2.48
III	880.5	902.5	22.0	2.44
IV	883.9	910.8	26.9	2.95
Year	874.4	898.4	24.0	2.67
1965:				
I	903.0	919.3	16.3	1.77
II	916.4	927.8	11.4	1.23
III	932.3	936.3	4.0	.43
IV	952.0	945.0	−7.0	−.74
Year	925.9	932.1	6.2	0.67
1966:				
I	969.6	953.7	−15.9	−1.67
II	976.3	962.5	−13.8	−1.43
III	985.4	971.5	−13.9	−1.43
IV	992.8	980.4	−12.4	−1.26
Year	981.0	967.0	−14.0	−1.45
1967:				
I	994.4	989.5	−4.9	−0.50
II	1,001.3	998.6	−2.7	−.27
III	1,013.6	1,007.9	−5.7	−.57
IV	1,021.5	1,017.2	−4.3	−.42
Year	1,007.7	1,003.3	−4.4	−0.44
1968:	1,031.4	1,026.6	−4.8	−0.47
I				
II	1,048.4	1,036.1	−13.4	−1.28
III	1,061.8	1,045.7	−16.1	−1.54
IV	1,064.7	1,055.3	−9.4	−.89
Year	1,051.8	1,040.9	−10.9	−1.05
1969:				
I	1,074.8	1,065.7	−9.1	−0.85
II	1,079.6	1,076.2	−3.4	−.32
III	1,083.4	1,086.8	3.4	.31
IV	1,077.5	1,097.6	20.1	1.83
Year	1,078.8	1,081.6	2.8	0.26

ACTUAL AND POTENTIAL GROSS NATIONAL PRODUCT—Continued

[Billions of 1972 dollars; seasonally adjusted annual rate]

Period	Actual gross national product	Potential gross national product	Gross national product gap (potential less actual)	Gross national product as percent of potential gross national product
1970:				
I	1,073.6	1,108.4	34.8	3.14
II	1,074.1	1,119.3	45.2	4.04
III	1,082.0	1,130.3	48.3	4.27
IV	1,071.4	1,141.5	70.1	6.14
Year	1,075.3	1,124.9	49.6	4.41
1971:				
I	1,095.3	1,152.7	57.4	4.98
II	1,103.3	1,164.1	60.8	5.22
III	1,111.0	1,175.5	64.5	5.49
IV	1,120.5	1,187.1	66.6	5.61
Year	1,107.5	1,169.9	62.4	5.33
1972:				
I	1,141.2	1,198.8	57.6	4.80
II	1,163.0	1,210.6	47.6	3.93
III	1,178.0	1,222.6	44.6	3.65
IV	1,202.2	1,234.6	32.4	2.62
Year	1,171.1	1,216.7	45.6	3.75
1973:				
I	1,227.7	1,246.8	19.1	1.53
II	1,228.4	1,259.1	30.7	2.44
III	1,236.5	1,271.5	35.0	2.75
IV	1,240.9	1,284.0	43.1	3.36
Year	1,233.4	1,265.4	32.0	2.53
1974:				
I	1,228.7	1,296.6	67.9	5.24
II	1,217.2	1,309.4	92.2	7.04
III	1,210.2	1,322.3	112.1	8.48
IV	1,186.8	1,335.3	148.5	11.12
Year	1,210.7	1,315.9	105.2	7.99
1975:				
I	1,158.6	1,348.5	189.9	14.08
II	1,168.1	1,361.8	193.7	14.22
III	1,201.5	1,375.2	173.7	12.63
IV	1,217.4	1,388.8	171.4	12.34
Year	1,186.4	1,368.6	182.2	13.31
1976:				
I				
II				
III				
IV				
Year				
Projection:[1]				
1976 year	1,260.0	1,423.3	163.3	11.47
1977 year	1,332.0	1,480.2	148.2	10.01
1978 year	1,411.0	1,539.4	128.4	8.34
1979 year	1,503.0	1,601.0	98.0	6.12
1980 year	1,600.0	1,665.1	55.1	3.31
1981 year	1,679.0	1,727.5	48.5	2.81

[1] 1976–81 from President's budget p. 25–26.

SPECIAL NOTE ON POTENTIAL GNP

The following note has been provided by the Council of Economic Advisers regarding potential GNP.

The idea of potential GNP has had a long history. Its measurement by the Council of Economic Advisers was started in the Economic Report of the Council in 1962. Since that time, it has been used as a standard with which to evaluate the past and future behavior of the economy.

Potential GNP purports to measure what the economy would produce if all of its resources were fully utilized given the technology and institutional arrangements that have existed at the time. "Fully utilized" has never meant the kind of utilization that would prevail, say, under wartime conditions but rather the utilization that could be expected under conditions of reasonable price stability. This has always been less than complete utilization. Under ordinary circumstances, some unemployment is present because some workers are in the process of changing jobs; similarly, some old plants are idle because market conditions do not permit them to operate profitably. In the past, this degree of utilization has been reflected in an overall unemployment rate of 4 percent. The rate of inflation associated with that degree of unemployment has typically not been specified. Furthermore, motions of what constitutes reasonable price stability can vary over time.

Potential GNP is not something ordinarly observable. In practice, the Council in 1962 made the judgment that the economy was operating at 100 percent of potential in mid-1955. Since that time potential GNP has been estimated to grow at differing annual rates, as follows: 3.5 percent from the first quarter of 1952 to the fourth quarter of 1962, 3.75 percent from the fourth quarter of 1962 to the fourth quarter of 1968, 4 percent from the fourth quarter of 1968 to the fourth quarter of 1975. The Council estimates that from the end of 1968 to that of 1975, the average annual growth rate of potential GNP reflected a rise of 2.15 percent in the potential labor force, a 0.35 percent decline in annual hours of work, and a 2.2 percent rise in output per manhour at potential.

Prepared Statement of Robert R. Nathan

Mr. Chairman and members of the Joint Economic Committee, my name is Robert R. Nathan and I appear today as Chairman of the Council on National Priorities and Resources. I welcome the opportunity to discuss with you the President's proposed budget and economic policies for fiscal 1977 and the economic implications of these proposals.

The Council on National Priorities and Resources is a non-profit, non-partisan association committed to promoting government action to meet human needs. The participating members of the Council are: Amalgamated Clothing Workers of America, AFL–CIO; Americans for Democratic Action; American Federation of State, County and Municipal Employees, AFL–CIO; National Education Association; National Farmers Union; Oil, Chemical and Atomic Workers International Union, AFL–CIO; United Auto Workers; United Church Board for Homeland Ministries; United Mine Workers of America; United Presbyterian Church, USA; the U.S. Conference of Mayors; and the National Association of Home Builders.

President Ford's 1977 budget is the latest in a long line of Nixon and Ford programs and policies designed to stem inflation by consciously maintaining high unemployment and recession. The Administration budget does nothing more than extend the policies of the last several years—the very policies which are responsible for the present costly recession, the highest interest rates since the Civil War, the highest unemployment since the Great Depression, and a continuing high rate of damaging inflation.

Unfortunately, the timid and inadequate budget proposals of the Administration fail to give proper weight to the fact that the economy has still not recovered from the most serious recession since before World War II and that we are now suffering from the highest peacetime inflation rates in our history, with the exception of the runaway inflation rate of 1973–74. Unemployment remains above 8 percent, and rises to nearly 30 percent in some central cities. The GNP gap, the best measure of lost production and idle plants and equipment due to high unemployment, was running at an annual rate of $215 billion in the last quarter of 1975—an immense waste of resources. Yet, despite all this slack, inflation remains at 7 percent. Furthermore, long-term interest rates remain at intolerably high levels of 8 to 10 percent.

Ironically, by following Ford's anti-recovery fiscal policies, augmented by tight money restraints, we are ending up with both serious inflation and costly unemployment. According to the Administration's own estimates contained on page 25 of the Budget, unemployment would remain above 7 percent under President Ford's fine-tuning plan until near the end of 1977 and stay above 6 percent until late 1979. The benefits, as measured by progress toward price stability, under this game plan are projected to be both slow and modest, with consumer prices rising at or above 6 percent well into 1978. That is a far cry from any kind of price stability.

The continuing high unemployment that derives from the Administration's policy decision to curb inflation with a depressed economy has adverse ramifications which extend and reverberate throughout the economy. National output, workers' real income, corporate profits, private plant and equipment outlays, housing construction and economic activity in general are still at depressed levels. Without vigorous recovery efforts they will continue to remain far below potential for years to come, with wasted manpower, idle industrial capacity and a sense of national frustration and despair over our seeming inability to manage our economy more successfully. Coming at a time when confidence in government is at a low ebb, our economic failures are very serious.

Because of high unemployment, the deficit of the Federal Government and Federal agencies will be well over $50 billion in 1977. The large deficits we have been experiencing are attributable to the depressed economy and not to irresponsible and wasteful spending. When people are out of work, federal spending on unemployment compensation, food stamps, welfare and other income support spirals quickly. Such increases are recession-related. At the same time, and in even larger measure, tax revenues fall. Thus, recessions are a cause of big deficits. If the unemployment rate were at the 3.6 percent level of 1968 we would have a budget surplus of over $9 billion in fiscal 1977, rather than the $54 billion deficit of the Ford budget (including Federal agencies). The President's budget projects that if we had a 4 percent rate of unemployment we would have a $3 billion "full employment" surplus in 1977.

The plain and simple truth is that the Administration is mismanaging the economy. The seven years this nation has spent under Nixon-Ford policies have witnessed substantially higher unemployment, higher inflation and higher deficits that during the previous eight years. From 6.1 percent in 1961 the unemployment rate dropped to 3.6 percent in 1968. It than rose to 8.5 percent in 1975. Consumer prices rose 16 percent from 1961 to 1968. From 1969 to 1976 they increased 47 percent. Still more striking is the dramatic increase in the public debt. In the 22 years from 1946 to 1968, the Federal debt increased by just under $100 billion. In the seven years starting with 1969 it increased by $270 billion and by the end of 1976 the eight-year rise in the gross Federal debt will total about $275 billion.

The reason for the Administration's mismanagement of the economy lies in its "either-or" policy toward inflation and unemployment. The hypothetical tradeoff between inflation rates and unemployment, a theory at the heart of executive policy, places the whole battle against inflation in the wrong context. Yet, the emphasis that the country must place on fighting inflation need not and should not translate into the abandonment of efforts to control unemployment. We do not have to resign ourselves to either evil.

The human catastrophe of high unemployment during this recession has been immense. December 1975 still witnessed an intolerably high 8.3 percent level of unemployment. When one adds this official percentage of unemployment and the unemployment equivalent of those working part-time because of the recession and those who normally work but are not actively seeking a job because of poor job prospects, the rate of total idle time approaches 10 percent of the labor force.

The unemployment problem is compounded and made more immediately critical by the imminent expiration of unemployment benefits for many of the jobless. More than 3.1 percent of the labor force has been unemployed 15 weeks or longer. It is estimated that nearly one million people have been unemployed more than 65 weeks and have exhausted all unemployment benefits.

Unfortunately, the brunt of the continuing high unemployment rates has been borne by blacks and other minorities, with a jobless rate of 13.8% in December of 1975, by women (8.0%), teenagers (19.6%), and blue-collar workers (10.7%)—those least able to cope with unemployment.

The continuation for so many years of high unemployment has disastrous implications not only in terms of fundamental damage to the economy but also for the future earnings and job potential and the social and economic behavioral patterns of those most heavily hit by unemployment—especially teenagers. Teenagers, blacks, women and other groups experiencing unemployment disproportionate to their numbers are losing valuable skills, work experience and other opportunities while unemployed. In fact, given the high unemployment expected until 1980, many young people will be 24 or 25 before they have any prospect of holding a full-time job.

Given the drastic unemployment situation, the Council on National Priorities and Resources believes it is important—perhaps more critical than any other endeavor—that the Congress begin to commit substantially more resources to the goal of attaining full employment. Given the multiplier effects of such stimulation and the high marginal increase in government revenues in response to a rising GNP, such expansive programs can pay off in terms of lower deficits.

Last year, the Council made several urgent recommendations to the Congress with respect to programs we believe should be initiated or expanded as anti-recession measures to put this nation back to work. Given the durability of the recession, these recommendations, we believe, are just as appropriate in fiscal 1977. Our program recommendations include (1) drastic expansion of present CETA public service employment programs to provide an additional one million jobs on a temporary basis; (2) enactment of a $10 billion early-implementation public works employment program. The recent public works bill passed by the Congress takes us half-way toward the achievement of this goal; (3) "emergency" counter-cyclical assistance to state and local government to help stabilize local budgets and prevent further expenditures and service cutbacks and tax increases. Specifically, we support the Muskie counter-cyclical proposal passed by the Congress last week; (4) full funding of all authorized housing programs; (5) full funding of all federal education programs, which will result in the re-employment of thousands of laid-off teachers and teachers' aides; (6) greater congressional control and oversight of interest rates and monetary policy.

To battle effectively the crisis of unemployment and recession, we believe the government must adopt a strong and balanced package of such counter-cyclical programs. Such programs, tied to leading economic variables so as to phase out with recovery, should be made a permanent part of our automatic fiscal structure, thereby ensuring future economic stability without harmful fluctuation.

The Administration's argument against either temporary or permanent jobs programs is that it is preferable for the private sector to provide jobs to the unemployed than for the government sector to expand. Certainly, the government should encourage and facilitate the employment of as many workers as possible in the private sector. But at the present time, the Administration's planned recession makes the private sector incapable of providing a job to all who want to work. It is therefore both fiscally wise and humane for the federal government to redress the situation—by designing fiscal and monetary policies to stimulate hiring in the private sector and by providing jobs to those who cannot be absorbed. The very provision of public jobs will result in stimulation of private economic activity and therefore enlarge job opportunities in the private sector.

Of course, one of the major values of public service and public works programs is that we could begin to undertake construction projects and social services which are so desperately needed by the nation and which would add significantly to the nation's wealth. The rebuilding of the nation's railroads and the leveling of the railroad beds, the construction of mass transit rail systems and the production of needed city buses, the improvement of strip-mined and other exploited land, the construction of sewers, water treatment facilities and solid waste disposal plants and the provision of health care and day care services are among the many projects which could be legitimately and usefully undertaken. All of these propects have greater value than those likely to be undertaken through the stimulation of additional private investment.

We are convinced that overwhelmingly people prefer jobs to welfare and unemployment compensation. In the first ten months of 1975, unemployment benefits averaged $70 per week, hardly enough to provide a plush standard of living. More than a third of the unemployed did not receive unemployment benefits at all, despite recent extension of the system (SUA) to 12 million additional workers. Furthermore, only 18 percent of the families in which the head of household was unemployed received food stamps.

The ideological bias of the Ford Administration that every dollar spent by government is necessarily wasteful is a dangerous philosophy in the middle of the present recession. We must stop believing that private spending is always good and public spending always bad. There are many concerns and needs that can only be met by the federal government: Rapid mass transit, income for the elderly, guaranteed jobs and health care are just some of the areas in which government funds and active federal involvement are desirable. Almost everyone would agree that it is far preferable to use public resources for education than to spend private money on cigarettes, alcohol or firearms.

In addition to the temporary, counter-cyclical programs we recommend, permanent full employment programs are also needed. Even in a healthy economy, there will be workers who need government assistance. Increasingly, the economy is facing a greater problem of structural unemployment—more and more workers who are not qualified for decent jobs in the private sector. For these marginal members of the labor force, we must establish federal training programs, provide job placement assistance and, in the last resort, actual employment opportunities.

It has been 30 years since the Full Employment Act of 1946 was enacted, committing the U.S. Government to creating and maintaining economic conditions "under which there will be afforded useful employment opportunities including self-employment for those able, willing and seeking work." In those 30 years, the Act has been violated more than it has been obeyed.

In 1976 it is long past time for the federal government to begin guaranteeing and creating respectable jobs at reasonable pay for all Americans who want to work. The Humphrey-Hawkins bill (H.R. 50) introduced last year revived the spirit of the Full Employment Act, assuring jobs, either in the private or the public sector, to all people who want to work. The bill's commitment to a full employment economy through job guarantees is one we fully endorse. Hopefully, the revised version of this legislation, currently being developed, will spell out a procedure or mechanism for ensuring that full employment pledges will actually be implemented.

While not specifically advocating this approach, it does seem to me that there is a definite place for CETA public service employment programs, as part of a full-employment strategy. CETA can easily absorb more employees and it can do so effectively. Although established only a few years ago, CETA is already an important fiscal tool—one which offers a staff of people and an administrative apparatus specialized to individual localities and labor market areas.

Of course, to the extent that public service jobs are being substituted for existing employees, we must study the feasibility of providing large numbers of government jobs through other vehicles. CETA programs in and of themselves cannot bear the entire burden of "employer of last resort" federal policies. Therefore, in addition to expanded public service, Congress ought to coordinate public service employment, manpower training, job creation and unemployment insurance programs into a comprehensive and workable employment policy.

At the same time, various labor market policies should be pursued. The reduction of unemployment depends on the adoption of a lot of tough measures to make the national labor market more fluid and open, including the encouragement of occupational and geographic mobility and the reduction of barriers against youth and minorities, women and other disadvantaged groups. Unemployed workers should be aided in their search for employment and helped to upgrade their skills. Structural unemployment can be reduced, too, by targeting special assistance to those geographic areas of the country with chronic unemployment problems caused by failing or depressed industries, and to those groups with historically high rates of unemployment.

Thus, if the economy is to perform better, some very serious, long-range institutional changes will be needed. We urge the Joint Economic Committee and the Congress to begin to analyze which of these changes would be the most useful forerunners and components of a national full employment policy.

It is clear that the cost of the employment programs needed by this nation is immense. Clearly, an expenditure of that magnitude would require a major reordering of budget priorities.

Yet, much of the expense of putting people back to work is temporary and should be viewed as an investment rather than a loss. In the long run, we cannot afford the high cost of not putting people to work. If the economy were operating at full employment, the federal budget for fiscal year 1977 would show a surplus—a fact which conveys, simply and tellingly, the need to reach the elusive state of full employment. The high deficits of 1975 and 1976, as well as the deficit planned for 1977, are recession deficits, not spending deficits.

It is important to remember that stimulative expenditures for employment programs will over time reduce the deficits, since by putting people back to work, tax revenues are increased and unemployment expenditures and welfare costs reduced. Moreover, by reducing deficit in the future, we will begin to get a handle on the most rapidly growing part of our budget—namely interest payments. Thus, the Council's recommendations—by planning more spending and somewhat higher deficits immediately—would help us achieve full employment and a balanced budget more rapidly, thereby freeing valuable resources for new health and social initiatives. Greater spending and investment is necessary now so as to reduce unproductive spending, on unemployment compensation and other programs in the future.

Moreover, to some extent, increased spending for anti-recession programs can be offset by reductions in other programs. Given the constraints on our resources, wasteful government programs must be eliminated to make room for more productive expenditures. We must begin seriously to promote efficiency and economy in the use of all government funds. The Administration does not endorse this concept. Few, if any, of the President's budget cuts were made for efficiency reasons. Rather, the budget policy seems to be one of arbitrary and uneven cuts regardless of the effectiveness of various social programs. We urge the Congress to analyze closely the military budget and other budgets to reduce waste—and not just cut for the sake of cuts.

It is ironic that at the same time the Administration drastically cuts program benefits, it recommends large expenditures through the vehicle of tax subsidies. Tax expenditures are today the real "uncontrollables" in the budget, comprising nearly one-fourth of the total federal outlays each year. Certainly, the committees of the Congress must begin to analyze the social impact of tax expenditures, measuring the extent to which they overlap or counter the effect of direct budget expenditures, and eliminating these where desirable. The Council on National Priorities and Resources has analyzed the $100 billion tax expenditures budget and found that by eliminating only a dozen deductions, deferrals and credits serving no defensible national purpose, the nation could gain as much as $20–25 billion in additional revenues.

Despite reduction in wasteful expenditures and the returns to the Treasury generated by putting people back to work, there are nevertheless large expenditures associated with stimulative spending which could ignite inflationary forces. The answer to inflation lies not in running away from important expenditures but in fighting inflation while spending money for needed employment programs.

The terrible impact of inflation should not be minimized. While recession imposes hardships on the unemployed and results in a great waste of valuable resources, inflation is also debilitating. Low and middle-income workers, especially those on fixed incomes, have borne the burden of present inflation rates, watching the purchasing power of their wages decline, struggling to make ends meet, yet helpless to alleviate the problem. Thus, we must fight both inflation and unemployment.

High inflation imposes severe damages and uneven impacts on varied sectors of the economy. State and local governments, always vulnerable to inflationary increases in wages, social benefits, fuel costs and rising prices of investment outlays and interest rates, have experienced budget problems of unprecedented magnitude. At the same time that inflation has pressed the expenditure side of their budgets, the recession has resulted in a curtailment of revenues. The recession cut state and local revenues in 1975 by nearly $30 billion from what they would have been at full employment. Consequently, many states and municipalities have been forced to cut back services drastically, to lay off workers and to increase sales and property tax rates—actions which have clearly counteracted Federal efforts to stimulate the economy. The planned recession—as the anti-inflation weapon—has not only undermined the financial status of state and local governments but has made economic recovery more difficult and more elusive. The most recent study of the fiscal situation of states and local governments, published by your own committee in December 1975, found that "deflationary adjustments in state and local government operating and capital funds will combine to remove $7.5 to $8 billion from the economy . . . The magnitude of the adjustments and their concentration in the high unemployment jurisdictions indicates that considerable hardship will be imposed upon the affected jurisdictions."

The housing industry has been a severe victim of inflation. Prohibitively high long-term interest rates, along with the present inflated costs of construction, have led to falloffs in housing production and a distorted pattern of resource use. Increasingly money has been channeled from savings institutions into speculative, high-interest ventures and away from more solid investments like housing.

Another area hurt by the inflation has been the public utilities sector where the regulatory process has been made more difficult. Furthermore, increases in wages and other incomes have pushed workers into higher income brackets and cut into real income.

Traditional notions about inflation/unemployment tradeoffs no longer seem to offer much basis for total reliance on fiscal policy. Of course, excess demand should be avoided through sound monetary and fiscal policies but most of our inflation cannot be attributed to excess demand, nor have we come anywhere near price stability through tight monetary and fiscal policies. The Phillips "curve" has, for policy purposes, become a "straight line": At any level of unemployment, no matter how terribly high, we experience continuing inflation. It needs to be emphasized that very little if any of the recent inflation is due to enlarged government spending relative to revenues or to money expansion leading to overstimulation of the economy. Rather, the very severe rates of inflation were aggravated by special conditions in the food and energy markets, devaluations of the dollar, productivity declines during the recession, noncompetitive and monopolistic pricing policies, and other factors. With many of the causes of inflation unrelated to excess demand, it is not surprising that the response to the "soft economy" approach has been so disappointing.

With so much manpower and plant capacity idle and given the nature of present inflation rates, efforts to create jobs and stimulate the economy should not result in higher inflation rates. In fact, recessions, by reducing efficiency and productivity below what they would otherwise be, tend to contribute to higher unit costs and thus may aggravate inflation. Restrictive fiscal policies seem to bring lower inflation rates only after high and persistent unemployment. After three years of both less than normal GNP growth rates and costly deep recession, it is clear that fiscal restraint is not the viable solution to present-day inflation. This does not mean that aggregate monetary and fiscal measures are unrelated to inflation, but that they are not the sole solution nor are they adequate for the current situation.

