94TH CONGRESS
2d Session

SENATE

REPORT
No. 94-1372

# THE 1976 MIDYEAR REVIEW OF THE ECONOMY

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## REPORT

OF THE

## JOINT ECONOMIC COMMITTEE
## CONGRESS OF THE UNITED STATES

together with

## MINORITY, SUPPLEMENTAL, AND ADDITIONAL VIEWS

SEPTEMBER 29, 1976

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

77-711 WASHINGTON : 1976

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 85 cents

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In the second quarter the real growth rate fell to 4.5 percent, well below the target rate. Present indications are that third quarter growth has been little, if any, higher and indeed could be somewhat lower. Quarterly fluctuations around an underlying trend are to be expected. However, the persistence of below par economic performance over a six month period must be regarded as a clear signal that the recovery has departed from the desired path.

Examination of available forecasts for 1977 reinforces this conclusion. Estimates prepared by the Committee staff suggest a growth of real output of only 4½ to 5 percent next year. This estimate, which falls within the range of available private forecasts, implies only the most limited reduction in unemployment. The unemployment rate would still be well above 6 percent at the end of next year and could be as high as 7. This would be far short of the Committee's goal, stated in its 1976 annual report, published in March, of reducing unemployment to 6 percent or less by that time. Real output would be about 3 percent or nearly $55 billion below our recommended target (measured in 1976 prices). It would be a full 10 percent or $180 billion below its potential.

Reasonable progress toward full employment and full resource utilization has not been made in the past six months and does not appear to be in prospect for next year. The goals previously set by the Joint Economic Committee of bringing output to within 7 percent of its potential and reducing unemployment to 6 percent or less by the end of next year remain appropriate targets. The necessary policy steps should be taken to put the economy back on track toward these goals.

## THE RECOVERY TO DATE

During the year ending with the second quarter of 1976 real output grew 7.0 percent. Unemployment was reduced from 8.7 to 7.4 percent (quarterly averages) but since has risen to 7.9 percent. As shown in Chart 1, the pace of recovery has been about average when compared to previous postwar recovery periods. However, because this recession was so much deeper than the others, an average recovery has been insufficient to restore the economy to anything approaching a satisfactory level of resource utilization. Not only did the unemployment rate in the second quarter still exceed the peak quarter of any previous recession, but manufacturing capacity was far from fully utilized and the overall economy was operating about 11 percent below its potential.

94TH CONGRESS, 2d Session } SENATE { REPORT No. 94-1372

# 1976 MIDYEAR REVIEW OF THE ECONOMY

SEPTEMBER 27, 1976.—Ordered to be printed with illustrations

Mr. HUMPHREY, from the Joint Economic Committee, submitted the following

## REPORT

together with

## MINORITY, SUPPLEMENTAL AND ADDITIONAL VIEWS

(Pursuant to sec. 5(b) of Public Law 304, 79th Congress)

This Report is submitted in accordance with the continuing responsibility of the Joint Economic Committee to apprise the Congress of economic circumstances and make such recommendations as it deems advisable.

### I. INTRODUCTION

In 1974 and early 1975, the U.S. economy experienced its worst recession in nearly 40 years. The consequences of that recession inevitably remain with us, measured in terms of economic imbalance and human suffering. It will be several years, at best, before those consequences can be eradicated.

Although there has been recovery during the past year, the record provides little basis for complacency or self-congratulation. Production growth has been only about average compared to previous postwar recoveries, despite the much greater decline. Much of that growth has consisted simply of inventory rebuilding. Business fixed investment and residential construction have lagged badly and remain depressed sectors.

The recovery was sparked at least in part by the tax reduction passed by Congress in the spring of 1975. This stimulus has largely run its course, and, with fiscal policy recently turning somewhat more restrictive, such modest strength as the recovery has shown now appears to be weakening. Production growth has slowed, and unemployment recently has risen to the highest level since last December. Con-

trary to an apparently widespread impression, this high and rising unemployment is not limited to young people and women newly entering the labor force, but is widespread among all labor force groups.

It is possible, of course, that some unanticipated source of strength in the economy will emerge autonomously and give new vigor to the recovery. No such prospect presently is visible on the horizon, however. No sector of the economy holds real promise of unusual strength in the near term: personal consumption spending will be limited by the eroding effect of inflation on real incomes, business investment as yet shows few signs of its long-awaited revival, high costs of home building and home ownership limit the potential expansion of residential construction, financial stringency as well as smaller school populations argue against rapid growth of State and local government spending, and planned Federal budget policy will be only neutral in its economic impact.