What all of this says is that it is a total oversimplification to maintain, as does the President and so many of his advisors, that spending more for employment and recovery programs will automatically trigger a new wave of inflation. It is more likely that a positive fiscal program to promote a vigorous recovery will contribute to the fight against inflation, not aggravate it. It will increase supplies of goods and services. It will stimulate more investment in new capacity. It will improve productivity. It will bring an earlier end to recession-related budget deficits. Recovery will not overcome structural deficiencies in the marketplace, but prolonged recession and unemployment will not help either.

When the solutions to inflation do not lie in traditional fiscal tools, we must seek to understand the causes and formulate appropriate prescriptions. One of the problems repeatedly encountered in attempting to fight inflation is the lack of information we have about pricing behaviors of corporations and about monopolistic and oligopolistic practices in key industries and sectors of the economy. To make the marketplace function more effectively we must know more about how it functions. It has been 40 years since the Temporary National Economic Committee analyzed the economy, magnificently studying—without the aid of computers and without today's abundance of data—competitive and non-competitive practices. Given the price rigidities that exist in today's economy, it is time for the Congress to establish a new bipartisan blue ribbon TNEC to help us understand the causes of today's inflation, with a view toward improving the functioning of markets. We must stop the collusion that allows corporations to set prices without regard to market demand—and then to cut production and lay off workers when they have priced their products beyond the ability of consumers to pay.

In a more immediate time frame, we must begin selectively to restrain prices and costs through the establishment of firm guidelines and by tough intervention by the President and other appropriate leaders—essentially the reinstitution of the practices followed in 1960–1964.

The inflation has now become so enduring and so deeply embedded in our pricing system that traditional measures are simply inadequate to correct the problem. More and more economists are in agreement that we cannot rely totally on the marketplace for relative price stability. We should act resolutely to strengthen the functioning of the marketplace and supplement it, where needed, by direct measures. Without some kind of government intervention to delay or discourage unjustified price increases, we doom ourselves to continued high inflation.

We are not advocating across-the-board wage and price controls or price freezes, but rather, an incomes policy that exerts public pressure on those who unreasonably push up prices and costs. It is essential that such efforts be firm as well as fair and that the officials in charge believe in what they are doing. Controls under President Nixon were not well administered, nor were wage and price controls administered evenhandedly. Although wage increases are important elements in any direct stabilization program, we should recognize that the present spiral of inflation has not been caused by excessive wage increases. Labor will continue to resist Government intervention unless that they know that price increases will be restrained.

Federal Reserve policies must serve to accommodate the credit needs for a strong and sound recovery. High long-term interest rates will continue as long as high rates of inflation prevail, but selective measures can help meet the requirements for enlarged housing programs and other important sectors that depend on access to capital at reasonable rates. Without appropriate expansionary monetary policies, it will be impossible to restore economic growth and put people back to work. Such policies need not be inflationary.

There are other measures that can contribute significantly to the lessening of inflation. Outmoded regulations that impede competition and result in higher prices in some industries should be changed so as to better serve the needs of the public, and so as to result in reasonable prices. Antitrust laws must be strengthened and strictly enforced so as to root out administered pricing abuses and break up inefficient and harmful concentrations of market power. Long-term national food policies must be developed to increase agricultural production, build up food reserves and supervise the trading of U.S. firms with monopoly governments like the Soviet Union. A greater commitment of resources to research and development, especially to energy R&D, is essential. Decontrol should not be blindly pursued because it may do little to increase supplies but can result in much higher prices. Carefully considered moves toward deregulation and decontrol can pay off, but more harm than good can come from headlong dismantling of regulations.

Most important, though, are efforts to stimulate the economy. By increasing production, productivity will rise and inflation lessen. And the best way to stimulate the economy is by putting people back to work.

It is ironic that as we enter our bicentennial year, having enjoyed 200 years of prosperity and progress, we have still not found a way to ensure job opportunities for all citizens along with low inflation rates. The President's refusal to spend what is necessary to put people back to work—all in the name of holding down inflation—shows a bankruptcy of faith in the future health and vitality of our nation.

Clearly the solutions are not easy: Our nightmare problems of unemployment and economic stagnation will not be solved by modest means or quickly. It requires some fundamental reform of the American economy, and possibly the alteration of the institutional structure within which economic policy is set. There are many who argue that we must begin to establish major economic goals and plans for achieving and maintaining full employment and balanced growth.

Despite the complexity of the problems and their solutions, we are nevertheless optimistic. The heritage of this nation has been one of great creativity and initiative. The people of this nation do not lack the boldness and creativity necessary to solve our problems. Nor do they lack the maturity of opinion or honesty to undertake broad new programs to meet the needs of all citizens. The willingness of our people to make the tough decisions confronting this nation is our only cause for optimism and hope.

Chairman Humphrey. Now, Mr. Burress, please.

STATEMENT OF GLENN BURRESS, UNIVERSITY OF TEXAS OF THE PERMIAN BASIN, ODESSA, TEX., AND THE JOURNAL OF COMMERCE, NEW YORK, N.Y.

Mr. Burress. Before going into my statement, I would like to add a few comments on the matter of the deficits that Mr. Nathan just mentioned. I have been looking at this for some time and currently plan a series of articles on this in my column in the Journal of Commerce. And I have been looking especially at the growth of private debt or private deficits and other variables, like GNP, in the 1920's before we had Keynesian economics shaping the Federal Government's economic policies. One of the remarkable constants that we have had in this country going all the way back as far as we have GNP data, which goes back to 1921, Mr. Chairman, is that it has always taken about $2 of debt to increase GNP $1. Let me emphasize that this was true in the 1920's, a period of great stability and also a period before we had any of this talk of the Federal debt, deficits, or fiscal policy of Keynesian economics.

Total debt today is the sum of all past deficits. That's just a simple truism. Now if you want to know who the big deficit spenders have been, you look at the distribution of the total debt. Total debt in this country today is about $3 trillion. But, only about $500 billion of that is public debt. So $2,500 billion or so of it is private debt. What this means is, that for every $1 of public deficit spending we have had in the past, the private sector has had $5 of private deficit spending. The reason we now have a large Federal deficit today, to put differently the point Bob just made, is that the private deficits are inadequate. This is one way to view our current problem. In other words, when the private sector fails to provide the $2 of deficit or new debt to increase GNP by $1—then the response, you see, is that the economy falters, treasury revenues fall and the Federal deficit increases sharply. I plan, as I have said, a series of articles on this in the Journal of Commerce.

My testimony focuses pretty norrowly here today, Mr. Chairman, on the consumer. It is crucial that this Congress realize that the economics profession takes an inappropriate approach to explaining and forecasting consumer behavior. If this Congress is given explanations of the past and forecasts of the future that contradict available data on this dominant consumer sector of the U.S. economy, the Congress is prevented from designing appropriate policies to avoid the human pain and dollar costs of inflation and unemployment.

I'm going to skip part of this statement. But let me simply start with a couple of summary comments.

My approach to the consumer suggests that the rate of growth of real GNP will in 1976 exceed the standard forecast by nearly two points. I expect real GNP will in 1976 expand at about 8 percent. I will explain the rationale of this statement in more detail shortly.

But, to continue my summary, I am greatly disturbed about 1977 and 1978. I shall show below that there are generally unrecognized sources of restraint on the expansion of the economy that will become powerful in 1977 and 1978. To neutralize these retardants on recovery, this Congress will need to cut taxes something like $30 billion in 1977 and then cut taxes an additional $30 billion in 1978. It is, of course, quite possible that we may not want to neutralize all of this restraint by cutting taxes and/or increasing spending by these full amounts. Other things may come up. But it is imperative that these potential problems and their magnitudes be recognized as far in advance as possible. Otherwise you are denied the necessary time for careful deliberation required for policy formulation.

The main reason these problems may go unnoticed until it is too late to enact appropriate policies is, as already noted, that the economics profession continues to offer advice and forecast to leaders, both in and out of government, including members of this committee, on the basis of a defunct view of the consumer. This is the Keynesian model of the consumer. This Keynesian view did explain data on consumers in the 1930's and therefore was appropriate then. But this model is contradicted by data on virtually every post World War II recession and recovery and is therefore inappropriate today.

The guts of the problem is simply this. The Keynesian model is today found in all texts, taught in all graduate schools, and built into every major forecasting model, such as the models of Chase Econometrics, Inc., and Data Resources, Inc., used in the private sector and the CEA. These models assume that when the rate of growth of income slows or income falls in recessions, consumers react by reducing saving. Indeed, it is assured that consumers react to reduced income by reducing their saving faster than income falls.

Then during a recovery like the one underway now in 1976, the standard, accepted Keynesian model of the consumer tells those charged with planning and formation of policy, both private and public, that consumers will react to increased income in recovery by increasing saving. Indeed it is assumed that consumers will react to increased income by increasing their saving faster than income rises. Right now, you can see this is nearly every econometric model projecting for 1976.

I want to skip here the detailed logic of my theory in the interest of saving time but would like to put all of that in the longer prepared statement.

Chairman HUMPHREY. Yes, we will place your entire statement in the record.

Mr. BURRESS. As I have explained in detail in my prepared statement, one can insist on the Keynesian view that saving falls in recessions and rises in recoveries or he can accept my own view that saving rises in recessions and falls in recoveries.

It seems equally clear, at least to me, that the argument should be settled by the data. The data are clear. In every recession for 20 years, when incomes fell, spending was cut more than income. As a result, even the absolute level of saving rose as income fell. In every recovery for 20 years, when income has risen, spending has increased faster than income, contradicting the Keynesian depression model of the consumer. In four of these five recovery periods, the increase in spending was not only faster than income, but exceeded the increase in income. As a result, even the absolute level of saving fell. These most striking contradictions of the Keynesian depression model were recorded in 1955, 1959, 1968, and 1972.

I should add that Bart Tabor and George Topic—two of my students at Pitzer College in Claremont, Calif.—I took a look at the 1949–50 situation. That was the last postwar recession and recovery when the reported data appear consistent with the Keynesian model. It turns out when we took out the profits of the unincorporated firms from official data on personal saving and just looked at the saving of other consumers, the savings of those consumers rose sharply as income fell in 1949. Also, Mr. Chairman, the saving of these consumers fell sharply when income rose in 1950. So even though the official

1949–50 data appear to be consistent with Keynesian theory, the data for this single postwar recession are consistent with the Keynesian model only because the government includes in officially reported personal saving the business profits of the unincorporated firms.

Whatever the logic of settling the debate among economists on the basis of the data, continued use by virtually all economists of the Keynesian depression model in forecasting and planning policy, both private and public, clearly suggests the debate is one of faith. The debate is not unlike a debate over religion. Indeed, my experience demonstrates that to many economists, acceptance of the Keynesian model defines what is professional activity and what is not.

Why should this committee concern itself with what appears to be an esoteric debate among economists on theory and methodology?

The answer is that continued use of the Keynesian depression model long after it ceased to explain the data is a major source of serious forecasting errors. What this means is that, at times, the leadtime for identifying problems is cut so short that this Congress is prevented from enacting policies that could reduce human pain and suffering by reducing the rate of unemployment, reducing inflation and increasing the rate of growth. I need not further convince you, this committee, this Congress, or executives in private industry of the critical importance of this fundamental error in advice and forecasts most are receiving from their economists.

Our efforts to implement economic policy are, as a result, more like putting out fires. This Congress is never given the necessary time for the kind of deliberate debate and analysis required to reach this nation's long-run economic goals.

Before describing very briefly my alternative to the Keynesian model and how the model offers insights now into problems for 1977 and 1978, with enough leadtime for this Congress to act appropriately, let me cite some results of my alternative approach.

A year ago the major forecasting services projected sluggish recovery in 1975. It was projected that the 1975 tax cut and rebate would push the saving rate as high as 13.8 percent or more and consumers would be slow to spend the stimulant provided by Congress 9 months ago.

I told this committee a year ago the saving rate would not go nearly so high and that the tax cut and rebate would produce a much stronger recovery than others projected.

But I was more specific. Telling this committee that much auto spending had been postponed and therefore much could be accelerated, I forecast that the auto industry would be an important leader in a strong recovery. On this point I was most specific several days earlier in my February 18, 1975 Journal of Commerce article entitled, "Sharp Recovery in Auto Expected Later This Year," In that article I projected the annual rate of auto sales in the second half of 1975 at 9.3 million units. Actually 9.2 million units were sold.

For calendar year 1975, I projected auto sales at 8.5 million. Actually 8.6 million units were sold.

I shall cite just one more example now. In late July on the basis of the Keynesian view that consumers would be slow to spend their tax rebates, the third quarter saving rate was put at 9.0 percent by Chase Econometrics. It was put higher by others.

Taking my own non-Keynesian view of the consumer, I forecast that the third quarter recovery would be more vigorous than others suggested because the saving rate would be lower.

Specifically, at an August 4, 1975 Forecasting Conference on the campus of the University of Texas of the Permian Basin in Odessa and sponsored by financial executives of Odessa, Tex., I projected the third quarter saving rate would be 7.8 percent. It was first reported as 7.7 percent. It was then revised to 7.8 percent. Recovery in the third quarter was vigorous. Many other examples are cited in the prepared statement.

Turning now to the future, the major forecasting services, using the Keynesian model, are projecting that saving will rise slightly faster than income in 1976. It is projected that the absolute level of saving will rise about $15 billion.

My approach based on my own theory, grounded in postwar data, suggests saving in 1976 will fall about $5 billion. This suggests others are underestimating consumer spending in 1976 by about $20 billion. This likewise implies the standard forecast is overestimating the flow of personal saving into money and capital markets by $20 billion.

This, of course, explains why I believe real GNP will rise about 8 percent in 1976—almost 2 points higher than the standard forecast.

Turning to 1977–78, there is wide agreement that the economy will slowdown sharply. Most economists believe we will narrowly avoid a 1978 recession.

But here again, the models that crank out these results continued to use the Keynesian depression model of the consumer. That is, it is assumed that as income slows, saving will be cut and that consumer spending will hold up. We faced the same problem in 1973 that we face now. Back then economists forecast a 1973–74 growth recession. *Business Week* reported on April 21, 1973, on the basis of interviews with several top economists, that as income slowed later in 1973, savers consumers would dip into their saving and thus cushion any tendency towards recession. *Business Week* reported, in part, my rebuttal:

> That view is based on theory born of depression and is dead wrong. If income does slow, as we expect, consumers will save more, not less. And the increase in consumer saving will turn a growth recession into a full-blown recession.

Income slowed in late 1973. Did consumers dip into their savings to help prevent a recession? Or save more? The answer is that saving shot up to a quarter century high. There can be no doubt that this sharp increase in saving in the final quarter of 1973 played a key role in initiating the 1974–75 recession.

The similarities I am suggested here between the current debate over a 1977–78 slowdown and the same debate in early 1973 over a 1973–74 slowdown needs little elaboration. The projected 1977–78 slowdown will produce increased saving, not reduced saving. In the absence of preventive action by this Congress within the next 18 months, a severe 1978 recession is highly probable. One can envision a scenario that prevents a 1978 recession without preventive measures from Congress if he assumes a lucky combination of events. But we cannot leave the performance of the U.S. economy to luck.

The most important variable in my model is what I call predetermined debt repayments.

Predetermined debt repayments are defined as repayments in the current period, like this year, 1976, on borrowing before the current period started—such as before January 1, 1976. My work shows that sometimes predetermined debt repayments accelerate. When this happens, they act like a tax increase. That is, income that in the previous year that the consumer was free to spend must now go for debt repayments.

At other times, predetermined debt repayments decelerate. When this happens, they act like a tax rate cut. Income that had to be used the previous year for debt repayment is freed to spend. Expansion is stimulated.

Between mid-1975 and mid-1976, a deceleration of predetermined debt repayments freed funds to the consumer that has been required the preceding year for debt repayment. The absolute amount of stimulant was about $15 billion—nearly as large as the 1975 tax cut and rebate.

For calendar year 1976 my equations, based on data since 1971, put the stimulant at $8.2 billion. But given a reasonable forecast of consumer borrowing for 1976, and the unusual pattern of borrowing since 1972, this variable in calendar 1977 will act like a $10.6 billion tax increase. That is between 1976 and 1977, there will be a nearly $20 billion shift from these variables acting to restrain recovery.

The equations in the model already permit one to say something about 1978. The restraint from this variable will remain close to $10 billion.

Assuming no change in the tax rates, income taxes of individuals alone in 1977 will rise approximately $20 billion. This is the so-called "fiscal drag" created by the automatic growth of tax claims against income of consumers as the economy grows. A similar figure is reasonable for 1978.

This suggests that the combined restraint on the economy from predetermined debt repayments plus fiscal drag will be about $32 billion in 1977. It will be about the same in 1978. This clearly suggests the need to plan now a fiscal policy to prevent a 1978 recession. It would appear that tax cuts much larger than the levels being discussed would be in order. Thank you.

Chairman HUMPHREY. Thank you, your prepared statement will be made a part of the hearing record; also we have some good material for our discussion a little later.

[The prepared statement of Mr. Burress follows:]

PREPARED STATEMENT OF GLENN E. BURRESS

1976 FORECASTS TOO LOW; SERIOUS TROUBLE AHEAD IN 1977 AND 1978

Mr. Chairman, it is a distinct honor to be invited again to comment on the outlook. Just as I did last year, I shall focus my remarks on the implications of my dramatically different approach to how the consumer reacts to income change in recessions and recoveries.

At this time, this approach suggests the rate of growth of real GNP will in 1976 exceed the standard forecast by nearly two points. Real GNP will in 1976 expand at about 8%.

But I am greatly disturbed about 1977 and 1978. I shall show below that there are generally unrecognized sources of restraint on the expansion of the economy that will be powerful in 1977 and 1978. To neutralize these, the Congress will need to cut taxes $30-billion in 1977 and then cut taxes an additional $30-billion in 1978. It is, of course, quite possible that we may not want to neutralize all of this restraint by cutting taxes and/or increasing spending by these full amounts. But it is imperative that these potential problems and their magnitudes be recognized as far in advance as possible in the formulation of economic policy.

One reason these problems may go unnoticed until it is too late to enact appropriate policies is that the economics profession continues to offer advice and forecast to leaders both in and out of government, including members of this Committee, on the basis of a Keynesian view of the consumer. That view was appropriate for the 1930s. But it is inappropriate for the period since World War II.

The guts of the problem is simply this. This Keynesian model, found in all texts, taught in our graduate schools, and built into every major forecasting model (such as the models of Chase Econometrics, Inc., and Data Resources, Inc.) assumes that when the rate of growth of income slows or income falls in recessions, consumers react by reducing saving. Indeed it is assumed that consumers cut their saving faster than income.

Then during a recovery like the one now underway, the standard, accepted Keynesian model of the consumer tells those charged with planning policies, both private and public, that consumers will react to increased income in recovery by increasing saving. Indeed it is assumed that consumers will increase their saving faster than income.

The logic behind these conclusions seems compelling enough. It is assumed that the consumer's standard of living, and therefore his spending, is habit forming. If spending were habit forming, then when income falls in a recession, it is reasoned that consumers cannot cut spending as fast as income and therefore saving falls faster than income.

Then during the recovery, if spending were habit forming, it is reasoned that consumers, due to these spending habits, are unable to increase their spending as fast as income and therefore saving increases faster than income.

However logical this may seem, it simply is not appropriate to assume total consumer spending is habit forming. Consumers develop habits of using things like cars, appliances and the like. But they do not buy these items so frequently that they develop spending habits that prevent them from postponing some important outlays in recessions. Nor do consumers develop such powerful habits that they cannot accelerate spending during recoveries on items that were postponed in the previous recession.

If one rejects the notion that spending is habit forming and argues that spending can be postponed in recessions and then accelerated in recoveries, it is easy to see why saving might rise as income falls in a recession. It is also easy to see why saving might fall as income rises in recoveries. That is, if the recession is mild and the reduction in income is small, the postponement of some spending can cause a reduction in spending that exceeds the reduction in income. As a result, saving rises as income falls.

Then in recovery as income rises, spending that was postponed in the recession is now accelerated. The increase in spending can exceed the increase in income. As a result, saving falls as income rises.

It is clear, then, that one can build a case for the Keynesian view that saving falls in recessions and rises in recoveries or he can build a case for my own view that saving rises in recessions and falls in recoveries.

It seems equally clear, at least to me, that the argument should be settled by the data. The data are clear. In every recession for 20 years, when income fell, spending was cut more than income. Saving rose as income fell. In every recovery for 20 years, when income has rise, spending has increased faster than income, contradicting the depression model of the consumer. In four of these five recovery periods, the increase in spending exceeded the increase in income. As a result, even the absolute level of saving fell. These striking contradictions of the Keynesian depressilon model were recorded in 1955, 1959, 1968 and 1972.

Whatever the logic of settling the debate on the basis of the data, continued use of the Keynesian depression model in forecasting and planning policy, both private and public, suggests the question is one of faith among economists. The debate is not unlike a debate over religion. Indeed, my experience demonstrates that to many economists, acceptance of the Keynesian model defines what is professional activity and what is not.

Why should this Committee concern itself with what appears to be an esoteric debate among economists on theory and methodology?

The answer is that continued use of the Keynesian depression model long after it ceased to explain the data is a major sources of serious forecasting errors. What this means is that, at times, the lead time for identifying problems is cut so short that the Congress is prevented from enacting policies that could reduce unemployment, reduce inflation and increase the rate of growth.

Our efforts to implement economic policy are, as a result, more like putting out fires than the kind of deliberate debate and analysis required to reach our long-run goals.

Before describing very briefly my alternative to the Keynesian model and how the model offers insights now into problems for 1977 and 1978 with enough lead time to act, let me cite some results of my alternative approach.

A year ago the major forecasting services projected sluggish recovery in 1975. It was projected that the 1975 tax cut and rebate would push the saving rate as high as 13.8% and consumers would be slow to spend.

I told this Committee the saving rate would not be nearly so high and that the tax cut and rebate would produce a much stronger recovery than others projected.

But I was more specific. Citing to this committee that much auto spending had been postponed and therefore much could be accelerated, I forecast that the auto industry would be an important leader in the recovery.

I was even more specific. In a February 18, 1975 Journal of Commerce article entitled, "Sharp Recovery in Auto Expected Late This Year." In the article I projected the annual rate of auto sales in the second half of 1975 at 9.3 million units. 9.2 million units were sold.

For calendar year 1975, I projected auto sales at 8.5 million. 8.6 million units were sold.

In late July on the basis of the Keynesian view that consumers would be slow to spend their tax rebates, the third quarter saving rate was put at 9.0% by Chase Econometrics. It was put higher by others.

Taking my own non-Keynesian view of the consumer, I forecast that the third quarter recovery would be more vigorous than others suggested because the saving rate would be lower.

Specifically, at an August 4, 1975 forecasting conference on the campus of the University of Texas of the Permian Basin and sponsored by financial executives of Odessa, Texas, I projected the third quarter saving rate would be 7.8%. It was first reported as 7.7% then revised to 7.8%. Recovery in the third quarter was vigorous. I could cite other examples.

Turning now to the future, the major forecasting services, using the Keynesian model, are projecting that saving will rise slightly faster than income in 1976. It is projected that the absolute level of saving will rise about $15 billion.

My approach suggests saving in 1976 will fall about $5 billion. This suggests others are underestimating consumer spending in 1976 by about $20 billion. This likewise implies the standard forecast is overestimating the flow of personal saving into money and capital markets by $20 billion.

This, of course, explains why I believe real GNP will rise about 8% in 1976—almost two points higher than the standard forecast.

Turning to 1977–78, there is wide agreement that the economy will slow down sharply. Most economists believe we will narrowly avoid a 1978 recession.

But here again, the models that crank out these results use the Keynesian depression model of the consumer. That is, it is assumed that as income slows, consumer spending will hold up. To quote from Business Week in April, 1973 when a 1973–74 growth recession was being projected, they reported, on the basis of interviews with several top economists, "If as income slows later this year as is widely expected consumers will dip into their saving and thus cushion any tendencies towards recession." Business Week reported, in part, my rebuttal, "That view is based on theory born of depression and dead wrong. If income does slow, consumers will save more, not less. And the increase in consumer savings will turn a growth recession into a full-blown recession."

Income slowed in late 1973. The saving rate of consumers shot up to a quarter century high. There can be no doubt that this sharp increase in saving in the final quarter of 1973 played a key role in producing the 1974–75 recession.

The similarities I am suggesting here between the current debate over a 1977–78 slow down and the same debate in early 1973 need no elaboration.

The most important variable in my model is what I call predetermined debt repayments.

Predetermined debt repayments are defined as repayments in the current period, like this year 1976, on borrowing before the current period—such as before January 1, 1976. My work shows that sometimes predetermined debt repayments accelerate. Then they act like a tax increase. That is income that in the previous year that the consumer was free to spend must now go for debt repayments.

At other times, predetermined debt repayments decelerate, acting like a tax rate cut.

Between mid-1975 and mid-1976, a deceleration of predetermined debt repayments made funds free to the consumer that had been required for debt repayment. The absolute amount of stimulant was about $14 billion—nearly as large as the 1975 tax cut and rebate.

For calendar year 1976, the stimulant is approximately $7.6 billion. But given a reasonable forecast of consumer borrowing for 1976, this variable in calendar 1977 will act like a $12.6 billion tax increase. That is between 1976 and 1977, there will be a $20 billion shift in this variable towards restraint.

The equations in the model already permit one to say something about 1978. The restraint from this variable will remain close to $10 billion.

Assuming no change in the tax rates, income taxes of individuals in 1977 will rise approximately $20 billion—the fiscal drag created by the automatic growth of claims against income of consumers as the economy grows. A similar figure is reasonable for 1978.

This suggests that the combined restraint on the economy from predetermined debt repayments plus fiscal drag will be about $32 billion in 1977. It will be about the same in 1978. This clearly suggests the need to plan a fiscal policy for 1977 and 1978 that takes into account. It would appear that tax cuts much larger than the levels being discussed would be in order.

Chairman HUMPHREY. Mr. Parks, we welcome you.

STATEMENT OF ROBERT H. PARKS, ADVEST CO., NEW YORK

Mr. PARKS. I'm delighted to be back, Senator Humphrey and Senator Javits. I have just one opening comment. I regard economists as modern witch doctors.

Chairman HUMPHREY. Well, I am glad to have you say that right here in the presence of all of these economists.

Mr. PARKS. So be careful what we say.

I have been asked to appraise, as I understand it, the Economic Report of the President and the accompanying report of the Council of Economic Advisers. And I want to be very brief on this because I know you are interested in getting into some questions and discussion. So let me say at the outset I am concerned for many reasons, Mr. Chairman, that the inflation rate may turn out to be substantially higher than forecast by the CEA. I am concerned, as has already been indicated here, that real growth will turn out to be substantially lower in the absence quickly of major policy changes on both the monetary and fiscal fronts. I would argue that given the scenario and program of the CEA, there will be no prospect of any effective resolution of unemployment until sometime in the year of our Lord 1981. That is a long time away. And I would also argue that the possibility of this economic expansion aborting sometime late this year or sometime in early 1977, given our present policies, is one out of four.

Accordingly, I probably am a bit more concerned than my fellow witch doctors on this panel, who are already concerned.

Now, in reviewing the report of the CEA, it is important to look as well at the budget because there are developments that are analyzed by the CEA and not fully analyzed in the budget, and visa versa. And I would like to take a look at these documents on three counts: One is economic history as interpreted by the CEA.

Despite extensive review of developments by the CEA over the past few years, I would argue that this report is largely a whitewash of policy failures, of lost objectives, of defective economic theory of the type that Mr. Nathan so elegantly discussed. There are many economists—and I might add some legislators and some of them are right here today— who warned that the U.S. economy was headed into a major recession. I would argue that this worst recession by far in the postwar years was predictable. It was predicted and the warnings were ignored by the President's staff and the President himself.

I would argue, as was argued back in 1974, that very severe restrictive monetary and fiscal policies were being superimposed on an economy already headed downhill, on an economy in which excess demand was evaporating quickly. So in pursuing a policy of economic overkill, this administration seems to have lost all five of its explicit objectives.

That is to say, instead of the promised economic slowdown, the economy experienced a major cyclical fall; instead of a major promised balanced budget, a massive deficit was generated. This deficit, as Mr. Nathan has pointed out, was a consequence of economic overkill and by no means should be interpreted as a major force to generate harmonious and glorious expansion. That deficit should be dedicated to the policy of economic overkill.

Instead of securing additional capital formation—and you may remember the idea was to transfer spending power from consumption and government to capital formation—but by killing consumption, the derived demand for capital formation was killed. That depressed state of affairs is still with us.

Chairman HUMPHREY. Would you repeat that again?

Mr. PARKS. The idea set forth by the President and his advisers was simply this: There is too much spending on the government front; there is too much spending on the consumer front; there is too little spending in the way of capital formation—plant and equipment. And the idea was to transfer real resources from consumption and government to capital formation. This is part of the great WIN policy. All I am saying is that the demand for capital is based upon the demand for final consumer spending. If you kill spending for houses, for automobiles, for appliances, you will kill the demand for steel and steel facilities. There is no way in all of this world this economy can expand at a fairly vigorous pace unless there is a sustained and believable expansion in consumption.

Chairman HUMPHREY. You see this is right at the heart of the argument between some of us on economic policy. Mr. Simon said yesterday that if you could look down the road a little but, if business had some confidence, it would automatically just expand its facilities if they had the capital. This of course was the "crowding out" theory of deficit financing; that this was compelling business not to expand. He was saying if that crowding out didn't take place, regardless of consumption down here, they would build and they would expand; and that would create the jobs and the prosperity, et cetera. I was trying to point out my old dad used to tell me that we were no more prosperous than the man that walked through the front door of our store. Dad, of course, didn't have that much background on Wall Street or in economics except that he knew how to run a business. In other words, he said if they have it, we can get it; and if they don't have it, we can't get it.

The customer will ultimately determine what is going to happen in terms of our expansion.

Mr. PARKS. Yes, that is an elementary point.

Chairman HUMPHREY. It is elementary but the rhetoric hasn't been accepted.

Mr. PARKS. That basically takes me, Senator Humphrey, to what I would call a defective theory. You brought up one point. I also argued that the crowding out theory is, as applied to financial market, is just so much hogwash—as has been proven the case. In an economy operating with massive unemployed resources, the only way you can crowd out new financing on the Government side or the private side is to have a nonaccommodative monetary policy. Otherwise the argument makes little sense.

Now, I see in the Washington Post today—and I might add in the CEA report also—I see a new and rather convoluted crowding out thesis as applied to jobs and employment. The argument is that action by this Congress, that action by the administration to generate new employment will (1) displace private borrowing from the capital markets, (2) displace or impair capital formation in the private sector of the economy as a reflection of this inadequate financing, for example, and (3) displace workers.

In other words, the argument is that the Congress and the administration are tied completely and can do nothing to alleviate what is a major problem of unemployment.

I would argue here that the new crowding out thesis in the context of massive unemployed resources and in the context of an accomodative policy is just as unpersuasive as the old crowding out thesis advanced last year as applied to the financial markets.

Let me just finish up here. I will forget the prospects except to say this. I find the economic prospects for the United States economy weak. On many accounts given a shift toward more expansionary fiscal and monetary policies, I can see a rate of expansion and output approximating only 4½ to 5 percent.

Just one final comment on economic goals. I see forecasts and assumptions incorporated in the budget—and I will just make this one point—that the unemployment rate, as you know, for this passed through at 8.4 percent. Now, this was the basic unemployment rate. The rate jumped to 9.1 percent when an estimate is made for labor force time lost. That is for people working part time, Mr. Chairman. The rate jumps to 10.6 percent when an estimate is made—and this is an official estimate—of the discouraged worker, that is, of the man or woman who has just given up looking for a job. Now, it is interesting that the CEA makes a distinction between the forecast and the assumption. The forecast for the employment rate and this is the base rate, in 1976 is 7.7 percent. The forecast for 1977 is 6.9 percent.

I just note that the unemployment rate in 1977 would exceed the levels of unemployment that we experienced as a peak in the 1958 recession.

Following up on Mr. Nathan's comment, I am almost persuaded that this administration is endorsing the Marxist concept incorporated in Das Kapital—1867. There Karl Marx argued that capitalist management, in order to contain inflation should see to it that they create what he called a "reserve army of the unemployed." I just believe Mr. Nathan's comments are probably the most important comments made here today at this panel given the goals of this administration, given its present programs. I just believe that it is clear that the prospects for the unemployed would remain bleak through the year 1981.

Now, three conclusions. No. 1, the 1976 Economic Report of the President and the related CEA report are largely a whitewash of past errors. Some day a historian will look at this report and find little relationship to what happened in fact. No. 2, in the absence of new policies and facts, a serious question is raised as to whether even the moderate projections for the economy will in fact be realized. No. 3, the goals or assumptions of this administration in my judgment seem clearly to contradict the mandate of the Congress as spelled out in the Employment Act of 1946.

Thank you.

Mr. Chairman, I would like to submit the February 5, 1976 issue of the "Advest" newsletter, the text of which contains my summary statement.

Chairman HUMPHREY. Without any objection the newsletter will be included in the hearing record as your summary statement.

[The summary statement of Mr. Parks follows:]

SUMMARY STATEMENT OF ROBERT H. PARKS

IDEOLOGY, POLITICS AND THE ECONOMIC OUTLOOK

My assignment in the main is to appraise the 1976 Economic Report of the President and the accompanying Annual Report of the Council of Economic Advisers. I find problems with these reports on three counts.

First, the CEA's review of what has happened suffers, as expected, from the error of omission. Most noticeably is the role of governmental policymakers themselves played in pushing the economy into the worst recession in post-war history despite the warnings of many economists, legislators and others.[1]

Second, the CEA's projections of a moderate growth of the economy may not be realized unless policy shifts are instituted, and fast. The risks in my view are not adequately recognized.

Third, the "goals" of the Administration in key areas appear light-years away from the needs of the economy. This is particularly true for employment, even assuming the economy advances along the path foreseen by the CEA.

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[1] The warnings were dismissed almost completely by policymakers. My own views were set forth as follows: "The forward momentum of the economy in real terms is weak, and weakening further. The irony is that rapid inflation itself is further cutting into real buying power. The great irony is that governmental restrictive policies already in motion will likely further weaken demand. The greatest irony is that no early action on the policy front is being suggested by the Summit meetings. Next year is the word. In that case, the September 27–28 Summit session might just as well be held in the Coliseum in Rome, and the participants be provided with appropriate fiddles. (Economic and Investment Perspective entitled Economic Overkill, Sept. 9, 1974)."

Economic History

Despite extensive review of developments the past few years, the CEA report is largely a whitewash of policy failures, lost objectives, and defective economic theory:

(1) *Economic Overkill.*—The United States did not merely slide into the worst recession in postwar history. It was pushed into a "mini-depression" through restrictive monetary and fiscal policies superimposed on an economy already headed downhill. This was predictable, and many economists so warned.

(2) *Lost Objectives.*—Instead of the promised economic slowdown, the economy experienced a major cyclical fall. Instead of the promised balanced budget, a massive deficit was created. Instead of spurring additional capital formation, economic overkill killed consumption and the derived demand for capital.

(3) *Defective Theory.*—Fighting cost-push inflation and power-bloc pressures on prices through monetary and fiscal restriction was a perfect prescription for major recession. The new Spencerians, (classicists or Smithians) in charge assumed that the fiscal and monetary tools fashioned for use in a classical and purely competitive world would work as well in a world comprised of power blocs and extraordinary cost-push pressures on prices. They did not, predictably.

Economic Prospects

Most economists are on a bicentennial bandwagon rolling down Route 66. The happy consensus looks for real GNP to advance a healthy 6% and for price inflation to slow to 6%. The CEA is on the same bandwagon, but looks perhaps for a little more growth. But a number of cautions and caveats are in order at this juncture:

(1) *Demand Weakness.*—The leading indicators have flattened the past few months; real buying power of non-farm workers has been eroded, with real weekly earnings still almost 5% below the level of 1972 (Exhibit 1); foreign economies are experiencing a "sputtering" recovery, which foreshadows weakening of U.S. exports; a galaxy of depressants are still at work on housing demand, including high operating, financing, and construction costs; capital spending appears headed nowhere, possibly down in real terms; and bank loans to business remain extremely weak.

(2) *Policy Worries.*—Growth of the money aggregates are far below Federal Reserve targets. The money stock narrowly defined is just one case in point. It advanced but 3.1% the past thirteen weeks, and 4.6% this past year. Deflated for price rises, it fell absolutely over this entire period. The bank credit proxy advanced only 5.8% the past thirteen weeks and 3.3% this past year. It dropped absolutely when adjusted for price inflation.

At the fiscal level, a loss of borrowing power is forcing state and local governments to cut growth and raise taxes, and the full-employment surplus reported by state and local governments (Exhibit 2) could largely offset or negate Federal expansionary actions. That's another cause for worry.

Yet another worry is that inflation may speed beyond the expectations of policymakers, and induce them to restrict once again. Such a policy would be logical and laudable if an acceleration in the pace of inflation were to be caused by excess demand (hardly likely for a long period ahead), but would represent the height of folly if an inflation speed-up were explained rather by cost-push and power-bloc forces.

(3) *Defective Theory.*—This may come into play again. That is, just as the crowding-out thesis proved to be a phantom when applied to the capital markets, the new crowding-out proposition advanced by the CEA probably faces the same fate. The new thesis, developed on pages 46 and 47 and elsewhere in the CEA report, asserts that direct governmental funding and governmental deficits to generate employment will displace private borrowers from the market, displace private capital formation, hence displace private jobs.

This, in my judgment, is the essence of the convoluted jargon presented in the report. Apart from the jargon, however, the substance of the argument is spurious in the context of the present economy. The economy is still operating with massive unemployed resources, and given accommodative policy by the Federal Reserve, there is little risk that additional job-creating actions by the Congress or the Administration is going to displace private investment and private employment.

Economic Goals

The economic goals of the Adminstration are a worry too in that major problems would remain unresolved for years ahead. I have specific concern over the cutbacks scheduled in the budget for training, employment, and social services, and for the proposed cuts in education. Just about every other sector of the budget is headed up but these. My concern over these matters is heightened when consideration is given to the employment goals of the Adminstration.

(1) *The Numbers.*—What is our starting point? The overall employment rate for the fourth quarter 1975 is reported at 8.4%. The rate jumps to 9.1% when an estimate is made for labor force time lost, and to 10.6% when a further adjustment is made for discouraged workers who have just stopped looking for work. In other words, the additional adjustments add about two percentage points to the base. However defined, the starting point represents a personal tragedy for the unemployed.

(2) *The Goals.*—One is hard pressed to know just what the goals of this Administration are. The Budget, for example, goes to great pains to distinguish between short-term forecasts of the unemployment rate as against long-term assumptions.

Here are the numbers:

[In percent]

Year	Forecast	Assumptions
1975	8.5	
1976	7.7	
1977	6.9	
1978		6.4
1979		5.8
1980		5.2
1981		4.9

(3) *Policy and Ideology.*—One would almost have to believe that this Administration is endorsing the Marxist prescription for capitalist management to contain inflation. Marx argued in Das Kapital (1867) that the way to contain inflation is to provide for a "reserve army of the unemployed". The new classicists must be re-reading Marx. They are so far right, they are left.

In any event, these forecasts and assumptions spell extraordinary trouble ahead for labor, assuming these "goals" are realized. From a logical point of view, these numbers contradict the CEA rationale for promoting jobs. The idea is to promote moderate expansion to promote jobs, permanent jobs, over the long-run. I should think that the period 1975 to 1981 is fairly long-run, particularly for the unemployed.

From a legal point of view, these forecasts and assumptions stand in conflict with the mandate of Congress. That mandate, as quoted on page 158 of the CEA report, is as follows: "The principal directive of the Employment Act (of 1946) is that the Federal Government 'use all practicable means consistent with its needs and obligations . . . for the purpose of creating and maintaining . . . conditions . . . to promote maximum employment, production, and purchasing power.' "

Query: Would the forecasts and assumptions noted here meet this directive?

Conclusions [2]

(1) The 1976 Economic Report of the President and the related CEA report will largely whitewash for past errors.

(2) In the absence of new policy shifts, and fast, a serious question is raised as to whether even the moderate projections for the economy will in fact be realized. In the absence of additional steps to spur employment, the outlook for the unemployed will remain bleak for years ahead.

(3) Many of the projections, assumptions and "goals" incorporated in the President's report, the CEA report, and the Budget appear to contradict the directives of the Employment Act of 1946. Does not the Congress have an obligation to see that these directives are carried out?

[2] These conclusions are spelled out in somewhat more detail in the attached reports prepared for investment clients (Perspectives nos. 29 and 30).

EXHIBIT 1.—AVERAGE WEEKLY EARNINGS IN SELECTED PRIVATE NONAGRICULTURAL INDUSTRIES, 1947–75

[For production or nonsupervisory workers; monthly data seasonally adjusted]

Year or month	Average gross weekly earnings					Average spendable weekly earnings, total private nonagricultural [4]			
	Total private nonagricultural [1]		Manufacturing	Contract construction	Retail trade [3]	Amount		Percent change from preceding period [5]	
	Current dollars	1967 dollars [2]	Current dollars			Current dollars	1967 dollars [2]	Current dollars	1967 dollars
1947	$45.58	$68.13	$49.17	$58.87	$33.77	$44.64	$66.73		
1948	49.00	67.96	53.12	65.27	36.22	48.51	67.28	8.7	0.8
1949	50.24	70.36	53.88	67.56	38.42	49.74	69.66	2.5	3.5
1950	53.13	73.69	58.32	69.68	39.71	52.04	72.18	4.6	3.6
1951	57.86	74.37	63.34	76.96	42.82	55.79	71.71	7.2	−.7
1952	60.65	76.29	67.16	82.86	43.38	57.87	72.79	3.7	1.5
1953	63.76	79.60	70.47	86.41	45.36	60.31	75.29	4.2	3.4
1954	64.52	80.15	70.49	88.91	47.04	60.85	75.59	.9	.4
1955	67.72	84.44	75.70	90.90	48.75	63.41	79.06	4.2	4.6
1956	70.74	86.90	78.78	96.38	50.18	65.82	80.86	3.8	2.3
1957	73.33	86.99	81.59	100.27	52.20	67.71	80.32	2.9	−.7
1958	75.08	86.70	82.71	103.78	54.10	69.11	79.80	2.1	−.6
1959	78.78	90.24	88.26	108.41	56.15	71.86	82.31	4.0	3.1
1960	80.67	90.95	89.72	113.04	57.76	72.96	82.25	1.5	−.1
1961	82.60	92.19	92.34	118.08	58.66	74.48	83.13	2.1	1.1
1962	85.91	94.82	96.56	122.47	60.96	76.99	84.98	3.4	2.2
1963	88.46	96.47	99.63	127.19	62.66	78.56	85.67	2.0	.8
1964	91.33	98.31	102.97	132.06	64.75	82.57	88.88	5.1	3.7
1965	95.06	100.59	107.53	138.38	66.61	86.30	91.32	4.5	2.7
1966	98.82	101.67	112.34	146.26	68.57	88.66	91.21	2.7	−.1
1967	101.84	101.84	114.90	154.95	70.95	90.86	90.86	2.5	−.4
1968	107.73	103.39	122.51	164.49	74.95	95.28	91.44	4.9	.6
1969	114.61	104.38	129.51	181.54	78.66	99.99	91.07	4.9	−.4
1970	119.46	102.72	133.73	195.45	82.47	104.61	89.95	4.6	−1.2
1971	127.28	104.93	142.44	211.67	86.61	112.41	92.67	7.5	3.0
1972	136.16	108.67	154.69	222.51	90.99	121.09	96.64	7.7	4.3
1973	145.43	109.26	166.06	235.69	95.57	127.41	93.73	5.2	−.9
1974	154.45	104.57	176.40	249.08	101.04	134.37	90.97	5.5	−5.0
1975 [7]	163.89	101.67	189.51	264.98	107.89	145.93	90.53	8.6	−.5
1974: Jan	149.00	106.40	170.51	235.87	98.04	130.16	92.94	[6] −3.4	[6] −15.0
Feb	150.55	106.30	170.89	244.78	98.34	131.36	92.75	11.6	−2.4
Mar	150.88	105.46	171.70	241.78	99.03	131.61	91.99	2.3	−9.4
Apr	149.97	104.15	167.42	240.24	99.30	130.91	90.91	−6.2	−13.2
May	153.04	105.20	174.90	243.98	101.33	133.28	91.62	24.0	9.8
June	154.09	104.96	176.88	247.97	101.04	134.09	91.34	7.5	−3.6
July	155.61	105.11	178.49	249.44	101.71	135.26	91.37	11.0	.4
Aug	156.28	104.37	180.05	252.17	102.36	135.78	90.68	4.7	−8.7
Sept	157.32	103.85	180.75	253.96	102.38	136.58	90.16	7.3	−6.7
Oct	158.41	103.64	182.80	255.99	103.03	137.42	89.91	7.6	−3.3
Nov	157.47	102.07	181.31	257.52	103.35	136.70	88.61	−6.1	−16.0
Dec	158.99	102.26	182.03	261.80	104.00	137.87	88.67	10.8	.8
1975: Jan	159.64	102.02	182.28	261.52	104.65	138.38	88.43	[6] 4.5	[6] −3.2
Feb	159.92	101.64	181.58	256.86	105.30	138.59	88.08	1.8	−4.6
Mar	160.11	101.48	183.61	250.58	106.28	138.73	87.93	1.2	−2.0
Apr	160.47	101.11	184.94	264.22	106.27	139.00	87.58	2.4	−4.7
May	161.19	101.21	185.25	264.20	107.58	146.00	91.67	[6] 7.9	[6] 2.9
June	162.36	101.16	187.85	259.54	107.57	146.91	91.53	7.7	−1.8
July	163.44	100.67	189.91	265.35	107.55	147.76	91.01	7.2	−6.6
Aug	165.43	101.73	192.94	267.91	108.85	149.31	91.82	13.3	11.2
Sept	166.06	101.65	194.22	268.64	108.84	149.81	91.70	4.1	−1.6
Oct	167.61	101.93	195.02	267.91	110.14	151.02	91.84	10.1	1.8
Nov [7]	169.52	102.39	196.71	271.58	111.15	152.48	92.09	12.2	3.3
Dec [7]	170.46	102.45	199.49	276.75	110.48	153.20	92.08	5.8	−.1

[1] Also includes other private industry groups shown in table B–27.
[2] Earnings in current dollars divided by the consumer price index.
[3] Includes eating and drinking places.
[4] Average gross weekly earnings less social security and income taxes for a worker with three dependents.
[5] Monthly data are annual rates.
[6] In annualizing the rates of change, the effect of the change in tax rates at the beginning of 1974 and 1975 and in May 1975 is taken into account separately.
[7] Preliminary.