The prospect which emerges is one of below par economic performance. Real gross national product (GNP) may rise between 4 and 5 percent next year. This will be sufficient to absorb labor force growth and trend productivity gains, but it will not produce much reduction in unemployment. The unemployment rate, which it now appears will average at least 7.5 percent this year, would still average 7 percent or more next year. At the same time, inflation would continue at a rate of 5 percent or more—an improvement from the recent past, to be sure, but far from the degree of price stability which has been the postwar historical norm in this country.

The above projection assumes the continuation of current policies. It is not a satisfactory outlook. It represents a clear departure from the growth path which is essential if reasonably full employment is to be regained by the end of this decade.

This Committee has responsibility under the Employment Act of 1946 to advise the Congress whenever action is needed to promote "maximum employment, production and purchasing power." This is such a moment. While our forecast for expected growth of GNP during the next year is similar to that of other observers, we do not share the feeling of apparent satisfaction which has been expressed by Administration spokesmen and some private observers. Economic performance can and must be improved. Action will be needed in the months ahead to put the recovery back on track.

We have sounded such alarms before. In March of 1974, for example, we analyzed the impending recessionary consequences of world oil price increases and recommended an offsetting tax reduction. Unfortunately, the Administration failed to recognize the recessionary danger and actually proposed a tax increase in the fall of 1974. Tragically, a full year was allowed to pass before taxes were in fact reduced. As a consequence, the recession was far more severe than it need have been.

The Members of this Committee derive no pleasure from periodically serving as the bearers of bad news, but when economic problem emerge—and threaten to grow worse rather than better—warnings

must be sounded and action taken. It is for this reason that we want to focus attention on the poor economic prospects which lie ahead in the absence of policy changes.

We recognize that the adoption of major new initiatives will in all probability await the outcome of the November elections and the convening of a new Congress in January. New steps taken early in 1977 could begin to have important effects on the economy by mid-year. With many observers expecting the economy to weaken further after mid-1977 and to be quite weak in 1978, such action would be timely.

The months from now until January offer a valuable opportunity to develop and debate the new policies which are needed. This report attempts to lay out the reasons new policies are needed, the dimensions of the tasks which must be undertaken, and the policy alternatives which deserve the most serious and urgent consideration.

The months prior to January are not only a period for debate. There are numerous actions which the President can and should take now under existing legislative authority, particularly in the area of promoting greater price stability. The Federal Reserve's monetary policy actions will be, as always, a crucial factor in the health of the economy.

The economic policy of the present Administration is heavily influenced by the belief that rapid reduction in unemployment inevitably would produce serious inflationary consequences. We disagree. An extraordinarily high percentage of available labor and plant capacity remains idle. The emergence within the next year of new inflationary pressures stemming from excess demand on productive resources is the remotest of possibilities. Far more threatening are the inflationary implications of a sluggish economic performance which dampens productivity gains and forces willing workers to remain on unemployment compensation or welfare. In this report, we reaffirm our belief that, in the near term, a more rapid rate of economic growth would be anti-inflationary as well as essential for reducing unemployment.

## II. How Firm Is the Economic Recovery?

The period from the second quarter of 1975 to the second quarter of 1976 was a year of steady, but far from spectacular, recovery from the very deep recession of 1974 and early 1975. However, developments in the second quarter of this year and available data for the third quarter indicate that the recovery is no longer continuing at a satisfactory pace. New policies are needed to put the recovery back on track.

### GOALS FOR CONTINUED RECOVERY

As we have stressed in previous reports, continued strong growth of real output is essential to satisfactory progress toward full utilization of both labor and capital. More specifically, we have recommended a target of a steady 7 percent annual growth rate for real output through the end of next year.