Note.—See Note, Table B–27.

Source: Department of Labor, Bureau of Labor Statistics. 1976 CEA Report.

EXHIBIT 2.—ACTUAL AND FULL-EMPLOYMENT FEDERAL AND STATE AND LOCAL GOVERNMENT RECEIPTS AND EXPENDITURES, NATIONAL INCOME ACCOUNTS BASIS, CALENDAR YEARS 1969–75

[Billions of dollars; seasonally adjusted annual rates]

Calendar year	Federal Government			State and local government			Combined surplus or deficit (−)
	Receipts	Expenditures	Surplus or deficit (−)	Receipts	Expenditures	Surplus or deficit (−)	
Actual:							
1969	197.0	188.4	8.5	119.7	117.6	2.1	10.7
1970	192.1	204.2	−12.1	134.9	132.2	2.8	−9.4
1971	198.6	220.6	−22.0	152.6	148.9	3.7	−18.3
1972	227.5	244.7	−17.3	177.4	163.7	13.7	−3.5
1973	257.9	264.8	−6.9	193.8	180.9	12.9	6.0
1974	288.4	300.1	−11.7	209.4	201.3	8.1	−3.6
1975 [1]	283.5	356.9	−73.4	232.4	222.4	10.0	−63.5
1974:							
I	275.7	281.1	−5.3	201.9	192.6	9.4	4.0
II	285.6	293.5	−7.9	207.3	199.1	8.2	.3
III	299.2	307.2	−8.0	213.5	204.5	9.1	1.0
IV	293.1	318.6	−25.5	214.9	209.0	5.9	−19.6
1975:							
I	283.6	337.4	−53.7	221.2	215.5	5.7	−48.0
II	250.1	352.3	−102.2	228.2	219.4	8.8	−93.4
III	293.3	363.8	−70.5	237.7	224.8	12.9	−57.6
Full-employment:							
1969	199.7	188.8	10.9	120.1	117.6	2.6	13.5
1970	208.9	202.9	5.9	140.6	132.2	8.4	14.3
1971	218.6	218.2	.4	160.4	148.9	11.5	11.9
1972 [2]	234.4	242.7	−8.4	183.9	163.7	20.2	11.8
1973	271.2	263.7	7.5	198.7	180.9	17.8	25.3
1974	323.2	297.8	25.4	224.5	201.3	23.2	48.6
1975 [1]	340.8	348.3	−7.5	259.8	222.4	37.4	29.9
1974:							
I	297.3	279.5	17.8	211.2	192.6	18.6	36.4
II	315.6	291.9	23.7	220.2	199.1	21.1	44.8
III	337.0	305.0	32.0	229.8	204.5	25.3	57.3
IV	342.7	314.7	28.0	236.7	209.0	27.7	55.7
1975:							
I	344.8	329.8	15.1	249.6	215.5	34.1	49.2
II	309.8	343.0	−33.3	257.3	219.4	37.9	4.6
III	348.6	355.3	−6.7	263.9	224.8	39.1	32.4

[1] Preliminary.
[2] The $9.1 billion estimated increase in overwithholding of personal income taxes is not included in 1972 full-employment receipts.

Note.—Detail may not add to totals because of rounding.

Sources: Department of Commerce (Bureau of Economic Analysis), Office of Management and Budget, and Council of Economic Advisers. 1976 CEA Report.

Chairman HUMPHREY. Mr. Parks, you previously asked a very pertinent question. Does not the Congress have an obligation to see these directives are carried out?

Mr. PARKS. That was a rhetorical question.

Chairman HUMPHREY. It was a very good question. I might add that we are not only having trouble with this law but with a number of laws that the Government doesn't want to pay any attention to. They are deliberately ignoring them. It is constantly necessary to take the Government to court. I have never seen anything like it. I am not referring only to the Employment Act, because that is less of a directive, but I pointed out yesterday that we have laws on the books relating to the Department of Agriculture where people in my State had to go to Federal court to enjoin, first of all, the Secretary in one instance and also to direct him in another instance. It was a refusal to do anything under the law.

Now, if you as a private citizen did that, they would bring you before the court and you are either fined or you are jailed or at least you are humiliated. I want to say that I have never seen anything like it. It has become a characteristic of this Government to violate the law. I am sorry I didn't say it to the Council of Economic Advisers and others when they were up here because this is a fact.

The Employment Act of 1946 does mandate that the Government is to have policies that promote maximum employment and maximum income and maximum production. They have policies that promote exactly the opposite. They are lawbreakers. That is the only way you can identify them. I know when I make statements like that, somebody says, "You are too harsh; you are too radical," and what have you. But some poor soul out here, if he doesn't have the right kind of a staircase, OSHA moves in on him and the Department of Labor will come right in on him and force him to put in a new stairwell or force him to put in some exit signs or raise the ceiling or do something that will cost a lot of money. Yet a Cabinet officer, who is instructed by the Congress by law, just willy-nilly goes on his way because the Office of Management and Budget, who acts for the President says: "Well, I don't think we ought to do anything about that law now."

You say it is rhetorical question but it is not rhetorical. I charged repeatedly, and did so at the time of the Summit Conference by the way, that this Government, that this current administration is a law violater. I guess that is about as firm as you can get it.

I don't know what you can do about it.

You know we had Mr. MacAvoy come in here from the CEA. He is a decent man, and a nice man, but he was sitting here telling me none of the employment programs are working. I think they all ought to quit. I mean if you have a group of people that don't know how to make anything work, you ought to get them out. For anybody, for any responsible public official to tell us you can't make a public works employment program work—not that that is the most desirable way—but just to say it won't work is just outrageous. The whole reason is they are wedded to a religion, wedded to a philosophy, as was said here a moment ago; namely, that you are supposed to tolerate high rates of unemployment and high rates of unused plant capacity and high rates of unused capital in the name of combating inflation. That is the whole thing. I mentioned that we not only have unused human resources in this country, which is called unemployment or underemployment; but that we also have vast quantities of unused capital lying dormant. There isn't the demand for capital out there in those capital markets except for the people who don't need the capital. The people who don't need capital can get it; the people who need capital are the ones that cannot get it.

I want to give one other point for you gentlemen to think about. Have you watched the draught in the midwest? Do you know what is going to happen to the winter wheat crop? No one figures these things into these computations. I am here to tell you that there is a disaster underway. We are having duststorms. We are having massive movements of topsoil, which is killing off a lot of the planting. It cuts it right off. The duststorm cuts the plant right off like a knife. It is now estimated that our winter wheat crop will be anywhere from 20 to 30 percent below the projections. Has anybody realized what the means to food prices? When you have a bad winter wheat crop and you have low subsoil moisture, you also run the danger—and I don't see it will happen but you got to look at the possibilities ahead—the danger of having poor grain crops. Generally, dry seasons in the winter are followed by early frosts in the fall.

That is a factor that has to be considered in here and also the wage settlements that are coming up. What makes anybody think the labor movement is going to be peaceful and quiet in the big wage contracts that are coming up this year? I believe some of the big ones are coming up in 1976.

Mr. NATHAN. Yes, very big.

Chairman HUMPHREY. Do the auto contracts come up this year?

Mr. NATHAN. Yes, autos.

Chairman HUMPHREY. And steel? No, they don't come up here.

Mr. NATHAN. Rubber.

Chairman HUMPHREY. Rubber comes up here so this another factor that is in the picture that relates to employment and inflation.

Mr. Burress, you presented—well, I won't say novel but a lot of thoughtful comments—and I noted down here your thesis, so to speak, and your thesis was in the first paragraph of your statement; namely, you state: "How the consumer reacts to income change in recessions and recoveries." If I have it right, what you are saying is that when income is low, the savings are high and the spending is low?

Mr. BURRESS. Right.

Chairman HUMPHREY. You are also saying when incomes are higher savings are less, and spending exceeds income?

Mr. BURRESS. Not quite. It is not that spending exceeds income but that the increase in spending exceeds the increase in income. So saving is still positive. But during these periods of recoveries, given an increase in income, say $100, spending increases by say $120. Hence saving goes down by $20. But spending remains less than income and saving remains positive.

Chairman HUMPHREY. Yes, I didn't state it exactly. So your thesis is that it is like a built-in tax reduction under those conditions, under the latter conditions? Namely, that there is money released and that there is spending power that goes out and stimulates the economy, correct?

Mr. BURRESS. Let me start by saying this. When, as a student in 1958, I searched the data to find out why they were inconsistent with accepted Keynesian theory I was being taught. The one single variable—the one single set of statistics that seem to be related, to the pattern of inconsistencies, Mr. Chairman, was savings by installment debt. If you remove from the data on personal savings, the saving and dissaving by consumers through installment debt, then the adjusted data are consistent with our textbooks and what our forecasting models forecast. So, I focused research on the installment debt data to explain the inconsistencies. Turning now to your question, the way this works is that when you have a recession, especially a severe recession, like 1974, you get a predictable 4-year pattern of deceleration and acceleration of predetermined repayments. These repayments decelerate in the first year of recovery, like 1976, and provide a stimulant for the economy. I am sure this has been what has been at work, especially in the automobile sector, making that sector as strong as it has been this year. But then in 1977, once you have picked up this new borrowing and especially if borrowing fell 3 years earlier, as it did fall sharply 3 years before in the 1974 recession—these variables cause an acceleration of repayments that acts like a tax rate increase. This retards expansion. The third year after a recession, Mr. Chairman, the restraint is systematically maximized. We can expect this in 1978. So, it works both ways. In other words, it sometimes acts as a tax reduction like 1976, stimulating the economy. But at other times, like 1977 and 1978 it acts like a tax increase restraining the economy.

Chairman HUMPHREY. Now, in this panel, Mr. Ackley, I gather that you felt that the growth of real output as projected by the CEA—and your projections were somewhat within the same ballpark, that is you thought they were slightly more optimistic than yours—but your projections were somewhat within the same ballpark?

Mr. ACKLEY. Yes, they were appreciably more optimistic than mine. I tried to bring together the other forecasts that I know about.

Chairman HUMPHREY. Yes.

Mr. ACKLEY. And I would say generally, Mr. Chairman, that the Council's forecasts are somewhat more optimistic than the prevailing view. In fact, I know of but one forecaster, whose work I respect, who has a stronger forecast.

Chairman HUMPHREY. Now, you have Mr. Burress here who thinks you are going to have——

Mr. ACKLEY. Yes, now there are two.

Mr. BURRESS. Well, you know, all you can say is if the consumer behaves in this recovery the way he has in every other recovery, you are going to get some $20 billion more in spending than is currently projected.

Chairman HUMPHREY. Yes, I am simply noting that there is this intangible factor of consumer confidence or whatever you wish to call it that has tremendous impact. It may very well be that you get a little more upbeat this year because of the willingness of the consumers to spend. I think the stock market jumped. Without going into why it jumped it has an impact on the average citizen. From my conversations around, for examples, during the last couple of weekends back talking to my constituents, without them knowing what is really happening in the stock market, but still they would come to me and say; "well, it looks better doesn't it? The market is up? What do you think?" I was out to our Minnesota Industry and Commerce Association, I was with some of our friends in the labor movement, I talked to another group in northern Minnesota recently. I talked to the people in the journalism profession and in business, you know, in the main street type of business. Many of them indicated to me, and in fact the general line of thinking was that "well, it looks better."

Now, whether that has any impact on what their decisions will be, I don't know, but at least it is a psychological upbeat.

Now, Mr. Parks, you agree with the forecasts of the CEA?

Mr. PARKS. I agree under two assumptions: That there is quickly a stepup in monetary growth. Monetary growth is lightyears below its targets right now. And deflated for price inflation, monetary growth is negative over this past year. And I would argue that in the absence of some additional fiscal stimulus, we will not get the numbers the CEA has in mind.

Chairman HUMPHREY. I hear the bell. I have a piece of legislation down there that somebody is trying to derail. I have to keep one ear to that buzzer. Excuse me.

Mr. PARKS. I don't know why I am complimenting Mr. Nathan so much today, but when I talk about abortion possibilities, of the economy, I have in mind once again, Mr. Chairman, that for the eighth time in the postwar years, that if the inflation rate should step up substantially beyond the expectations of our policy managers, say late this year or early next, they could restrict once again and throw this economy into a recession. And this gets into, one, economic theory; and two, economic policy. And Mr. Nathan, I think, is persuaded, and I am also persuaded, that the inflation that we experienced has nothing to do that I can find with excess demand now or probably for 3 or 4 years ahead of us.

Mr. ACKLEY. Please add my name to your list.

Mr. PARKS. But it has a lot to do with that wheat you talked about.

Chairman HUMPHREY. Yes.

Mr. PARKS. It has a lot to do with the cold wave we have just experienced, which I understand is knocking up the price of crude oil. It has a lot to do with power blocks. I mean it has a lot to do with oligopolists who wear white sheets and the domestic ologopolists who wear Hicky Freeman suits. Inflation has a lot to do with frantic power struggle among power blocks.

You mentioned labor as a power block. It has a lot to do with the insistence on the part of the business community to try to lift the rate of return on capital, Mr. Chairman, that will begin to match the celestial costs of capital. And it is this terrific struggle among the power blocks, and the special forces, that generate inflation.

Chairman HUMPHREY. Which brings me to this. Unless there is another power block in the public interest——

Mr. PARKS. The government.

Chairman HUMPHREY. Namely, the government, the White House, backing up the Wage and Price Stability Council, which it doesn't do—I mean for all practical purposes the Wage and Price Stability Council is like the bastard child at a family reunion. It is way off on the side and no one wants to admit paternity. As a matter of fact, no one wants to even bring them into the friendly social circle. They are just off over there and left on their own. We come up here and we have the Council of Economic Advisers talking to us about inflation and they never mention the Wage and Price Stability Council. They did not mention it once. I had to bring it up myself, you know, and indicated that first of all, the Council never used its subpena power, I picked on the Council a little bit but I think I was in error. I think the Council has tried to do a little something but has not had any help. If you are not going to have controls, which I personally don't want us to have, then I think you have to have this investigative work on the part of the Council, you have to have the Council on top of these wage-price settlements, you have to have them on top particularly of these built-in administered prices, and you have to have the White House behind it.

I will never forget Lyndon Johnson's kind of jawboning. He knew how to jawbone friend or foe. Of course it isn't just jawboning. That is really a misname. What it really means is the the President of the United States, that his officers of government must put their prestige and their power behind the public interest and say: "we are not going to let there be a big ripoff here because at least we are going to expose it." Today we have the top officials in this government coming before committees like this indicating that for all practical purposes there is none of this going on.

It is just incredible. Senator Proxmire has gone through the increases in prices time after time in this committee, the increases in prices in certain categories of our industrial plant and pointing out that there is no excess demand, there is no pressure of demand, but yet prices go on up. They haven't even negotiated a new wage contract yet prices go on up. The government just sits back here and says "ho hum." I mean this will make Rip Van Winkle look like a bundle of energy.

Mr. Burress, do you want to get in on that?

Mr. BURRESS. Mr. Chairman, I want to throw out a comment on the question about the projected reductions in the rate of unemployment. I didn't get a copy of the Economic Report, but in general the standard forecast is for the rate of unemployment to fall say to 7 or 7½ percent by the end of 1976. It may do so because of the stronger recovery I am projecting for 1976. Here is one of the things that concerns me. There is a serious inconsistency in the models at this point in time. The models I understand the Council uses—such as DRI and Chase Econometrics—have real GNP toward the end of 1976 back at the same peak level recorded at the end of 1973. Okay? We had quite a decline in output per man-hour, Mr. Chairman, in the private sector during this recession. Now these same models have private output per man-hour at the end of 1976 back where it was at the end of 1973. Clearly this must suggest that at least for private GNP, it is going to require no more workers or man-hours to produce our private GNP at the end of 1976 than it did at the end of 1973. At the end of 1973 we had a 4.8-percent unemployment rate. Over those 3 years we will have added 6 percent to the labor force. That gives you a 10.8-percent rate of unemployment at the end of 1976. Now, you must reduce this by adding in the Government workers. But this gets the rate down to not less than 9.5 percent. I questioned each of the forecasting services about this inconsistency: Wharton, DRI, UCLA and Chase Econometrics. No one said they could explain this inconsistency. In general, their response was "yes, the unemployment numbers that the model produced were too high." And one of them admitted—and this is on the record because I had permission to print this in my column: "We fudged. We just added 400,000 workers to get the unemployment rate down where it should be." A second said essentially the same thing.

So what I am saying is that if productivity should rise the way it is projected, then there is less hope for getting the unemployment down anywhere near the levels that are projected by the CEA and others.

Chairman HUMPHREY. Gentlemen, I have a serious problem. I have to go over to the Senate floor. I am terribly sorry that I have to interrupt this hearing. I thought I had a Senator over there to handle this bill but apparently not. This is an embarrassing moment but I have no choice because legislation comes first. I want to thank you all very much for your testimony and your time. It has put a great burden upon you but you have been very helpful to us in advising us on this.

You know we had I think this morning some of the best testimony we have had. It is regretable that we were unable to more closely examine what your observations are. I know how terribly busy you are and I really hesitate to ask you to do something more than you have but you can do this as a public service—and I ask it as a public official—because I have so many questions I want to ask you. I think what I will do is to take out of the questions about three basic questions and send them to each of you. If over the next 10 days or so you could give us the benefit of your counsel, we would appreciate it.

I wanted to ask a little on the rate of monetary growth and monetary policy. I surely wanted to ask a little more on the budget policy and on these job creation programs.

I notice that you, Mr. Ackley, were somewhat concerned about public job creation programs. Now, I am too. I don't think they are, you know, as productive as I would like. I feel like Bob Nathan, that is, that we don't have too good alternatives. We have the alternative—and I'm speaking now about the immediate situation—we have the alternative of public service jobs that could at least give some contribution to the general well-being or no jobs. There is a real serious problem ahead of us with the ending of the unemployment compensation benefits. If they end, you will have about 1 million workers who will have exhausted 65 weeks or more of unemployment compensation benefits. Of course the State funds, many of them are totally out. In the Federal Government you are in a real sense federalizing the whole thing with direct appropriations from the Treasury.

So if you don't mind, I will see that you get two or three questions like this. Also on the recovery targets I have some questions on that.

Let me take 1 minute. Do you have anything further you would like to add, Mr. Ackley?

Mr. ACKLEY. I think I agree with almost everything that has been said at the table today. If I summarize, I would be merely repetitive.

Chairman HUMPHREY. Mr. Nathan.

Mr. NATHAN. Not really. Let me add some things in response to your questions.

Chairman HUMPHREY. Quickly, do you think the Federal Reserve Board is keeping abreast of these developments?

Mr. NATHAN. I think the Federal Reserve Board's monetary policies are pretty much the same as the fiscal policy; namely, "let's move up but be careful, careful, careful, careful." It is "you know, let's lean on the down side." And I think there are two things wrong with it: one, I think it is an illusion that this is going to bring price stability; second, it is just going to continue a fantastic waste of resources, of unemployment, and a large GNP gap and a much bigger deficit.

Chairman HUMPHREY. Mr. Ackley.

Mr. ACKLEY. I don't think monetary policy is nearly as important as fiscal policy. At the moment, I don't think what the Fed is doing is making very much difference. It could toward the end of the year. As business activity recovers, it might very well require a faster rate of monetary growth than the Fed will be providing; and at that point they should provide it.

Chairman HUMPHREY. Mr. Burress?

Mr. BURRESS. Well, I have the opportunity to interview for my column, Mr. Chairman, Federal Reserve officials frequently. And one thing that is very clear: None of us know for sure what is making the money supply behave the way it has.

How GNP could grow in the second half of 1975 nearly eight times as fast as the money supply as interest rates fell is a question that remains unanswered. It bothers all of us.

In other words, there is just a lot of questions here where we don't know the answers. Yet we must give these questions hard and careful thought and I look forward to receiving your letter and questions.

Chairman HUMPHREY. Yes, we will be very specific in our questioning.

Mr. Parks.

Mr. PARKS. Just one comment. I don't think we are dealing with economics at all. I think we are dealing with ideology. I think we are dealing with the economists who have responsibility for establishing policy and carrying through policy and who are right out of the 19th century: who look at a competitive classical model that does not exist. The case has not been demonstrated at all that the slow growth program or the no growth program, as it might turn out to be, is going to solve the problem of inflation even though the costs are immense.

Chairman HUMPHREY. Just a professional question. Mr. Ackley, you were the former president of the American Economic Association?

Mr. ACKLEY. No I was vice president.

Chairman HUMPHREY. Well, you didn't do any better than I did. [Laughter].

Chairman HUMPHREY. You know now when judges are appointed, the President gets some recommendations from the American Bar Association. He is not compelled of course to abide by those. The State governors frequently do this. What would you think about having some sort of professional committee of your economists making some recommendations on economic appointments? Does that make any sense?

Mr. ACKLEY. It makes sense but whether you could persuade them to do it, I don't know. I rather doubt it.

Chairman HUMPHREY. You mean persuade whom to do it?

Mr. ACKLEY. The economists.

Chairman HUMPHREY. You mean they are a rather individualistic bunch?

Mr. ACKLEY. Well, it is worth thinking about.

Mr. NATHAN. It is worth thinking about but one of the problems I think that was just raised here by Mr. Parks is very true. It is an ideological problem. And I couldn't imagine Gardner Ackley or

Walter Heller getting along with President Ford or vice versa for more than 24 hours.

Chairman HUMPHREY. Thank you gentlemen. That concludes this morning's session.

[Whereupon, at 12 p.m., the committee recessed, to reconvene at 2:45 p.m., the same day.]

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF GARDNER ACKLEY TO ADDITIONAL WRITTEN QUESTIONS POSED BY CHAIRMAN HUMPHREY

Question 1. Economic Outlook 1976: The Commerce Department survey of business investment plans indicates a drop in business investment of about 4 percent in real terms. The CEA predicts a 4 to 5 percent increase. I am informed that the Commerce survey has a good "track" record. Why should we expect it to be wrong by as much as 8 or 9 percent this year?

Answer. As I indicated in my testimony, I believe that CEA is predicting an 8% real increase in plant and equipment investment in 1976, even higher than your question indicates. I think that an 8% gain is a somewhat optimistic forecast, although I do expect a solid rise in investment this year. However, I find even less plausible the second successive large increase in real investment which seems to be implied by CEA's forecast for 1977. Perhaps I should say, rather, that I find it implausible given the fiscal policies proposed in the Economic Report and the Budget.

Question 2. Recovery targets: With the unemployment rate at 8.3 percent in December, it would require about 8 percent real output growth to reduce unemployment to 7 percent by the end of this year. Another 7 percent growth, roughly, would be required to bring unemployment to 6 percent by the end of 1977. Do you regard such growth rates as desirable? Attainable? Would growth in the 7 to 8 percent range this year and next be inflationary?

If you do not endorse these targets, what targets would you propose?

What fiscal and monetary policies are needed to attain these targets?

Answer. I regard the growth rates of 8% in 1976 and 7% in 1977 as highly desirable outcomes. I doubt that any policy changes initiated now could promise the attainment of 8% growth in 1976—although it is not completely outside the range of probability that an 8% real output growth might occur anyway this year. Policies could be still adjusted to aim for 7% or 8% growth in 1977, with roughly equal chances of over-shoot or under-shoot. Such rates of output growth would add very little to whatever inflation would have occurred with a slower growth rate.

Question 3. Budget policy: The cost of maintaining the present level of Federal government services in real terms in fiscal 1977 would be about $420 to $425 billion. We have come to call this the "current services budget." Would you regard this as about the right amount for the Federal Government to be spending in FY 1977? How much would you add or cut? If spending were to be at this level, what tax policy would be needed should the tax cuts presently in effect extended? Enlarged?

Answer. Whether a budget for fiscal 1977 or $420 to $425 billion is the right figure depends not so much on fiscal policy objectives as it does on social goals and political preferences, including—an important measure—one's views about what ought to be spent for national defense. Almost any size budget can be compatible with almost any desired fiscal policy, if tax rates are properly adjusted. Although I have not made careful calculations (not having a big econometric model for simulation purposes), I believe that with a budget of the size specified, the tax cuts now in effect should still be extended, although I am not sure whether the proposed enlargement of these cuts (beginning in the second half of this year) would be necessary in order to achieve the real growth targets referred to in question 2.

Question 4. The Administration estimates that the full employment budget will move from a deficit of $16 billion in fiscal 1976 to a surplus of $3 billion in fiscal 1977. If examined on a quarterly basis, the swing would be even more dramatic. Is a budget swing of this magnitude desirable at this early stage of the recovery? What would you recommend with respect to the full-employment budget? Would you allow it to remain in deficit for the time being? Move it slowly toward surplus? What?

Answer. As indicated in my testimony, the sharp shift from a $16 billion full employment deficit in fiscal 1976 to a surplus of $3 billion in fiscal 1977 is not desirable. I would allow the full employment budget to remain in deficit, although planning slowly to reduce it, with the goal of moving into surplus as the unemployment rate approaches 5%. However, such a plan ought to be adjusted in either direction to whatever extent appears necessary to assure neither too slow nor too rapid an approach to the 5% unemployment level.

Question 5. Monetary policy: I am puzzled by the recent behavior of the money supply and interest rates. Interest rates have dropped noticeably in the last few weeks, yet the money supply has not grown at all. Bank loans to business have again begun dropping. What does this tell us about the state of the private economy and the demand for credit? Is the economy weaker than we think?

Are you satisfied with recent Federal Reserve policy? The Fed has failed to meet even the bottom of its 5 to 7½ percent money growth range. Now they have lowered the bottom of the range to 4½ percent. Does that represent the kind of policy stance that will give active support to a possibly faltering recovery?

Would you express your monetary policy recommendations for the coming year in terms of money supply or interest rates? Or both? What would be your specific recommendation?

Answer. The behavior of the money supply and interest rates you have described is indeed puzzling; but I have never believed that the money demand function was highly stable. I do not interpret it as meaning that the economy is weaker than we thought, if that means an unemployment rate higher or a GNP level lower than the current short-term expectation. I have no problem with recent monetary policies so long as interest rates stay where they are, and recovery continues. I don't care whether monetary policy objectives are expressed in terms of money supply growth or interest rates; more fundamentally, they should be expressed in terms of supporting a desirable expansion of output and employment. I do not know—in advance—what money growth is necessary to achieve this (and neither does the Fed). But any appreciable run-up in interest rates later this year would surely threaten its achievement.

Question 6. Inflation: The Administration is projecting a 6 percent inflation rate both this year and next. Can't we do better than that? The CEA Report makes no reference to the Council on Wage and Price Stability. It is as if they never heard of them. Yet it was President Ford who created the Council on Wage and Price Stability. Would you comment please on the type of price-wage policy we need in this year of rapidly rising profits and important collective bargaining negotiations?

Answer. My own forecast is for 4% to 8% range of inflation, reflecting my greater uncertainty about our ability to predict price level changes. We could aim for a lower range of price increase, but we have to consider the costs. Certainly, trying to achieve it by extra unemployment would not be worth the cost. A vigorous price-wage policy to lower the expected inflation rate has certain political, and possibly economic, costs; but I think they are small enough to be worth assuming. However, given this Administration's basic political attitudes, it is a waste of time to urge it.

Question 7. Social security tax: Virtually the only new policy proposal contained in the President's budget is a request for an increase in the social security tax rate. Assuming that the social security system needs additional financing (which has yet to be clearly demonstrated) do you feel this can best be achieved through an increase in the tax rate, an increase in the wage base, a transfer from general revenues or how? How serious would the social security tax increase be in terms of adding to inflation (it raises labor costs) and in terms of discouraging growth of employment?

Answer. Some transfer of social security financing to general revenues is long overdue. The Payroll Tax is a miserable tax; its importance in our tax system has already more than doubled in recent years, and should not be allowed to increase further. For the long run, we should plan to integrate the Payroll Tax into the Personal Income Tax.

AFTERNOON SESSION

Representative MOORHEAD. The Joint Economic Committee will please come to order. We have with us today Mr. Earl Butz, Secretary of Agriculture, and Mr. Elliot Richardson newly confirmed Secretary of Commerce. I have just a brief opening statement this afternoon. We had an interesting session this morning with top private economists on the economic outlook. One of the major points that they all stressed was the need for a good harvest this coming crop year if we are to succeed in holding inflation in retail goods prices and consumer prices generally under control. There is every indication from your department's own data, Mr. Butz, that farmers are trying to maximize production.

As of January 1, for example, wheat planting intentions are 5 percent above last year's level. Prospective acreage to be planted in corn is up 4 percent. With fair weather and if these intentions are realized, and I am emphasize that, we have a good chance of holding inflation in retail food prices at 4 or 5 percent this year, which is much better than 14.5 percent in 1973 and 1974, and is below 1975's 8.5 percent.

Last year, we saw similar intentions. Prospective plantings were at record levels, and despite target prices and loan levels well below the level of variable production costs, still we did have record plants. Farmers gambled that they would not need to resort to inadequate price supports. Farmers gambled because reserve levels of carryover stocks were at an 18-year low. Even a bumper harvest, they correctly decided, would not force commodity prices below production costs.

However, it is not the same this year. We largely rebuilt our commodity stocks. Farmers, therefore, have a lot to lose if we have another bumper crop. Mr. Butz, my fear is this, without a loan rate at least equal to production costs and with stocks now rebuilt, well, I am concerned that farmers will not go all out. They will play it safe and not seek to maximize production. If they reduce their plantings or if they do not go all-out, their prices will go through the floor. And it is certainly a good possibility, despite optimistic spring planting intentions, there will be another sharp run-up in retail prices next fall. I will be discussing with you shortly the possibility of increasing these target prices and loan levels, as we tried to do last year about this time.

Mr. Richardson, it is particularly nice to have you here before the Joint Economic Committee. I believe it is for the first time, even though you held many high offices in this Nation. I particularly welcome you today. I remember with great pleasure being with you in England at your just-immediate incarnation before this one. And I welcome you back to the United States. But, I think, well, I am just pleased to see that you have this new assignment, even though I won't be able to go and visit you in England again.

I know that you have just taken over as Secretary of Commerce and it takes time to acclimatize one's self to new situations, but I know that you are an old hand in Government and can give us a good perspective of how the economic policies of the Government can be expected to proceed. I note from your prepared statement that you have adopted the position taken by the executive branch; namely, that inflation is our No. 1 problem and is the most corrosive of diseases and the most insidious and is a malignancy that will feed upon itself. You do go on to talk about unemployment as a "tragic waste" but you are against creating jobs with public funds.

And one of the things that we want to know is, as you say, and other administration witnesses have said, that we must provide the proper climate for investment. We hope to have a chance to discuss these priorities with you later.

Before I yield to Mrs. Heckler, I should state that we do have the Natural Gas bill on the House floor today, and we may have to interrupt from time to time because of votes. We will try to keep that to a minimum to avoid imposing on your time unnecessarily, but I hope you will understand it. I would expect to hear first from Secretary Butz and then follow that immediately by testimony from Secretary Richardson. At that time, the committee would like to then address questions to both of the witnesses. The witnesses, in accordance with standard procedure, can either read the statement or highlight it. But, in any event, your prepared statements in full will be, without objection, made a part of the record. And I understand, Secretary Richardson, you have a longer statement than your intended oral presentation. That will also, without objection, be made a part of the record.

Mrs. Heckler.

Representative HECKLER. Mr. Chairman, I do not wish to prolong this hearing, in view of the fact that we have a very serious business on the floor and our witnesses have very important considerations in their own offices. I would like, at the outset, to express my appreciation to both members of the Cabinet for appearing here at a unique session. It is very rare that the Joint Economic Committee meets on this side of the House, or rather this side of the Capitol, I should say; however, it will be a pleasure to hear your testimony. And I look forward to listening to you.

Thank you.

Representative MOORHEAD. Secretary Butz.

STATEMENT OF HON. EARL L. BUTZ, SECRETARY OF AGRICULTURE

Secretary BUTZ. Well, Mr. Chairman, and Mrs. Heckler, I am glad to hear you say it is very rare the committee meets on this side of the Capitol, because my card said we were meeting over on the Senate side. We went over there, and somebody said, "No, today they will be on the more important side of the Capitol" so we quickly hurried over here. We didn't ask which side that was.

Representative HECKLER. Well, I agree with that assessment.

Secretary BUTZ. Mr. Chairman, I would like to file my statement to have that placed in the record, and make a brief oral synopsis of the high points that affect agriculture's impact on the economy generally.

Representative MOORHEAD. Fine, please proceed.

Secretary BUTZ. We are operating now in the third year of the Agricultural Act of 1973. This act followed the Agricultural Act of 1970. And under the two acts, and especially under the second act, we have expressed a complete turnaround in agricultural policy in this country and one that I think is as anti-inflationary as any agricultural policy we followed in the last 40 years in this country. I say that because the emphasis of current agricultural policy is on full production. And in my book, at least, if there is any anti-action for inflation, it is full production; it is plenty of whatever you have to put on the market. That is the thrust of agricultural policy at the present time.

As you indicated, our farmers have responded marvelously the last 2 years. Their intentions in 1976 are again to respond for a full production, and given anything like the average growing conditions in 1976, we will achieve that—we will again have plenty.

With this has come much less dependence on Government than we had previously in our agricultural policy and much more market orientation than we had before. I think it has paid off well. I think it has paid off not alone in terms of full production, but also in terms of farm income.

Our farmers have just finished the third year of the highest net farm incomes on record in the United States. The best we could do previous to these last 3 years was $18.2 billion of total net. Now, that is after production expenses. That was in 1972. In 1973, that figure rose to about $33 billion. And in 1974 it was around $26 billion. We don't have the final figures yet for 1975, but it will be around $25 billion.

It is too early, of course, to predict with any degree of accuracy what the figure will be in 1976, but we anticipate it should be again around that level. So, from our farmers' point of view, in the aggregate they have experienced during these 3 years, and will experience in this next year, a high net farm income.

Some other factors have contributed to this. And I think significant developments have occurred. We have substantially reduced the cost of Government programs to the Treasury. As recently as 4 years ago, we were spending $4 billion a year in payments to our farmers. That has now been reduced to where it was of the magnitude of $0.8 billion last year. Much of this was for disaster payments where we had crop failures, flood, or droughts, as the case may be. During peak inventory periods of the 1960's we were spending about $1 million a day just to store commodities we had. This has now been reduced virtually to the vanishing point.

So that we have substantially gotten the Government out of the commodity business, and it no longer competes with our farmers. We have also substantially increased our exports. Three years ago or 4 years ago, our exports were $7 billion. Last year, they were just under $22 billion. We have virtually tripled our exports of agricultural products from this country. We think the exports in the current year will be in that range of $22 billion or perhaps a bit more. Our physical volume of exports will be up this year over last year, of course. The dollar value will be, as I say, in the magnitude of $22 billion or more again this year.

Our agricultural imports run substantially less. We imported about $10 billion of agricultural commodities last year. That is half the sugar we eat, coffee, tea, and things like that. This means that agriculture made a net plus contribution to our balance of payments last year of $12 billion. This is very significant, I think, Mr. Chairman, in view of the fact that our overall trade balance last year, as reported by the Commerce Department, was a $11 billion-plus. And now I want to remind my colleague sitting next to me, as he assumes the new responsibilities of the Department of Commerce, that of the $11 billion-plus contribution to foreign trade last year, Mr. Richardson, overall agriculture made a contribution of $12 billion. I give him this, just so he never forgets the overall importance of this figure, when you get your figures out, Secretary Richardson.

We have, I think, made substantial progress in rural development. We have very markedly slowed the exodus of population from rural areas. As a matter of fact, if you take rural areas, including the small town parts of America, the population flow has reversed in the past year. We had some reduction in the numbers of farms last year in America. We reduced about 22,000 farms in America last year. While we decry the reduction of even 22,000, the numbers of farms are substantially better than the approximately 100,000 per-year reduction we were experiencing in the last 4 or 5 years of the 1960's. This has been markedly slowed down. We brought, I think, a new sense of belonging, a new sense of importance to rural America. Our farmers feel it and our rural businessmen feel it as evidenced even in the increased enrollment in agricultural schools in our land grant colleges. In the last 2 years, these schools have been areas of the most rapid expansion of many of our land grant colleges, which is just another factor reflecting the renewed confidence in rural America and the renewed sense of belonging and sense of opportunity in this whole agricultural area. It is all tied together, it seems to me.

You mentioned food prices, Mr. Chairman, and they have been substantially slowed. We did have a substantial rise in food prices from 1973 to 1974, as you pointed out, the average annual increase was approximately 14.5 percent. The annual average increase was approximately 8½ percent from 1974 to 1975. At the present time, we project an average increase in food at retail in the year ahead—and that is average 1975 to average 1976—of approximately 4½ percent. Much will depend, of course, on the kind of production we have in 1976, but that is our present projection.

But, let me hasten to point out, Mr. Chairman, that of those increases, approximately three-fourths of that increase occurred after food left the farm. It represents increased costs of processing and distribution; it represents increased fuel costs; it represents transportation costs. The fact that we slowed our trucks to 55 miles an hour, for example, has added to the food bill. I cite that simply as a case in point. Much of it is increased labor costs. Much of it—and I am sorry to have to sit here and say it—much of it is the result of the restrictive practices that have been written in the labor-management contracts in many sectors of the food line, whether processing or distribution, as the case may be.

But again, I want to point out that approximately three-fourths of this increase occurred after food left the farm. At the present time, our farmers get about 42 percent of the consumers' food dollar. We are all prone to chase that 42-cent rabbit, but I think we ought to be chasing the 58 percent rabbit, where the real pay dirt is, to look for efficiencies in that area. But the important thing, as you pointed out, Mr. Chairman, is that we are going to have a much smaller increase in the next year. I think the increase in retail food prices in the next year will be less than the increase in the Consumer Price Index generally. They will be less than the increase in the wholesale price index. They will be less than the increase in average wage increases, as we now project them.

I presume from the standpoint of the overall economy, Mr. Chairman, you may regard that as at least a healthy factor or at least an anti-inflationary factor. And I think it is fair to say that our farmers are a major anti-inflationary force in this country, because they are in a stance of full production. And they are going to be that again in 1976, as you pointed out.

Now, their intentions are to plant approximately 2 or more million acres in 1976 than last year. Those, of course, won't be the best acres. The best acres are already under cultivation. We are going to have an increase in corn acreage this year. We are going to have an increase in wheat acreage, as you pointed out. But the condition of winter wheat is such that our total wheat crop may not be quite as large as last year, when we had a record crop of 2.1 billion bushels. Our crop this year will probably be in excess of 2 billion bushels, which is a large wheat crop, especially when you consider that our domestic requirements for wheat, including that we eat and that our domestic requirements for wheat and that we use for feed and that we use for seed and industrial purposes, those figures are only about 700 million bushels. We produce nearly two or three times as much as we consume domestically. Our soybean acreage will be down some next year. Our cotton acreage will be up.

Next, just a word about livestock. We are going to increase our pork market some next year. We were short last year in pork. We had the lowest per-capita pork consumption in some 40 years, which reflected the very short corn crop we had in 1974. Hog numbers are picking up some. Cattle slaughter will continue at a pretty high level. We just finished our year of the highest per-capita availability of beef on record.

Our January 1 estimate of cattle numbers on farms was just released last week. It showed a decrease of over 3 million head. That is the first time in some years we showed a decrease in cattle numbers and that makes adjustment to the very rapid buildup in numbers we had over recent years. I think this foretells better economic conditions for our cattle farmers in the years ahead, Mr. Chairman.

We are going to have a good year in 1976 for hog producers. Dairy has come through several months prices substantially above a year ago, with feed costs down from a year ago. Our dairy production is increasing some. I think dairy will be in a fairly stable position in the year ahead.

So looking ahead for the year ahead, I am reasonably optimistic. Looking further down the road, Mr. Chairman, I think the world's number one problem in the 25-year context is to be able to increase food production enough to feed 80 percent more people by the end of this century than we have now. We have right now approximately 3.8 billion people in the world. Projections are that we will have 7 billion people by the end of this century. That means in this next 25 years we must learn somehow how to feed almost as many more people as we have learned to feed since the dawn of history. This is almost a frightening challenge for the whole food industry, both here and around the world.

We can meet it, I think, if we continue to give agriculture top priority; if we continue to support research and innovation; if we can move agriculture higher up on the priority scale of some of the developing nations and it has been so that instead of adding a new jumbo jet to their national airlines, Mr. Chairman, they will put their investment in a drainage plant or a fertilizer plant or something like that. I think we must address ourselves to these problems promptly if we are not going to be caught short of what I think is the world's number one problem. That is all the statement I care to make. Thank you.

Representative MOORHEAD. Thank you for a very eloquent statement, Mr. Secretary.

Your prepared statement will be printed in the hearing record.

[The prepared statement of Secretary Butz follows:]

PREPARED STATEMENT OF HON. EARL L. BUTZ

Mr. Chairman and Members of the Committee: I am happy to meet with you today because there are many good things to report. Not only for last year's results, and this year's prospects, but also in respect to trends of the past several years.

To gain a perspective on those trends, think for a moment about the changes in American agriculture since 1971. Farm net income has nearly doubled. Farmers' assets have jumped by over two-thirds. Exports of farm products have nearly tripled. The huge government grain surpluses have disappeared.

It wasn't long ago that farmers were kept in a constant quandary, wondering if and when somebody in Washington was going to unload some of that govenment-held surplus on the market, driving low crop prices even lower. Now farmers can judge for themselves whether to sell their grain now or hold it a while longer.

No single reason accounts for these changes. But getting the government off the farmer's back has a lot to do with it. Freedom of choice has brought greater output and more efficient use of resources. The farmer does best when he decides himself what and how much to plant; it was under that decision-making that 1975 production broke all past records.

Freeing farmers to produce and market to the best of their ability has done something else. Farmers are respected now, no longer the butt of jokes about eating at the public trough. There is more confidence in rural America. Enrollments in colleges of agriculture are rising, high school Vo-Ag classes are larger, the average age of farmers is declining, and the exodus from rural America has halted.

Thus, there is widespread awareness that agriculture and food are vital subjects in the world, today and for the foreseeable future.

American farmers are in good shape now to cope with that future.

They entered the new year with record assets and the third highest net farm income on record, despite 1975's wrenching downturn in the U.S. and world economy. As we see it now, farmers will do at least as well this year, even though their costs of doing business will continue to rise.

There are also good things to say about the 1976 situation from the consumer's standpoint. Food prices, which rose much less last year than in 1974, should rise much less this year than last. In my statement to this Committee last spring, I anticipated that food prices would increase 7½ to 9 percent in 1975, down from over 14 percent in 1974. The actual rise for 1975 was 8½ percent.

Three-fourths of that 8½ percent rise came after the products left farmers' hands. The farm-retail price spread is still undergoing a further disturbing rise. It is the main reason we expect another, though smaller, rise in food prices for 1976.

Now I would like to discuss the agricultural situation in more detail.

CROPS

Thanks to bigger acreages and good weather, especially at harvest, farmers last year achieved record crop output. They planted 2 percent more winter wheat last fall. They expect to increase plantings of other major field crops this spring by 1 percent.

They are likely to plant more corn, cotton, and spring-planted wheat but less soybeans. They owned large stocks of wheat, rice, feed grains, and soybeans at the start of 1976. This was the result of large 1975 crops, smaller than expected gains in domestic use of grains in the second half of 1975, and a delay in some marketings. Meanwhile, exports were far and away the largest on record.

The 1975 wheat harvest of 2.1 billion bushels marked the third successive record-setting year. Exports are also expected to be a record, totaling 1.3–1.4 billion bushels. Domestic use in 1975/76 continues to lag as relatively strong wheat prices have cut sharply into wheat feed use. July 1 carryover stocks will show an increase from the low reached in the summer of 1974. The projected stock level of about 400 million bushels is still small compared with the early 1970's.

Although wheat prices remain well above the levels of the early 1970's, they have fallen from the peaks of the last 2 years. The 1975/76 season average price for wheat is estimated at about $3.50 per bushel.

The higher acreage indicated for 1976 must be assessed in light of unfavorable winter weather. However, another crop exceeding 2 billion bushels is possible if the weather improves.

Farmers intend to plant almost 81 million acres of corn in 1976, 4 percent more than in 1975, and a total of 126 million acres to the four feed grains (corn, sorghum, oats, and barley), 2 percent more than in 1975.

We expect some price strength for corn this spring as a result of heavier domestic feeding and continued record-large exports. The season average farm price may be $2.50 to $2.75, compared with about $3 last year. For the whole 1975/76 marketing year, domestic use and export movement likely will total slightly below 1975's production of 5.7 billion bushels, resulting in a small buildup in carryover next fall to around 500–600 million bushels from 359 million last fall.

The soybean supply for 1975/76 totals about a fourth above the previous year. Total use will expand less than that, and carryover stocks next fall will rise, perhaps to a record level of 300–350 million bushels. For the entire season, farmers' prices are expected to average $4.50–$4.75 per bushel, down sharply from the record $6.64 of last season. Based on January 1 intensions farmers will plant 3 to 4 million fewer acres to soybeans in 1976 than the 54.6 million in 1975. Soybeans are losing ground to corn and cotton.

The 1975/76 season for U.S. cotton features sharply smaller production, much larger domestic use, and reduced exports. The total supply, at 14.1 million bales, is smallest since the 1920's. Total use could reach a million bales above 1974/75's 9.8 million bales. Consequently, stocks next summer may be well below the 5.7 million bales of last summer. The price of base quality SLM 1-1/16-inch cotton in mid-January was about 57 cents per pound, compared with 56 cents a month earlier and about 36 cents last January. Farmers intend to devote nearly a fifth more acreage to cotton this spring. If yields recover to more normal levels, production could total much above last year. The optimistic planting intentions for cotton are resulting from higher prices and better market prospects than for soybeans and other competing crops.

LIVESTOCK

Production is increasing this year and prices are well above a year ago, so the income picture on the livestock side looks good. Beef output may rise 2 to 4 percent; pork production is rising and will begin exceeding year-ago levels after midyear. Broiler and milk production for the year will be up, too.

The cattle inventory as of January 1 fell 3 percent from the year before, ending an expansion that had lasted 9 years. The peaking in cattle numbers and the recent pickup in cattle feeding have improved the feedlot demand for replacement cattle, and should provide for improved returns to cow-calf operators later in 1976.

If fed beef production rises this winter and spring as expected, it will be the first year-to-year increase in 3 years. There were 28 percent more cattle in feedlots in 23 States on January 1 than a year ago.