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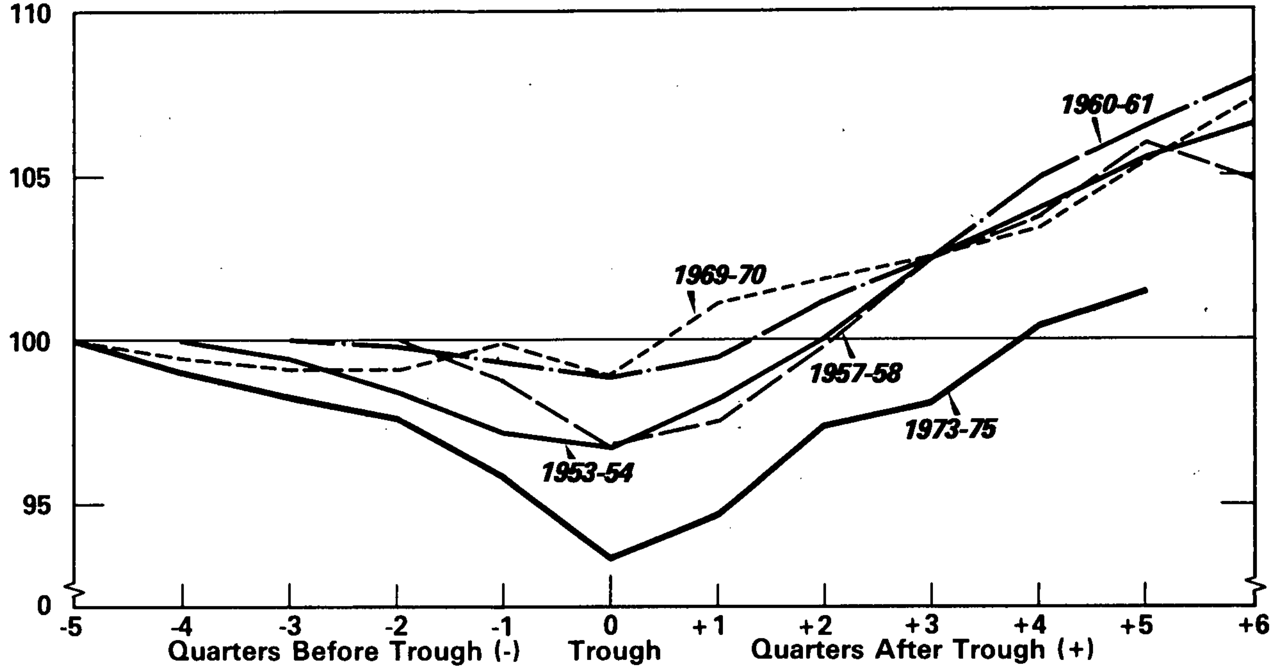
CHART 1

# POSTWAR RECESSION AND RECOVERY PATHS

(Indexes of GNP in 1972 dollars, previous peak = 100)




Source: U.S. Department of Commerce

*Recent Indicators.*—Available data for recent months indicate a definite slowing of the rate of economic expansion. Retail sales showed no growth from April through July and if adjusted for price increases actually fell nearly 2 percent. Advance data for August indicate a strong pickup in retail sales, but this early data often undergoes substantial revision.

Inventories rose fairly strongly during the April-July period, probably in part representing unintended accumulation due to poor sales. With poor sales and accumulating inventories, growth of industrial production in June, July, and August fell below a 6 percent annual rate. This compares with a 13 percent increase during the previous year and is the smallest three month gain experienced at any time during the recovery to date.

Housing starts, building permits, and total construction spending also have shown little growth. For the past year, monthly housing start figures have fluctuated within a range of 1.24 to 1.54 million (annual rate). Figures for the most recent three months (June–August), though still within this range, do suggest a modest upward trend, as do building permit data for July and August. However, housing starts remain far below prerecession levels of 2 million and above. Total new construction spending has been essentially flat for the past six months (February–July). After correction for inflation, construction spending in July was actually below year earlier levels.

Labor market data present not just a slow rate of improvement, but in many respects an actual deterioration. The overall unemployment rate has risen from 7.3 percent in May to 7.9 percent in August. This increase in unemployment has been shared by all major groups in the labor force. Growth of employment has continued, but at a reduced rate. The index of aggregate private nonfarm production hours worked has not risen since May, and private nonfarm payroll employment was lower in August than it was two years earlier in August 1974.

In sum, it will require very strong performance in September to produce a third quarter growth rate even equal to the disappointing rate of the second quarter. In fact, another drop in the growth rate in the third quarter is a strong possibility.

*Employment and Unemployment.*—After declining quite rapidly in the second half of 1975 and early 1976, the unemployment rate has increased steadily since May when it reached a low point of 7.3 percent. In August, the unemployment rate rose to 7.9 percent, the highest level in 1976. The sticky nature of the unemployment rate thus far in 1976 is consistent with the sharp slowdown in real growth during the second quarter and the preliminary evidence that third quarter production growth is no higher.

Also contributing to a continuing high unemployment rate has been a strong increase in the labor force. Since January 1976, the labor force has grown by 1.8 million, or at an annual rate of almost 4 percent. While labor force growth usually picks up as an economic recovery progresses, the recent increases have exceeded those in any past

recovery and have exceeded recent projections which took into account the continuing increases in labor force participation rates of adult women.

Monthly changes in the labor force, employment, and unemployment sometimes can be quite erratic. A temporary slowing of labor force growth during the next few months would not be surprising. If so, only modest growth of employment would cause unemployment to drop. A drop in unemployment coming from strong employment growth and occurring despite continued labor force growthh would be a clearer indicator of economic strength, however.

The overall unemployment rate, even though distressingly high, masks the much greater labor market difficulties suffered by some groups which still experienced double-digit unemployment rates. In August, the unemployment rate for white teenagers exceeded 17 percent, and for black teenagers it was over 40 percent. The unemployment rate for blue-collar workers was close to 10 percent, and among construction workers it was 17 percent.