Profit margins for cattle feeders are being squeezed this winter. Fed steer prices have moved lower under the pressure of record beef production, reflecting the very heavy slaughter of range cattle versus fed cattle. Choice steer prices at Omaha in early February were below $40 per 100 pounds, down $13 from last year's peak. However, if we have average weather conditions for pastures and crops,. slaughter of nonfed cattle likely will decline this year, which will give some support to prices.

Pork supplies will be lower than usual through midyear. The December inventory of hogs and pigs was down a fourth from a year earlier, with much of the decline in heavy hogs. The inventory makeup suggests first quarter will be 10 to 15 percent below a year earlier with the deficit narrowing to 3 to 5 percent in the second quarter. Farmers' farrowing plans point to gains in the second half.

Market hog prices have run mostly $48–$51 per 100 pounds since last November, about $10 above a year earlier. Feed costs have been dropping profit margins for hogs continue favorable.

Recent gains in milk output likely will continue. Production during the first half of 1976 is expected to be about 1 percent above a year earlier. Farmers received $10.20 per 100 pounds of milk in January, up $1.87 from last January. In coming months prices likely will decline at a sharper rate than usual, reflecting slower sales, especially of butter. However, chese sales have been strong and fluid milk sales remain above year-earlier levels.

A favorable relationship between broiler prices and feed prices is expected to continue in coming months, and broiler output during the first half of 1976 is expected to be around 10 percent above January-June 1975. Less of a rise is likely in the second half. Prices have declined from last fall's levels but have remained relatively strong. Reflecting the larger supplies, broilers this winter and spring will sell in the low to mid-40 cents a pound range despite relatively high red meat prices.

FOREIGN TRADE

The value of U.S. agricultural exports in the current fiscal year should total near the 1974/75 record, but the volume will jump by over one-fifth. With 1975's record farm output here at home, together with the slow gains in domestic use of crop products, exports must get much of the credit for maintaining farmers' net income over the past months.

Some people blame the slide in crop prices since early last fall on the temporary hold that was put on our grain sales to Russia. They forget that exports kept rising, and in the fourth quarter of 1975 reached unprecedented totals one-third above year-earlier levels. Furthermore, the temporary hold gave us time to judge the size of our corn crop, and was instrumental in getting a long-term grain agreement with the Soviet Union. This agreement is a real plus for American farmers.

The output of one out of every 3½ harvested acres goes abroad. But agricultural exports do a lot more than help the farmer. Our nation would really be in trouble if we hadn't had large favorable balances of agricultural exports to make up for huge trade deficits elsewhere in our economy. We must keep promoting agricultural exports; they are vital to the economic welfare of the nation and more people should come to understand that.

The fact that consumer food prices went up much less in 1975 than in 1974 puts in perspective those horror stories about how much last summer's sale of grain to Russia would affect food prices. "Negligible" was my assessment at the time, and still is.

AGRICULTURAL PRODUCTIVITY

The 1970's saw a basic shift in farm policy, permitting farmers not only to plant more acres but also to shift production from one crop to another. Farm output increased 14 percent between 1970 and 1975 with substantial gains in efficiency. Part of the increase was due to fuller employment of fixed capital inputs such as land and machinery.

The 1970's are identified with "all-out" farm production. Between 1973 and 1975, farmers planted an average of 360 million acres of cropland for crops, compared with 337 million acres during the 1960's. We have produced some record crops. But the 1970's have also included some difficult times such as when southern leaf blight cut corn production in 1970; the 1974 drought that crippled feed grain output in the Corn Belt and Plain States; and the near doubling of fertilizer prices between the spring of 1973 and 1975.

Over the next 5 years, improved cultural practices and continuing advances in technology should increase productivity and help offset the impact on yields from less productive acreage entering the larger cropland base. At the same time, total output will continue to increase to meet the anticipated greater domestic and foreign demand.

FARM INCOME

Farm income during the first half of 1976 will likely continue close to the improved levels of the second half of 1975 and well above the reduced early 1975 levels. Income prospects for all of 1976 are very tentative. As the year unfolds, returns to farmers will depend increasingly on the growing season and prospects for U.S. and world crops. However, with a strengthening general economy, the small grain stocks, and prospects for another good U.S. crop, there are solid reasons to expect that farm income will hold around levels of the past 2 years.

Production of all major livestock and livestock products is increasing. But considering the growing consumer buying power, prospective gains in red meat supplies are modest. Livestock product prices, responding to increasing supplies, are down from the highs of last summer. But they continue well above a year ago. For the year, prices of livestock products may approximate the relatively favorable 1975 averages. This will mean increased receipts from livestock in 1976.

The 1976 picture for crops is less clear, but a high level of returns is in the making for the 1975 crops now being marketed. Moreover, there is no basis for expecting anything but another good crop in 1976. Producer prices for crops have been relatively favorable, world grain stocks are low, and production costs are rising more slowly. Reflecting this, farmers probably will step up plantings. With continued larger supplies of crops, grower prices will likely average below 1975 levels. But if domestic and export markets hold up as expected, total grower earnings from crops will be well maintained.

The trends in supply and cost of farm inputs will continue to improve for the farmer. Fertilizer supplies generally will be larger, with prices running possibly a fourth below last spring. Pesticide supplies will be adequate at price levels slightly below 1975. The supply and price outlook for fuel points to some easing from last fall.

Prospective returns and cost trends point to a net farm income in 1976 about as good as net income for 1975.

RETAIL FOOD PRICES

Retail food prices for all of 1975 averaged 8½ percent above 1974. This compares with increases of about 14½ percent for each of the preceding 2 years.

Retail food prices are expected to rise about 1 percent each quarter through mid-1976, averaging around 6 percent above the first half of 1975. Widening farm-retail spreads along with higher prices for fishery items and imported foods will account for most of the increase in average food prices.

Red meat prices are expected to average close to last fall's level during the first half of this year with increases for beef and veal about offset by lower pork prices. Poultry and egg prices may also decline moderately. Retail dairy prices, which advanced rapidly late last year, may stabilize this winter and decline some in the spring as supplies increase. Fresh produce prices are likely to advance seasonally during the winter and early spring. However, prices of most other crop-related foods, such as processed fruits and vegetables, cereal and bakery products, and vegetable oil products, will probably remain relatively stable.

MARKETING SPREADS

Farm-to-retail marketing spreads this year will likely again account for more of the rise in retail food prices than will changes in farm prices. Widening spreads last year accounted for almost three-fourths of the rise. However, the increase in marketing spreads should moderate from the 9 percent rise in 1975, mainly because of prospects for a slower increase in prices of materials and services purchased by food marketing firms.

Prices of many products sold by farmers have fallen as a result of record grain harvests last fall and rising production of meat and most other livestock products. However, there have not been corresponding adjustments in retail prices. Where retail price reductions have been posted, they have lagged the declines in farm prices. The retail cost for a market basket of all farm foods rose about 1½ percent from last September to December. During the same period, the farm value of these foods fell nearly 7 percent. The differences between the farm and retail values—the farm-retail price spread—thus widened sharply, by nearly 8 percent in only 4 months.

Prices for intermediate goods and services purchased by food marketing firms rose 13 percent in 1975, compared with 19 percent in 1974. Packaging materials, which account for an eighth of total marketing costs, jumped 15 percent in 1975, but 23 percent in 1974. The energy cost spiral—an unprecedented 46 percent in 1974—slowed to 17 percent in 1975. Interest rates dropped to 8.2 percent by third quarter 1975, compared with 12.4 percent a year earlier. And the increase in cost of shipping food products by rail, 16 percent in 1974, slowed to a 13 percent rate last year.

In contrast, labor cost, the biggest expense item for food marketing firms, accelerated. Hourly earnings of food marketing employees increased about 10 percent in 1975, up from the year-earlier increase of 9 percent and an annual average increase of a little over 6 percent in the early 1970's.

Profit-to-sales ratios (after taxes) for leading food chains during the first 9 months of 1975 were almost unchanged from a year earlier at 0.9 percent of sales, excluding A&P which had a large write-off due to store closings. Profits after taxes for 14 leading chains, excluding A&P, amounted to 11 percent of stockholders' equity in 1974, up substantially from 1972 and 1973. Available data suggest that equity profits for 1975 held around the 1974 rate.

However, as raw material costs declined in 1975, profit margins of food manufacturing companies rose. These margins, as reported by the Federal Trade Commission, averaged 3.2 percent of sales in the first 9 months of 1975, compared with 2.9 percent a year earlier. Returns on stockholder equity rose from 13.6 percent to 14.4 percent. But by third quarter 1975, margins surged to a 2-year high, averaging 3.7 percent of sales and 17.2 percent return on stockholder equity.

We must watch such developments closely, just as we must stay vigilant in the promotion of our agricultural markets abroad and in the protection of the farmer's planting and marketing freedom here at home. The payoff is increased activity in the agricultural sector to the benefit of all Americans and our trading partners abroad. Thank you.

Representative Moorhead. Now, Secretary Richardson, please.

STATEMENT OF HON. ELLIOT L. RICHARDSON, SECRETARY OF COMMERCE, ACCOMPANIED BY MAYNARD COMIEZ, ACTING CHIEF ECONOMIST; BEATRICE N. VACCARA, ASSOCIATE DIRECTOR FOR NATIONAL ANALYSIS AND PROJECTIONS; AND JOHN E. CREMEANS, CHIEF STATISTICIAN, BUREAU OF ECONOMIC ANALYSIS, DEPARTMENT OF COMMERCE

Secretary Richardson. Thank you very much, Mr. Chairman, and Congresswoman Heckler. It is a pleasure to be here today. This is, as you pointed out, my first appearance before this committee, and I welcome the opportunity, even though I have, as you also pointed out, only been Secretary of the Department of Commerce a couple of days. At the same time, I have come here from an experience in the United Kingdom, which in many respects may be relevant for the problems that confront this country at the present time. And I may have occasion in my summary of my prepared statement to touch on this aspect of the situation.

I would appreciate, as you mentioned, Mr. Chairman, having that full statement printed in the record.

Representative MOORHEAD. Fine.

Secretary RICHARDSON. May I, before proceeding—in the event that I may need to call upon them in areas where my own direct information is inadequate—may I identify for the record three of my Department of Commerce colleagues. First, and behind me to my left, is Mr. Maynard Comiez, Acting Chief Economist; on his left is Mrs. Beatrice Vaccara, Associate Director for National Analysis and Projections of the Bureau of Economic Analysis; and on Mr. Comiez's right and immediately behind me is Mr. Jack Cremeans, Chief Statistician for the Bureau of Economic Analysis.

Representative MOORHEAD. We welcome all of you to the committee.

Secretary RICHARDSON. Thank you, Mr. Chairman.

As I indicated a moment ago, it seems to me generally relevant that I have seen in the United Kingdom in recent months a situation in which there has emerged a broad consensus on the proposition that inflation creates unemployment. It is really remarkable, beginning particularly in June, to see the Trade Union Council and the national union leadership, which until then had been negotiating wage agreements which called for massive increases for their rank and file membership, come to the realization that the result would be not only to fuel galloping inflation, but, over time, to reduce the numbers of jobs available for their membership.

And so we have seen, since June of 1975, the British Government follow policies directed toward reducing inflation in order, in due course, to protect employment. Persistent inflation creates a climate of uncertainty that discourages long-term investment. That, in turn, adversely affects our economic growth rate, our productive potential, our employment level, and the creation of jobs.

This essentially is the set of inter-related propositions that are now the subject of basic consensus in the United Kingdom. And I think it is fair to say they are more nearly the subject of basic consensus in the United States, in light of our own recent experience with the combination of under utilized capacity and unemployment in a situation of continuing inflation, than they have heretofore been.

At any rate, from whatever perspective one views inflation, no redeeming features are to be found. Any postulated solution to our problem which is likely to lead to a resurgence of inflation as a byproduct, is no solution at all. It will almost certainly make matters worse. The dominant objective to be pursued, as I see it, is the long term, healthy growth of the American economy. Thus, the President's economic goal is to create an economic environment in which stable and noninflationary growth can be achieved.

Unemployment and inflation are not opposites to be traded off one against the other. They are related symptoms of an unhealthy economy. The inefficient use of physical resources is a waste; the underutilization or nonutilization of human resources is a tragic waste. It carries unacceptably high social costs above and beyond the economic costs of foregone production of goods and services.

Since inflation was the major underlying cause of recession and the consequent unemployment, any policy that seeks to reduce unemployment at the price of more inflation is doomed from the start.

Like inflation itself, such stimulation may appear attractive at first; but too soon it succeeds only in defeating its own well-intentioned purpose. The proper course, in my view, is to encourage the investment that is a necessary precondition to the creation of jobs. Only thus can we help to control inflation and provide job opportunities; produce meaningful, productive, dependable, and lasting jobs for the millions now looking for employment and the millions that will be seeking admission into the labor force in the years ahead.

I am of course aware of the expressed feelings of some of this committee that the administration is uncaring or insensitive with regard to the plight of the unemployed. Certainly, those of you who have known Gerald Ford on this Hill know that he is a decent and compassionate man and human being who cares very deeply about the plight of all Americans. As for myself, no one can spend as many years as I did at HEW without being reinforced in a natural sensitivity to the emptiness and despair that attach to being disadvantaged.

A recent study of capital requirements of the U.S. economy, undertaken by the Commerce Department's Bureau of Economic Analysis at the request of the Council of Economic Advisors, shows that:

One: In order to assure a 1980 capital stock sufficient to meet the needs for a full-employment economy, pollution abatement and decreasing dependence on foreign petroleum—which admittedly may be difficult to do by 1980—private fixed investment —in 1972 prices—during the period 1971–80 will need to be 11.4 percent of GNP.

This percentage is considerably higher than the 10.4 percent in 1965–70 and the 10.2 percent of the 1971–74 period. Moreover, in light of the low-investment level during 1971-74, fixed capital investment for the remaining 6 years—1975–80—must total 12 percent of cumulative GNP. Further, investment having been less than 10 percent of GNP in 1975 and not expected to be 10 percent this year, the study results suggest that the investment ration will have to be greater than 12 percent in the next 4 years to satsify the goals I outlined.

Two: These requirements for an increased share of GNP devoted to investment are associated with three factors:

(a) Changing technology in selected industries with an increasing ratio of capital to output. This is the major cause of the need for devoting an increased share of GNP to fixed investment.

(b) Increased needs for capital investment as a result of the energy situation.

(c) Investment in pollution abatement equipment as a consequence of legislation relating to clean air and clean water.

If it were not for these factors, the 1971–80 cumulative investment needs would require only 9.9 percent of GNP.

Given these findings, it follows that if we are to meet the goals set forth, economic policies should be directed toward the assurance that there will be adequate investment to support a higher-employment economy without weakening consumer demand. The President's program to increase private-sector activity relative to Government spending is, in my view, the only realistic means of achieving this goal.

Both in our democracy and our economy—two sides of the same coin—we have always emphasized individual decision and choice.

I believe it essential that we do not deviate from the course that has made the United States uniquely the kind of country it is.

Obviously, the Government must have a role—as where social costs and benefits, for example, are not translatable through the private market mechanism. In addition to its overall economic stabilization role, Government also bears the responsibility to maintain competitive market conditions.

On the other hand, it has grown increasingly apparent that a more reasonable approach to Government regulation is necessary. In addition to deregulation, or modified regulation, of major economic areas—transportation, for example—there is also a clear trade-off in such areas as occupational safety and environmental standards: As between productivity and profitability, on the one hand, and social benefits, on the other. There is always a fulcrum, a point of balance. Surely we should be able to strike that reasonable balance between the tenets of free enterprise and our responsibility to protect the interests of the people—as citizens and as consumers.

Turning to international economic conditions, U.S. trade performance was exceedingly strong in 1975 in nonagricultural as well as in the agricultural sector, to which Secretary Butz has referred. Indeed the nonagricultural increase in 1975 was higher than the agricultural increase. As the U.S. and other nations recover from the global recession, we would naturallly expect this large surplus to diminish. The extent of the reduction will depend upon such factors as: Our rate of recovery versus the speed of the recovery in other countries; the performance of the lesser developed countries in their development process; price and productivity changes; and the overall competitiveness of American goods ain international markets.

Over the long perspective, U.S. producers need to remain highly competitive in the international area. The ability to sell our products in the world market enables us to purchase other items from abroad which we cannot produce as efficiently. Our policies must therefore enable the United States to continue to enter freely into world trade.

The floating exchange rate system has afforded vital flexibility in dealing with the upheavals of the recent past. However, U.S. trade can benefit from less erratic fluctuations in world currencies. The recent IMF agreement is a step in this direction, in addition to helping the LDC's with respect to their reserve problems.

We must continue to deal with the real dimensions of international trade. It is essential that we maintain the momentum in removing tariff and nontariff barriers to trade in the new round of multilateral trade negotiations, with the goal of reaching a successful conclusion in these negotiations in 1977. Similarly, it is essential that a multinational cooperative approach to solving the energy problem be pursued.

In summary, Mr. Chairman, I have represented some of my views on the economic problems we face today and those which, absent judicious moderation in the formulation of economic policy, could becloud the future. And I have discussed what I see as our place in the global economy of which we are inescapably a part.

Let me close by assuring you of my deep conviction that the sweeping social goals and visions of the 1960's were not only compassionate and just, but necessary.

By all means, let us adhere strongly to those goals and visions. But let us do so from the firm foundation of a healthy free market, free enterprise, private sector system. Let us create and increase real wealth through that system, so that everyone is afforded the opportunity to share in that wealth on a more equitable basis than we have yet achieved.

That concludes my summary of my longer, written statement, Mr. Chairman. I would be glad to join my colleague and friend, Secretary Butz, in responding to your questions. I trust we end up presenting a united front.

Representative MOORHEAD. Thank you, Mr. Secretary, for presenting your usual articulate statements.

Your prepared statement will be printed in the hearing record at this point.

[The prepared statement of Secretary Richardson follows:]

PREPARED STATEMENT OF HON. ELLIOT L. RICHARDSON

Mr. Chairman and Members of the Committee:

While I have been privileged, in various capacities, to meet with many of the distinguished Members of the Joint Economic Committee, this is my first appearance before this Committee as Secretary of Commerce. I am pleased to be here, and to participate in the consultative process that lies at the very foundation of the Executive-Legislative relationship.

That relationship is inherently one of tension, to be sure—as it was intended to be—but I earnestly believe it to be a creative tension that has served the Nation well, and will so continue to do. Ishall always be happy to contribute, in whatever way I can, to that vital process.

You have already received the Economic Report of the President and the Annual Report of the Council of Economic Advisers. In addition, last week you heard from the Council of Economic Advisers and the Director of OMB, and yesterday from Secretary Simon.

It would therefore add little to the process for me to recite again in the facts and figures of the economic recovery to date, and the range of possible future developments. Rather, I feel it would be more useful for me to share with you some of my views on current and potential domestic problem areas, and on international economic conditions.

Following that brief statement, I will be happy to respond to any questions you may have.

The problem areas on which I will focus—problems we face today and which, if not carefully attended, pose a serious threat to the long-term future of the economy—are: (1) inflation; (2) unemployment; (3) economic growth; and (4) the relationship between government and the private sector. Obviously, all of these are inextricably interrelated—and ultimately related to our standard of living, our role in the world, and our most precious liberties.

INFLATION

Inflation is the most corrosive of diseases. It is also the most insidious in that, in its early stages, it appears to be benign. The illusion is fostered that everything is getting bigger and better, that the country and the people are prospering more than ever.

As we have learned to our sorrow, however—or should have learned—inflation is a malignancy that will feed upon itself and the economy to grow ever larger unless we stop it. Worst of all, the erosion of purchasing power that is virtually inevitable with inflation is the cruelest and most regressive hidden tax of all. While it eats away at the well-being of all segments of society, it strikes hardest and most harshly at those with the least resistance, those who are already disadvantaged: the poor, those in the middle-income range, and the aged.

For example, recent surveys by the Bureau of Labor Statistics show that a family of four with moderate income of $8,000–10,000—a category not likely to receive food stamps—spends more than one-fifth of its total before-tax income on food. The share for families of lower income is undoubtedly as large or larger. From 1970–1975, food prices rose 53 percent, an average of more than 10 percent a year. Other above-average price rises during that period include a 56 percent increase in home fuel and utilities, and a 60 percent rise in gasoline and motor oil. These price increases, like those for food, are disproportionately heavy burdens on the lower-income groups.

While many middle- and upper-income families and individuals have some savings that they can fall back upon to help cushion their inflation-eroded purchasing power, most of the lower-income groups and the aged do not have that flexibility. Clearly, those people whose income are relatively fixed, those who have no savings, or those whose meager savings are primarily in monetary assets have lost substantially because of the magnitude of inflation during the past few years.

It is therefore vital that policies aimed at economic stabilization be judiciously evaluated in order to avoid any potential inflationary impact. In seeking to reduce unemployment, for example, I concur with the Chairman of the CEA that it must be lowered "as rapidly as is consistent with the need to ensure that the reductions will be lasting." What will we have really gained if, by taking strong ad hoc measures to force unemployment down rapidly, we merely invite worse inflation and greater hardship for the longer term?

Thus, our major contribction to improving the situation of those most brutually oppressed by inflation is to control inflation, rather than attempting to compensate for it through increased Federal expenditures. Federal spending has its place, to be sure, but that place is as a secondary line of defense.

To recognize this problem and its ramifications is to recognize that careful budget planning, a deceleration in the growth of Federal spending and the avoidance of the waste and excesses that aggravate inflation are essential. This is not to say that Federal spending should decline, but—as the President has pointed out—that its rate of growth must be lowered.

The more so, I would say, because, in addition to its very direct and easily observable effects, the erosion of purchasing power by inflation destabilizes the economy, aborting recovery and creating recession. These effects arise from a dampening of consumer confidence; discouragement of personal consumption; and a distortion of inventory decisions taken by business.

Persistent and erratic inflation, further, creates a climate of uncertainty that discourages long-term investment. That, in turn, adversely affects our economic growth rate, our productive potential, our employment level and the creation of jobs.

From whatever perspective one views inflation, then, no redeeming features are to be found. Any postulated solution to our problems that is likely to lead to a resurgence of inflation as a by-product is no solution at all; it will almost certainly make matters worse.

The dominant objective to be pursued, as I see it, is the long-term healthy growth of the American economy. Thus, the President's key economic goal is to create an economic environment in which sustainable, noninflationary growth can be achieved.

UNEMPLOYMENT

Unemployment and inflation are not opposites, to be traded off one against the other. They are related symptoms of an unhealthy economy. The inefficient use of physical resources is a waste; the underutilization or nonutilization of human resources is a tragic waste. It carries an unacceptably high social cost above and beyond the economic cost of forgone production of goods and services.

We have seen how sharply rising prices, in recent years, brought about a climate of uncertainty and contributed to a sharp reduction in the purchasing power of household assets in savings accounts and securities. Consumers, in turn, cut back on expenditures, and already swollen inventories backed up in distribution channels. High interest rates, reflecting inflation premiums, discouraged business investment and housing. By early 1975, the result was a sharp cutback in production and employment.

Since inflation, then, was a major underlying cause of the recession and the consequent unemployment, any policy that seeks to reduce unemployment at the price of more inflation is doomed from the start. Like inflation itself, such stimulation may appear attractive at first—but too soon it succeeds only in defeating its own well-intentioned purpose.

The proper course, in my view, is to encourage the investment that is a necessary precondition to the creation of jobs. Only thus can we help to control inflation, and provide job opportunities—meaningful, productive and dependable lasting jobs—for the millions now looking for employment, and the millions who will be seeking admission to the labor force in the years ahead.

I am of course aware of the expressed feelings of some on this Committee that the Administration is uncaring or insensitive with regard to the plight of the unemployed. Certainly, those of you have known Gerald Ford on this Hill know that he is a decent and compassionate human being who cares very deeply about the plight of all Americans. As for myself, no one can spend as many years as I did at HEW without being reinforced in a natural sensitivity to the emptiness and despair that attach to being disadvantaged.

But I must repeat, in all conscience and sincerity: creating jobs with public funds—except as a last resort in extreme crisis—is, like inflation itself, a snare and a delusion. It will not solve a fundamental problem; it will merely displace it in time. The reckoning will come soon enough, as it did in 1974, and we will all, inevitably, be worse off. And the very worst off, as always, will be those who need assistance the most—and whom artificial job creation was intended to help.

ECONOMIC GROWTH

The primary goal, to reiterate, is long-term economic growth. Steady, healthy and, above all, sustainable. That is the kind of growth that provides the material product and services to satisfy the needs and wants of society—and the conditions under which the labor force can be as fully employed as possible in productive endeavors.

Steady and sustained economic growth will provide the proper climate for adequate investment. Increased investment in plant and equipment is critical from both the short-term and long-term viewpoints. It is a prime element of a satisfactory and durable economic recovery. And over the longer run, it builds the foundation for a rise in real wages and higher standards of living.

In this connection, it is important to call to the Committee's attention a recent study of capital requirements of the U.S. economy undertaken by the Commerce Department's Bureau of Economic Analysis at the request of the Council of Economic Advisers. The objective of the study was to estimate the cumulative amount of business investment in fixed non-residential capital that would be required during the period 1971–1980 in order to assure a 1980 capital stock sufficient to meet the needs of a full-employment economy, as well as the requirements for pollution abatement and for decreasing dependence on foreign sources of petroleum.

Briefly, the major findings of the study are as follows:

1. In order to assure a 1980 capital stock sufficient to achieve these goals—which admittedly may be difficult to do by 1980—private fixed investment (in 1972 prices) during the period 1971–1980 will need to be 11.4 percent of GNP.

This percentage is considerably higher than the 10.4 percent characteristic of the 1965–1970 period and the 10.2 percent of the 1971–1974 period. Moreover, given the low level of investment during 1971–1974, for the remaining six years, 1975–1980, fixed capital investment must total 12.0 percent of cumulative GNP. Furthermore, since investment was less than 10 percent of GNP in 1975 and is not expected to be 10 percent this year, the study results suggest that the investment ratio will have to be greater than 12 percent in the next 4 years to satisfy the several goals previously mentioned.

2. These requirements for an increased share of GNP devoted to investment are associated with three factors:

a. Changing technology in selected industries where the capital/output ratios have been increasing. This factor is the major cause of the need for an increased share of GNP devoted to fixed investment.

b. Increased needs for capital investment as a result of the "energy situation."

c. Investment in pollution abatement equipment as a consequence of legislation relating to "clean air" and "clean water."

If it were not for these factors, the 1971–1980 cumulative investment needs would require only 9.9 percent of GNP.

Given these findings, it follows that if we are to meet the goals set forth, economic policies should be directed toward the assurance that there will be adequate investment to support a high-employment economy without weakening consumer demand. The President's program to increase private-sector activity relative to government spending is, in my view, the only realistic means of achieving this goal.

RELATIONSHIP BETWEEN GOVERNMENT AND PRIVATE SECTOR

Both in our democracy and our economy—two sides of the same coin—we have always emphasized individual decision and choice. I believe it essential that we not deviate from the course that has made the United States uniquely the kind of country it is.

Obviously, the Government must have a role—as where social costs and benefits, for example, are not translatable through the private market mechanism. In addition to its overall economic stabilization role, it also bears the responsibility to maintain competitive market conditions.

On the other hand, it has grown increasingly apparent that a more reasonable approach to government regulation is necessary. In addition to deregulation, or modified regulation, of major economic areas—transportation, for example—there is also a clear tradeoff in such areas as occupational safety and environmental standards: as between productivity and profitability, on the one hand, and social benefits, on the other. There is always a fulcrum, a point of balance. Surely we should be able to strike that reasonable balance between the tenets of free enterprise and our responsibility to protect the interests of the people—as citizens and as consumers.

INTERNATIONAL ECONOMIC CONDITIONS

U.S. trade performance was exceeding strong in 1975, with a record surplus by whatever measure is employed. As the U.S. and other nations recover from the global recession, we would naturally expect this large surplus to diminish. The extent of the reduction will depend upon such factors as: our rate of recovery versus the speed of the recovery in other countries; the performance of the lesser developed countries in their development process; price and productivity changes; and the overall competitiveness of American goods in international markets.

Over the long perspective, U.S. producers need to remain highly competitive in the international area. The ability to sell our products in the world market enables us to purchase other items from abroad which we cannot produce as efficiently. Our policies must therefore enable the United States to continue to enter freely into world trade.

The floating exchange rate system has afforded vital flexibility in dealing with the upheavals of the recent past. However, U.S. trade can benefit from less erratic fluctuations in world currencies. The recent IMF agreement is a step in this direction, as well as helping the LDCs with respect to their reserve problems.

We must continue to deal with the real dimensions of international trade. It is essential that we maintain the momentum in removing tariff and non-tariff barriers to trade in the new round of Multilateral Trade Negotiations, with the goal of reaching a successful conclusion in these negotiations in 1977. Similarly, it is essential that a multinational cooperative approach to solving the energy problem be pursued.

Mr. Chairman, I have represented some of my views on the economic problems we face today and those which, absent judicious moderation in the formulation of economic policy, could becloud our future. And I have discussed what I see as our place in the global economy of which we are inescapably a part.

Let me close by assuring you of my deep conviction that the sweeping social goals and visions of the 1960s were not only compassionate and just, but necessary.

By all means, let us adhere strongly to those goals and visions. But let us do so from the firm foundation of a healthy free-market, free-enterprise, private-sector system. Let us create and increase real wealth through that system, so that everyone is afforded the opportunity to share in that wealth on a more equitable basis than we have yet achieved.

The proper role of government is to create and nurture the climate and the environment within which private free enterprise can achieve its maximum productivity and efficiency.

I know that you, Mr. Chairman, have had medically-related training, as I did during World War II. And there have been many physicians in my family. I trust, therefore, that you will permit me a medical metaphor to close my statement.

The primary doctrine of the healer is primum non nocere—above all, do no harm. Yet, there is a class of maladies known as "iatrogenic" diseases. These are ailments from which the patient was not suffering when he consulted the doctor—but which the treatment itself, the prescribed medications, or a hospital confinement brought about.

I would urge this distinguished Committee, and the Congress, in your deliberations and debate on the great issues of our economy, to be exceedingly cautious, above all, to do no harm. And to be as certain as human fallibility will permit, in prescribing remedies for our ailments, that the cure is not worse than the disease—and will not carry the germs of a more severe epidemic than anything we have yet suffered.

The President, in my opinion, has done what conscientious practitioners almost invariably do: he has prescribed a conservative regimen to continue the healing process that has already gotten under way.

I agree with and support both his prognosis and his prescription for full economic health.

I will be happy now to respond to your questions.

Representative MOORHEAD. First, Secretary Butz, I think that both Mrs. Heckler and I come from largely urban areas, but I think we share the belief that a sound economic situation in the farm economy is essential for sound economy generally. And I think we both supported programs which were designed to help the farm economy. But, we do have to face the situation, as Secretary Richardson said in his prepared statement that from 1970 to 1975, food prices rose 53 percent. In your statement, you put great emphasis on the spread between the farm prices and the price at the retail level. What is your testimony about that 53 percent increase from 1970 to 1975? What percent of that benefited the farmer and what percent was involved in that spread that you described?

Secretary BUTZ. Well, I think a part of that went to all sectors of the food production and marketing chain. A part of it, indeed, went to the farmer, as indicated by his enhanced net income position. He was long overdue in this. For many, many years, our per capita farm income lagged substantially behind a per capita income of nonfarm people. The last 3 years shows it has at least been much closer and even above in 1973. But, usually, it has been a bit below the income of nonfarm people.

The increase in costs, the increase in what we call the farmer-retail price spread, has in large part been associated with increased cost and in some case, increased services. The proportion of after tax income in America spent for food still remains quite low. It is approximately 17 percent right now. Three years ago, it was a bit lower than that. It got down to 16.3 percent. In the last year or two, it has, indeed, increased a little bit, but still is very substantially below the figure that it rested at 10 years ago or 20 years ago. In 1950, that figure was 22.4 percent, as I recall.

The U.S. consumer today pays a smaller share of after-tax income for food than consumers anyplace else on the face of the Earth. Canada is the only other nation below 20 percent. Europe ranges from 23 to 28 or 29 percent. When you go into the eastern European nations and the socialist nations, it will run in the magnitude of 40 percent of, as best you can measure, their take-home pay for food, or their net income for food. Other countries, it runs as high as 70 percent.

The plain facts are that even at present prices, food is a relative bargain in the United States. And because we spend only 17 percent of our after-tax income for food, we are able to have better than 90 percent of our families with a TV set, almost 80 percent with an automobile, nearly two-thirds with two automobiles, and the material levels of living we have in America because we spend so little for food, relatively. And yet a part of the increases in the costs of food, and I must point this out, is because we demand and therefore pay for more services with our food.

The TV dinners don't come for free. Somebody has to be paid for putting them together. The fact that today we process about 54 percent of our potato crop is important. And somebody has to pay for that. You have to peel a potato to put it in the American kitchen now. It won't go in unpeeled anymore. And somebody has to pay for that.

The fact that we have become a Nation of snack eaters is significant. I see Mrs. Heckler doesn't agree with that—I mean, you know, you shake your head, but I stand on the fact that 54 percent of our potatoes are processed before they reach the consumer.

Representative HECKLER. Sir, I disagree with the illusion to the American housewife as being too lazy to peel potatoes. I disagree with that entirely.

Secretary BUTZ. Well, I stand on the fact that 54 percent are processed before they hit the home now and before they are consumed. And somebody peels them before they hit the ultimate consumer. And while you may peel your own, there are many, many housewives that are busy and that will grab the frozen——

[Laughter]

Secretary BUTZ. I obviously said the wrong thing.

Representative HECKLER. I, too, am busy.

Secretary BUTZ. But I mean, one-third of our housewives work. They hold down a full-time job, as you do, too, and they simply take processed foods. The fact that we eat over one-third of our meals outside the home in America—and they don't come for cheap—is also important. And that is in that 17 percent of after-tax income spent for food. You know, you go downtown to Washington tonight and if you look around a good deal, you will find a place you can get a decent dinner for $5.00 if you don't take a drink with it. In that restaurant tonight, you would spend $5.00 for that dinner. If they put an empty plate in front of you, it would cost you $3. And we charge the whole $5.00 as part of our food bill. And yet, even with all of this, we get it for about 17 percent of after-tax income.

I think food is a pretty good bargain in America. Unfortunately it has been the subject of a lot of criticism. Food is about the only thing we have left that we pay cash for in America. We sign a slip for everything else. We sign a slip for our gasoline and for our drugs. The housewives of America have a dozen credit cards—and you probably have that many in your pocket, too—and every place they go they sign a slip for it, except food. And this makes everybody aware of any change in food prices. And the plain facts are that last year food did not increase as much in price as transportation, as medical services, or as a host of other services and goods.

Representative MOORHEAD. I am going to direct this question to Secretary Richardson. But, as I hear the two statements, I would say that Secretary Butz's representing, if you will, the farm economy, gives us a far more optimistic picture of the future than you do, Secretary Richardson, representing the nonfarm part of our economy. Is that correct, sir?

Secretary RICHARDSON. Well, I wouldn't want to characterize my statement, Mr. Chairman, as a pessimistic statement. What I tried to do was to depict the dimensions of the task confronting us in seeking to meet a set of interrelated objectives, including full employment and economic growth and dealing with the problems of the environment and so on. And I do that, and to meet this combination of goals, I emphasize that we must seek to create an economic climate that will encourage investment. And that, in turn, was related to my earlier testimony dealing with the destructive impact of inflation. And certainly, where investment is concerned, inflation is destructive in at least two respects: One, is that it creates uncertainties for the consumer who will save a relatively higher proportion of income and defer expenditures, particularly expenditures of items involving substantial costs. And we have seen this, of course, in the decline of the housing market, amongst other things.

The other consequence of inflation from the standpoint of long-term investment is uncertainties created for the planner in business, who has to make judgments about future demand. And if that person sees that the consumer is holding onto his money in a stagnate economy, that planner will hold back on plans to expand production. And so, you have a self-reinforcing process where, at the same time, you have inflationary trends built into the economy, partly through expectations themselves.

Representative MOORHEAD. Mr. Secretary. I do want to ask you a little bit more about this promotion of investment, but just to be technical, in your testimony, you gave the percentages during the 1965–70 period and the 1971–74 period. Do you have similar figures for the period 1960 to 1965?

Secretary RICHARDSON. Well, I will ask Mrs. Vaccara, who worked on this, to respond.

Mrs. VACCARA. I don't recall the numbers, but they were somewhat higher in the 1965–70 period.

Representative MOORHEAD. I think if you could supply that figure for the record, because that was a period of relatively full employment and price stability, that would be helpful.

Mrs. VACCARA. We would be happy to supply that number for you.

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

For the 5-year period 1960 to 1964, the share of business fixed investment in Gross National Product—in 1972 dollars—was 8.9 percent.

Secretary RICHARDSON. You know, sustaining the momentum of the moderation of the Eisenhower administration.

Representative MOORHEAD. I beg your pardon.

Secretary RICHARDSON. Sustained on the momentum of the moderation of the Eisenhower administration.

Representative MOORHEAD. I wasn't bringing that up politically. It is true, if you look at that period, we see that we did reduce unemployment or unemployment was reduced and prices remained stable. So, I think it is a figure that should be included.

Secretary RICHARDSON. We would be very glad to furnish that. I think it is a very pertinent question.

Representative MOORHEAD. Now, you do stress very heavily the importance of the promotion of investment, but I didn't see any specific recommendations, Mr. Secretary, toward achieving that goal. Could you give us any specific recommendations?

Secretary RICHARDSON. Well, I did refer, in my longer statement, and I omitted it in my summary, to the President's proposal that would create incentives to investment in areas of high unemployment. This is a specific recommendation by the administration, which seems to me to make sense in terms of the creation of permanent jobs. Because certainly, for the long-term, Mr. Chairman, permanent jobs will be created in the private sector only as a result of expanded investment. Beyond that, my own view is—and certainly, this is only a reflection of administration policy with which I agree—the prospects for investment really are, we think, a function of the creation of confidence and the prospect of stable, long-term growth. My own view is that, indeed, as Government policymakers, we tend to understate, if anything, the importance of confidence itself because this is the ingredient absolutely critical to the kinds of decision that consumers make from day to day—that is, whether to save or spend—and the same is true of people who make business decisions. So, I am talking about a policy designed to encourage investment when I speak about a policy that is designed to contain inflation and to create confidence.

Representative MOORHEAD. Thank you, Mr. Secretary.

Mrs. Heckler.

Representative HECKLER. Yes, thank you, Mr. Chairman.

Secretary Butz, about a week ago there were some reports in the papers that were rather confusing on the subject of our total grain stocks. I wonder if you could tell us what the present status is in terms of the number of days' usage, compared to last years' and, as well, Secretary Butz, could you tell me what monitoring system is used to get up to date reports on grain exports and grain export sales?

Secretary BUTZ. Taking your first question first, our current grain stock situation is substantially better than it was 1 year ago now. That is because of the very sharp drop in the corn crop we had in 1974, where the dry weather that occurred in July and August caused us to reduce our estimated corn production by nearly 1.5 billion bushels during the months of the summer of 1974. We had good production in 1975. We came into the current crop marketing year with relatively low carry-in because of the last year's short production. However, we had record crops in 1975. We had a record wheat crop of over 2.1 billion bushels. We had a near record crop of 5.7 billion bushels of corn. Our other feed grains were good. Our cotton production was down somewhat last year, which was not bad, because we had a heavy carry-in of cotton. We will have a carry-out of grain stocks at the end of the current crop year substantially above the carry-in at the start of the current crop year.

Therefore, our inventory situation, or our reserve situation, if you may choose to call it that, is in a very healthy situation right now.

The second question, for some 2 years now, we have had a requirement that every export sale of 50,000 tons of grains or more must be reported within 24 hours. Those are reported. These are sales that I speak of. Of course, we also monitor shipments whenever the ship is loaded. These are reported to us every 24 hours. They are published once a week. I am not sure whether it is on Thursday afternoon or Friday afternoon. They are published after the market closes once a week. And we feel we have very accurate and very current figures on export sales.

Representative HECKLER. I would like to have your assessment of the rice bill. What is the impact of the recent rice bill that Congress has just passed in view of the fact that rice harvests have been successful, as I understand it, throughout the world and the possibility of increasing our export market just simply does not exist today and there are very large sized stocks on hand. What will the new rice bill do to that situation?

Secretary BUTZ. The new rice bill represents, I think, a turnaround in our policy with respect to rice that makes our rice policy now relatively consistent with our governmental policy on food grains and feed grains. I say "other foods grains" and that is wheat especially, and the feed grains and cotton and soybeans, Mrs. Heckler.

We are now moving rice production toward the target price concept, which is very similar to the concept that we have under the Agriculture Act of 1973 for the other grains and for cotton. We are permitting what we call open-ended production of rice, which means that there will be no restrictions on rice production this year under the new program, as there are no restraints on the production of the other crops. This is a departure from the system of quotas that has been in effect for rice production where we had quotas that could not be reduced below a minimum of 1.6 million acres, roughly, although I don't have the exact figures here. Those quotas are held primarily by farmers in California, Texas, Arkansas and Louisiana, with a few other states having some quotas. We are moving away from the quotas system. We are moving toward the target price concept—with a gradual transition period—and the associated loan concept for rice that is now applicable to other crops. This new rice bill has a tenure that will correspond to the tenure of the general farm bill. It will expire in—it will expire with the 1977 crop year, so that there will be need for new farm legislation that year.

We feel that this will permit added entry of American rice into the world commercial markets. I think rice has depended entirely too much on Public Law 480 for its export market, and too little on commercial markets.

It is true that there have been good rice crops around the world. We don't produce a large share of the world's production. We only produce around 2 percent of the world's rice production, but we export nearly 60 percent of the rice we do produce, because we are not a rice-eating nation. And we supply approximately a third of the rice that moves in international trade. Therefore, we are an important factor in the international market for rice. I think this new program will permit us to move more aggressively toward market expansion of rice than the old program did.

Representative HECKLER. One final question, which is just a general policy question. Obviously, I do come from an urban area largely, and an area in which the problems of the consumers and the housewife you mentioned—housewives being, the full-time housewives, I think, the most unvalued person in this society—nonetheless, housewives that I speak to, as well as heads of households, are still deeply concerned about food prices. And just yesterday, in the Domestic Marketing Subcommittee of the Agriculture Committee, we heard testimony from a series of potato growers who testified that the increase in markup on fresh produce, which is not going to be processed, between the time it leaves the farm and ultimately reaches the consumer in a supermarket in Massachusetts, Washington, or any other place in this country, that the increase in price is often as high as 100 percent. Now, I know that the consumers have spoken out. I know many of them, thousands wrote in opposition to the beef-grading decision, for example. And yet their words, their input virtually went unheeded.

And I think we have a problem of having established or having to live with a conditional relationship that is really unfair to the farmer and unfair to the consumer. It is an adversary relationship. Mr. Butz, I would like, as a consumer representative, to find out how we can become allies; how you, as Secretary of Agriculture, can work with consumer advocates, housewives, et cetera. I would like to know how we can mutually resolve the difficulties, the enormous gap in communications, so that we can not only speak to each other, but maybe even hear each other. I don't think that there is presently, in your Department, or in any of the departments, of really adequate consumer access. And for this reason, I favor the Consumer Protection Agency, with the elimination of the consumer services in the various departments. And that was my idea and my amendment, which I brought to Mr. McClosky.

But, as a matter of fact, we do expect and, unfortunately, it looks like that particular piece of legislation is not going to be favorably looked upon by the White House so that we are going to go back to square one. What can we do? How can we really start to look at the food prices, and have each side really appreciate the other's point of view? How can the consumer have better access to you and still allow you to do your job well in terms of supporting the farmer? Because of course, if the farmer does not produce, we have no food to argue about. What can we do?

Secretary BUTZ. I think the consumer has access to the Department of Agriculture. I wish, however, the organized consumers—if I can use that term and of course I don't hear a uniform voice from consumers on beef grading, for example, because there is one consumer group that said they didn't want any change and another group wanted change. They were just like the producers, where one group of producers wanted a change and one didn't—but it has been alleged that we didn't pay any attention to the consumer input in our changes on beef grades. Well, we did; we just paid attention to the other group of consumers speaking in this case. I wish consumers were consistent. If these very same consumer groups that protested so loudly that the Department of Agriculture is insensitive to consumer needs and food prices had had the courage yesterday to have taken the stand on the side of supporting the President's veto of the increased dairy supports bill that would have added approximately $1.2 billion to consumer prices of milk over the next years, Mrs.

Heckler, if those same consumer groups had had the courage—and I may say Ralph Nader; I will put him in the same category—if they had had the courage to come on this Hill and sit in opposition to some of their political friends up here, then I would have thought that they were truly the consumers' friends. But, where were they yesterday? We tried to get them yesterday to stand behind supporting the President's veto of a $1.2 billion increase in the consumer cost of dairy products, but they were absent.

Therefore, I simply have got to say that I regard them as being more political than economic in cases like this.

All right now, that is a lecture you didn't ask for, but I wanted to get it off my chest, because I never thought I would want them to be allied with me, but yesterday I did, and they weren't here. We supposted the President's veto without——

Representative HECKLER. But I asked——

Secretary BUTZ [continuing]. And at the very same time yesterday, or the day before, one of those groups sent me a protest with much publicity, Mrs. Heckler, about why don't you investigate the combines of the large dairy co-ops that are raising consumer prices of dairy products by $200 million a year. And when I wanted them up here to save a ripoff of $1.2 billion, they weren't here. OK, so much for that. I pay my respects to the consumer groups with that little speech.

Now then, why don't we get together? We should get together. Our interests are the same. The interests of the Department of Agriculture are in consumers. They buy our products. We do have common interests. And I think, Mrs. Heckler, the fact that in the last 3 years, we have turned our farm policy around from one of scarcity, from one of quotas, from one of allotments, from one of curtailments, from one of cutbacks, to one of full protection, Mrs. Heckler, that this administration and Agriculture has indeed been the consumer's friend. Because you can't maintain with any degree of credibility, you can't maintain that a program of scarcity is in the interests of the American consumer.

Mrs. HECKLER. Well——

Secretary BUTZ [continuing]. Now then, I think our farmers are doing their part. Our farmers have a record of increased production per worker and increased efficiency per worker unmatched in any other major sector of the American society. They are pretty efficient. And they are efficient because our farmers have not learned yet to punch the clock at 40 hours. They haven't learned yet, in Massachusetts, to go out to the cow stable and say, "Look, boss, I am going to be gone for the weekend, so let's shut it off for 3 days." And most important of all, they haven't learned to put two drivers in the tractor, like the locomotive that goes through town.

Now, let's take a case in point. I think you heard me make this illustration the other day in the Agriculture Committee. Right now, we have about 5 cents worth of wheat in a 1-pound loaf of bread——

Representative HECKLER. Yes, I heard that, and——

Secretary BUTZ. Well, I want the Chairman to hear it, too. As I recall, the other day I was asked what a loaf of bread cost and I checked up then—and I hope you have, too—but there is about 5 cents worth of wheat right now, at farm price, in a loaf of white bread that sells in this town for 45 to 50 cents. That means about one-tenth of that loaf of bread is wheat. It costs more in major American cities to move that loaf of bread from the bakery door to the supermarket shelves than it costs to put the wheat in the bread. And the woman who complains the loudest about the price of that bread is often the wife of the man who drives the delivery truck. Now, I think that is the place we have to attack. We have got to increase the efficiency of the utilization of equipment and especially utilization of labor in the whole processing and distribution chain.

Representative HECKLER. Well, Mr. Secretary, if we can get back to that simple potato, that increases 100 percent in price from the time it leaves the farm in Maine or wherever and reaches the supermarket. That 100-percent markup is what the housewife or the consumers are really screaming about. And when I speak of consumers, I am not talking about groups, about organizations; I am talking about people, I am talking about the purchasers. What can your Department do to help us probe the mystery of high food prices?

Certainly, we want a fair return for the farmer. We want the farmer to have an incentive. And personally, I know how hard they work and I think this is something that is well respected in my area.

Nonetheless, food prices are staggering. And there is that mystery that shrouds the whole issue. Isn't it possible for you to become the great hero for the American people as well as the farmer and help us reveal or disclose or determine where the villain lies?

Secretary BUTZ. I certainly can. This morning, in Sioux City, Iowa, a major beef packing center, there were perhaps 100 refrigerated trucks that left Sioux City, Iowa this morning, and headed for Washington, for Philadelphia, New York, and Boston with beef halves hanging on the rail in that truck. Half the space in that truck was full of air because of some silly rule of the Meat Cutters Union that you had to break that carcass down in New York City behind the counter the same way granddad did, except you use a power saw instead of breaking it down in Sioux City, putting it in boxes, filling the truck truck-full, and having one driver take a full truck across the country instead of half a truck across the country.

I certainly can point out some illustrations or the fact that after 6 p.m. in Chicago and Cleveland, you can't buy any meat in the supermarkets. You cover up the counter, even though the store is open 24 hours, because of some silly rule in the Meat Cutters' Union that you are supposed to cover the counter at 6 o'clock. I guess you've got to write that into the price meat also.

I can give you another illustration. You say what can I do? I would like to make enough housewives mad enough that they will demand something be done about this.

Representative HECKLER. Well, there is probably one facet of commodity sales that is a problem and a different problem in another. But the fact is, no one is putting it all together and the housewife doesn't know where to go except he or she is extremely frustrated and has just lost faith. And I think that any innovative thinking that your Department could give as to how we could create an effective and meaningful mechanisms for exchange within your Department and the consumers, well, I think this would be terribly important in terms of dealing with the problems and perhaps in terms of resolving some of these high costs. I don't think it is fair to blame the farmer, and most thinking people do not.

But, the fact is that the consumer feels that there is no place to go right now. And somehow or another, I would hope your Department will face that fact. I know I am running out of time, Mr. Chairman.

Representative HECKLER. But I would like to ask——

Secretary BUTZ. In this connection, I would be glad to supply you with 100 illustrations of the kind I just did.

Representative HECKLER. Somehow or another, these illustrations have been on a fragmented basis and do not provide the response or the answers to the overall problem. So we have to put it all together.

And there has to be a dialog which responds to consumer letters and complaints and——

Secretary BUTZ. Okay, let's get at another problem. In this town, in the supermarkets in this town, you've got to hire enough checkout people at the checkout counters to take care of the rush period from 3 in the afternoon until 7. Then you've got to hire enough stock personnel to take care of the job of filling the shelves in the morning from 6 until 10 in the morning. You can't move the stock fellow over to the checkout counter when he has some time off, or vice versa. And you simply overstaff the establishment. Now, I guess that has to be written into the price of groceries, too.

Representative HECKLER. I think there are lots of other things that can be written into the price and perhaps we can find a way to have a more extended conversation on this. Maybe we can have some joint hearings.

I would like to shift the problem now to Mr. Richardson, because, after all, we are talking about commerce, too. And as I recall, the Commission on Productivity made over 100 recommendations to the President on the subject of increasing the productivity of employees and the systems within the food industry. I wonder if this might be a very unfair question, since you have been on the job just 3 days, but I wonder if your Department could tell us what has happened to those recommendations?

Secretary RICHARDSON. I really don't know where, exactly, they stand. I do think, though, that your question and Secretary Butz's answers and the role of the Department of Commerce are closely related. He has touched on a number of things that affect the ultimate price of food to the consumer, which do involve productivity in its essence and the utilization of people.

And I would be glad to furnish, for the record, what I can in the way of a response to the question of what is being done about these recommendations. I would be very interested myself in knowing the answer to this.

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

With respect to the Department's position on the former National Commission on Productivity's (now the National Center for Productivity) recommendations of two years ago, it should be noted that the Secretary of Commerce was, and still is, a member of this body and has consistently supported its work.

The Department of Commerce plans to undertake several projects involving food distribution. The primary vehicle for this work will be the Advisory Committee on Food Processing and Distribution, which was recently approved by the Department and is now awaiting Office of Management and Budget approval. Specific areas of study will include modularization, which has the potential to substantially improve the use of truck and warehouse space and thus increase productivity in food distribution; the economic impact of the automated front end, which represents the application of computer technology to the grocery store and is expected to result in improved productivity and the generation of data for management control not previously available; and an analysis of the difficulties and possible remedies to providing retail food outlets for inner city residents, a growing social problem. In addition, the Committee would also represent a vehicle for reevaluating, with the assistance of the National Center for Productivity, the previous National Commission's approximately 100 recommendations for increasing productivity in the food industry, and for assigning priorities to these recommendations.

Secretary RICHARDSON. Of course, you get into a whole series of interesting and difficult problems here when you are concerned with the interrelationship between prices and productivity and employment. Some of the practices that Secretary Butz has referred to are practices whose objective is obviously to protect or to create jobs. And if you were to wipe them out overnight, you would certainly reduce the price of food to the housewife. You would also be putting a lot of people out of work. The problem, on the face of it, must be one that is solved over time to the extent that we combine the overall growth of the economy with job creation in new areas where people are more efficiently used, so that we can reduce their excessive utilization in situations like those that he has referred to. And that really is the course that our economy has historically followed. We have been able to sustain relatively high employment because we have encouraged growth an innovation. And we have been able to do this while increasing the rates of wages and per-capita disposable income. Thus, if you are looking for someplace to start to deal with the things in an interlocking cycle of related phenomena, it seems to me that the most important place to begin is with the encouragement of the innovative technological growth and developmental process itself, which is a long way of saying investment in the productive economy.

Let me go back to the United Kingdom again. There has been a tendency—for a lot of historical reasons, Representative Heckler, that I won't go into—a tendency in Britain for the worker to think in terms of the protection of the job and the distribution of what has tended to be assumed to be a relatively fixed pie, as distinguished from the wholehearted cooperation of the worker in helping to make the pie larger. The result, therefore, is a whole set of attitudes, including the protection of the job, the stretching out of the work, a resistence to the adoption of innovative techniques that may have the result of laying people off. And the result is visible. It not only discourages growth, but it also perpetuates a relatively low-wage economy.

I think there is developing in the United Kingdom now a realization that these policies require abandonment and redirection. And I think it is clear that a solution in the interest of the housewife with respect to the cost of the potato has to be a part of the process whereby the economy is able to employ people who are now underemployed or are engaged in unnecessary work.

Representative HECKLER. Thank you, Mr. Secretary.

Representative MOORHEAD. I will yield to the distinguished senior Senator from New York.

Senator JAVITS. Well, thank you, Mr. Chairman. I just came to greet my friend and brother Elliot Richardson in his new role. That was all. And I would like to listen a minute.

Senator RICHARDSON. Thank you very much, Senator Javits. It is a pleasure to see you. I have seen you on the bench of a number of other committees, but this is the first time I have seen you in your capacity as a monetary commentator and policymaker in the Nation's economy.

Senator JAVITS. Thank you very much. And I would like to greet the Secretary of Agriculture, also.

Representative MOORHEAD. Secretary Richardson, the Commerce Department has acquired a reputation for being one of the most continuously reorganized agencies in the Government. And it was recently published that Commerce is again undergoing a reorganization. I understand that the post of Assistant Secretary for Economic Affairs is going to be downgraded to that of Chief Economists, but a new position, the Assistant Secretary for Policy will coordinate a large number of economic areas.

Now, what assurances does this committee have that a new policy layer on top of those who released the economic data will insure the continued impartiality and objectivity of economic data? Where does the Bureau of Economic Analysis and the Bureau of the Census fit into this new reorganizational scheme? And what benefits do you think that the reorganization will bring to the formulation of policy? We certainly want to continue to rely on Commerce producing, as nearly as one can, impartial and objective economic analyses on which so many departments and agencies in the Congress rely.

Secretary RICHARDSON. Well, I am so glad you raised this question, Mr. Chairman, because in doing, you have indicated that there must exist misunderstandings with respect to the rather limited steps that I have taken since coming to the Department of Commerce. I would have said that we had upgraded the position of the principal economic officer of the Department by renaming his title as Chief Economist for the Department. Certainly there is no element of downgrading involved. He will preserve the same relationship to the Bureau of Economic Analysis that the Assistant Secretary for Economic Affairs had. He will, in other words, Mr. Chairman, be a policy spokesman for the Department and an adviser to the Secretary in economic matters, utilizing the data developed by the Bureau of Economic Analysis in the light of its interpretations of those data.

But, as this committee is well aware, the Bureau of Economic Analysis cannot both be a widely respected entity, charged with the compilation of the Economic information—as it is and will certainly be as long as I am Secretary of Commerce—and at the same time, be charged with the formulation of policy recommendations to the Department and the administration in economic areas. So that is the function of the Chief Economist.

Now, the Office of Assistant Secretary for Policy creates a position coordinated with that of the Chief Economist and also reporting to the Secretary of Commerce. There is no interposed layer between the Chief Economist and the Secretary. The reason for creating the position of Assistant Secretary for Policy is simply that the Department of Commerce impinges on such a wide area of the national activity that it is important for the Secretary to have the benefit of a staff, whose function is to analyze current issues and to help formulate priorities. Also, Mr. Chairman, because of the degree to which these problems cut across agency lines and thus necessitate the creation of various interdepartmental bodies, Cabinet committees, and so on, there is a need to have at a higher level in the Department a person whose role is to assume general responsibility for the manner in which the Department of Commerce relates to and makes its contribution to the role of these various interdepartmental entities.

Representative MOORHEAD. Thank you, Mr. Secretary. This committee wants to get the unvarnished statistics brought before it.

Secretary RICHARDSON. I understand. And I appreciate——

Representative MOORHEAD. Mr. Secretary, I have to leave for a vote. Senator Javits has agreeed to take the Chair. I will be back very briefly.

Senator JAVITS. I would like to ask the Secretary of Agriculture what he thinks will be the effect of the rice bill, which we passed in the Senate just yesterday, considering the fact that the industry here in this country depends largely on exports and that crops are said to be very good around the world and that there are or will be substantial stocks? So can the Secretary give us some guidance as to the effect of this new bill and why it should or should not become law?

Secretary BUTZ. Well, the effect of the new bill on the domestic rice industry will be to free it from the rigid production quotas that have been existing. It will permit rice, given time, to move into areas of more efficient production than has been in the past. Therefore, it will tend to make our national rice industry a more competitive industry than it has been in the past. It is true, as you say, that there are substantial stocks of rice in this country at the moment. We have had a good rice crop around the world. However, it has only been 2 years since there was a very short rice crop and rice was very high priced. That could happen again. We export roughly 60 percent of the rice we grow in this country and we supply roughly a third of the world's international trade in rice. I think the longrun effects of this bill will be to make us more competitive in rice and will help us to get a more nearly commercial market for rice with less dependence on Public Law 480 commitments for rice production in this country.

Senator JAVITS. So, you consider the nature of the bill and its fundamental thrust desirable?

Secretary BUTZ. Yes, I do.

Senator JAVITS. Secretary Richardson, we have been having quite some discussion, including a discussion this morning in the Joint Economic Committee, as to the situation of our policy respecting economic activity. On the one hand, the posture of the administration has been characterized as endeavoring to bring money into capital investment facilities, into investment, et cetera, especially in areas which have serious unemployment—and that has been called with the cliche of a "trickle-down theory"—as opposed to the argument, on the other side, that we needed to deal with unemployment, which is considered to be the principal issue of the day, on a more direct basis as, for example, in public service jobs, in signing this bill, which relates to our overriding the President's veto, as it is clear he will veto it. It relates to publc works, to short-term public works. Could you give us such work as has been done in the Commerce Department already as to what you consider to be the pros and cons of that situation looked at from your vantage point as Secretary of Commerce?

Secretary RICHARDSON. I would be glad to try to do that, Senator Javits. I think you have to start with a number of factors that belong in the solution of this equation. One is the timelag in the effectiveness of any given approach; one is the aggregate costs to the taxpayer, and one is the impact of the dollars involved in creating jobs. A final factor is the kinds of jobs that are involved and the permanence of those jobs, Senator.

The administration's view—and this is the view which we in the Department of Commerce share—is that the money involved can more efficiently be used if it is directed toward the creation of permanent jobs in the private sector. We think that the experience with public service jobs so far as it has been evaluated to date, Senator, suggests that the effect is principally to use Federal money for the payment of people who would have been employed anyway by local governments. It has been estimated that the displacement effect over time is as high as 90 percent.

We also think that the value of emphasizing incentives to invest in private plants and private production has the advantage of bringing into existence productive capacity, as well as creating permanent jobs that will help to deal with the problem I covered in my statement; namely, the problem of the private fixed investment needed over the remainder of this decade in order to satisfy the combined objectives of a full employment economy, pollution abatement and decreasing dependence on foreign petroleum.

So, in other words, given a choice in the use of resources held down in aggregate amount by a concern with preventing a resurgence of inflation—we think that the resources are better used in the stimulation of incentives to invest. And I don't think we should apologize for following that course or be intimidated by the "trickle down" label.

Senator JAVITS. Well, the difficulty with the thesis which you expound is that it presupposes a continuance of a highly unaccepted level of unemployment. As far as we can see, even by the Federal Government's own projections, you would still be over 7½ percent in 1979 and maybe even later than that. So, that is one part of our problem.

Another part of our problem is that we are obviously going to be cutting down on the duration of unemployment compensation. We have already reduced considerably, as of January 1, Mr. Secretary, the number of weeks that it can be drawn. Hence, as there are 100,000 expirations a month, we will speedily get an enormous number of new people on welfare. So, isn't it a better tradeoff—so this is the question: Isn't it a better tradeoff to deal with the job situation by giving jobs in a pattern which is now established, albeit not entirely the potimum—to wit, public service jobs—than withholding back from that and letting people go on welfare for the reasons that I have mentioned?

Secretary RICHARDSON. Well, I think there are a couple of things to be said about that, Senator Javits. One is—and frankly, since I have returned, I recognized that it was important for me to get and to analyze the composition of the unemployed segment of the labor force in terms of who are the unemployed, how long have they been unemployed and so on. Obviously the critical questions are: What is the degree of hardship, on whose part, and for how long? Depending on what the breakdown looks like, the question of whether or not public service jobs are an effective response to that problem may depend on that in considerable part.

In any event, turning to the other side of the question, which is assuming that people do go on welfare, and coming then to the question of whether there should be some work requirement attached to this, I think you've got quite a different question, because it involves the problem of whether or not they should work in effect for the welfare check if they are able bodied or otherwise able to work. I think a very good case can be made for that requirement, but that is a rather different question than whether or not an added amount of money should be appropriated by the Government for the creation of public service jobs per se, as distinguished from, in effect, creating an administrative mechanism under which people, who happen to be on welfare, and who, if they are able to work, be required to work.

Senator JAVITS. Of course, you would be correct if we had a Federal welfare system, which we do not. One of the things that has broken, for example, New York City's back is the welfare load, because it shared it 50–50, whereas the unemployment compensation comes out of the unemployment insurance system or the Federal Government, as the case may be, if you are a covered or an uncovered employee. And that is one of the difficulties.

You may find that even welfare standards will be very much debased because the money simply isn't there to meet it and that the attitude taken by the President—to wit: that he feels the dignity of unemployment compensation, which at least theoretically you have earned by the quarters in which you have been at work, is a great moral factor for the factor—and the President may, indeed, decide that is beneficial. Because if the worker gets into the poverty syndrome, if he kind of accepts it as a demeaning position in life and crawls into his hole and stays there in terms of any more enterprise or ambition, then——

Secretary RICHARDSON. Well, that is a very serious problem. I am not sure I know what the facts are on the prospects for having to reduce the duration of unemployment compensation. I certainly think that it is better to utilize unemployment compensation as long as it can be used to the extent that the individual has reason to hope that he will have reemployment within the same form of experience. In any event, if you are talking about new money for public service jobs versus the question of incentives to create employment, it seems to me that the value inherent in the expansion of the economy and the creation of permanent jobs does have a very strong claim over a course which at first creates temporary jobs, many of which, according to the analysis of figures in the past experience with public service jobs, are jobs for people who would have been employed anyway, with the result that you end up utilizing a very large proportion of all the Federal money and simply displacing municipal costs.

What you are doing, in effect, to expand the general revenue sharing program. In any event, when the question of additional money comes up against the problem of aggregate government spending, you have to look at the problem of inflationary impact and the consequences on confidence, and the consequences of confidence, in turn, on the stimulus of the investments that will improve the employment situation. It is that set of related considerations, in any event, that has led the administration to believe that, on balance, it is better to hold down aggregate spending, to create incentives for investment, and to deal, as best you can, in the short term with the problem of unemployment itself.

Senator JAVITS. Well, thank you, Mr. Secretary. It is a very illuminating explanation of the administration's position. I don't agree with it, but I appreciate the clarity wth which you set it forth. Thank you very much, Mr. Chairman.

Representative MOORHEAD. Thank you. Mrs. Heckler has one question.

Representative HECKLER. Just one further question on the same subject.

As you know, Mr. Secretary, we do have considerable unemployment in Massachusetts at 12 percent. Now, I do agree with your emphasis on long-term improvement in the economy and the need to create a healthy economy and the need to fight inflation. But, really, for those people who are unemployed, Mr. Secretary, the problem is acute now. And somehow it seems as though it is difficult to strike a balance. But since the administration uses the term "balance" consistently, how can you balance the longrun interests of the country with the short-term anxiety? You, in your statement, referred to the social cost of unemployment—and I see this every day—and then there is the economic cost. What do we do Monday morning for literally thousands of people who are out of work and who want to work and who are left in probably the most impoverished role in their lives in terms of the fact that they feel totally hopeless? What is the shortrun answer? Is there really no other way, except grin and bear it and go for the long haul? Isn't there any way to address the short-term needs of the population and of the youth. For example, ,this summer, are they going to be just on the streets all over the country? Is the administration going to have any program for youth?

Secretary RICHARDSON. Starting at the very end of your question, I don't know what approach the administration may have in mind with respect to youth. I will have to try and find out more about that.

But, I think on the problem of the unemployed, quite a lot, of course, is done today in our society by comparison with what we did in the period of the Great Depression. That fact goes a long way, I suppose, toward explaining in turn the fact that we have been able to endure the relatively high level of unemployment, as we have recently had, without more hardship. We do have substantial cushioning devices through the combination of unemployment compensation, some union agreements, the combination of medicaid, food stamps, and so on. We also have a situation in which it is more common for both the husband and wife to be employed. Often there are other members of the family who are also employed. It is fair to say that in much of your own district, even in the best of times, the official unemployment figure averages around 8 percent. And yet in those very periods, there are many jobs going begging. There is a certain amount of sophistication in that area with respect to riding the unemployment compensation system among members of a family who move in and out of employment. All of these things contribute to the degree to which we have been able to tolerate the situation.

Now, certainly, the Government and this administration are committed to the relief of outright hardship. But when it comes to the question of whether an individual is really that much better off in the short term by being put into public service jobs versus devoting efforts to stimulating employment through the encouragement of confidence in the overall direction of the private sector, I think the former is rather doubtful. It looks like you are doing something, but when you count whom you have helped and what the cost is, clearly it is false. You know, it is hard to resist the "don't just stand there—do something" syndrome. And I can understand that all right. But, I really think that we also need to look at the other side of it, which is that when we do yield to the impulse, but don't accomplish very much, when it turns out that most of the people who are employed would be employed anyway, and where, according to some estimates, the result of the net increase in jobs is the payment of $90,000 of taxpayers' money per job, then we have the problems of the disillusionment with well-meaning attempts by Government to solve problems that have resulted in a cumulative lack of confidence in the structure itself.

So. I really think that in the present circumstances, unless we are pretty sure that a given proposal is going to work reasonably well, we are probably better off in resisting the impulse and trying to do what we can to improve the performance of the system as a whole.

Representative HECKLER. Well, I might just add in that context, I think that the public works appropriation carries with it both the opportunity for people to work and second to do something productive, rather than merely hold a job; that is, working on the capital improvements badly needed in a community so you are not making work, but actually doing something that the community badly needs. And I think that approach is far preferable to CETA. But, if the administration vetoes both programs and really allows the situation to merely vegetate, I question it personally.

I thank you for your explanation. It does provide clarity. But, I certainly would question whether it is an adequate response to the really significant problems of short-term unemployment.

Thank you, Mr. Secretary.

Representative MOORHEAD. We have another vote on. I presume that you gentlemen would be willing to answer questions submitted to you in writing, would you not? Maybe in the few minutes I have left, I can ask Mr. Butz a few quick questions, which I hope have quick answers.

I am hearing fears from the Midwest and also from California that the drought situation without rain or snow endangers this year's crop. In other words, it is not as optimistic as the testimony you presented to us. Would you want to comment?

Secretary BUTZ. In local area, that is true. It is not general. As is always true in any year, there are localities not as well off as others. I think there is no serious threat at the moment to a sizable production in 1976.

Representative MOORHEAD. Another question, sir. What is the Department of Agriculture doing to correct the breakdown in the quality control over the grain being exported?

Secretary BUTZ. A great deal. We have assigned added inspectors to the gulf ports where the primary product is. We have assigned added supervisors to our graders down there. There is legislation going through the Congress to give the Department added authority. At the present time, the Department does not have the authority to make initial inspections. We can do review inspections. This is the only place in which inspections are done in the private sector, rather than the public sector. It is this legislation comes through, we will have added authority. But, at the moment, I think we are moving in cooperation with the Department of Justice and in cooperation with the District Attorney down there. Mr. Chairman, in cooperation with the FBI also, to correct the situation.

Representative MOORHEAD. Well, thank you very much, gentlemen, for your statements. We will adjourn.

But before I adjourn, I want to say to Secretary Richardson that I do believe that it is possible to have short-run programs to aid unemployment and have them structured in such a way that they would not continue and hence contribute to inflation after we have attained recovery. So, I want to express to you my view that I share the views of Mrs. Heckler and Senator Javits.

Again, thank you very much, gentlemen. I am sorry it has gone so long, but it has been an extremely instructive session to us.

The Joint Economic Committee is adjourned.

[Whereupon, at 4:15 p.m., the committee recessed, to reconvene at 10 a.m., Friday, February 6, 1976.]

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