The claim by some that unemployment has remained high largely because the women and teenagers who have entered the labor force cannot find jobs is not borne out by the available data. While it is true that adult women have been entering the labor force in record numbers, they are also finding jobs in record numbers. The fact is that unemployment remains very high for all labor force groups.

As shown in Table 1, the adult male unemployment rate is still close to double the rate prevailing when the overall unemployment was at its October 1973 prerecession low. The rate for adult women is 70 percent above October 1973, a proportionately smalled increase. Unemployment rates for household heads—both male and female—are almost twice as high as those prevailing in October 1973.

The unemployment rate for adult women is still substantially above the rate for men, but the relative difference is less than it was prior to the recession. This is at least partly attributable to much higher employment gains among women. From May 1975 to May 1976, the employment of women increased by 1,633,000 while the employment of men rose only 1,172,000. As Table 2 demonstrates, this is partly due to the fact that industries where women traditionally hold a high percentage of jobs have been expanding relatively rapidly. Employment of women in finance, services, and public administration has increased during the period of almost 940,000 accounting for more than half of the total gain in women's employment.

The expansion of traditional clerical jobs, however, does not entirely explain the more rapid rise in female employment. In both durable and nondurable manufacturing, the gains in female employment have outstripped those in male employment even though men traditionally hold a 3 to 1 advantage in total manufacturing employment. Whether this represents more aggressive job search by women, the regaining of ground lost in particular industries during the recession, or particular employment patterns of manufacturing industries where women predominate has not been determined.

TABLE 1.—SELECTED UNEMPLOYMENT RATES

| | October 1973 (prerecession low) | May 1975 (recession peak) | August 1976 (latest) | Percent change in unemployment rate, October 1973 to August 1976 |
|---|---|---|---|---|
| All workers | 4.7 | 8.9 | 7.9 | 68 |
| Adult men | 3.1 | 7.2 | 5.9 | 90 |
| Adult women | 4.5 | 8.4 | 7.7 | 71 |
| Both sexes ages 16 to 19 | 14.3 | 20.3 | 19.7 | 38 |
| White | 4.2 | 8.3 | 7.1 | 69 |
| Black and other | 8.5 | 14.2 | 13.6 | 60 |
| Household heads | 2.7 | 6.1 | 5.2 | 93 |
| White collar | 2.7 | 5.3 | 5.0 | 85 |
| Blue collar | 5.3 | 12.8 | 9.8 | 85 |
| Construction | 8.9 | 20.9 | 17.1 | 92 |

Source: Department of Labor, Bureau of Labor Statistics.

TABLE 2.—EMPLOYMENT CHANGES BY INDUSTRY AND SEX MAY 1975 TO MAY 1976

| Industry group | Change in adult employment [1] (thousands) | | Percent change in adult employment [1] | |
|---|---|---|---|---|
| | Male | Female | Male | Female |
| Total | 1,172 | 1,633 | 2.9 | 6.1 |
| Mining | −5 | −4 | −7.5 | −5.6 |
| Construction | 70 | 39 | 2.0 | 23.0 |
| Manufacturing | 399 | 495 | 3.1 | 10.0 |
| Transportation | 31 | 8 | .8 | .7 |
| Trade | 271 | 158 | 3.8 | 2.9 |
| Finance | −36 | 180 | −1.8 | 8.7 |
| Services | 431 | 718 | 6.1 | 6.3 |
| Public administration | 11 | 39 | .4 | 2.7 |

[1] Persons 20 years of age and over.

Source: Department of Labor, Bureau of Labor Statistics.

The sluggish performance of the economy during the second and third quarters of this year has left the unemployment rate on a very high plateau. Even assuming a pickup in economic activity during the fourth quarter, the unemployment rate is likely to remain above 7 percent at the end of 1976 and average close to 7.5 percent for the year as a whole. Administration economists and many private economists had forecast an unemployment rate below 7 percent at the end of this year. However, given the 7.9 percent rate prevailing in August, it is highly unlikely that employment could increase enough to reduce the rate by a full percentage point. Even assuming that the labor force does not grow at all in the last four months of the year, which is improbable, employment would have to grow by 1 million in these four months, or at an annual rate of 3 million.

It is more likely that the unemployment rate will be well above 7 percent at the end of the year. Given the modest growth of the economy which is likely for 1977, the unemployment rate will drop very gradually at best. Due to expected labor force growth and productivity gains, the economy must grow 3½ to 4 percent next year to maintain a constant unemployment rate. An additional 3 percent growth is needed to reduce the unemployment rate by 1 percentage point. Thus,

if the unemployment rate is above 7 percent at the end of 1976 it is likely to still be 6½ percent or above at the end of next year unless real GNP growth exceeds the 4 to 5 percent range.

*Legislative Action to Create Jobs in 1977.*—Before the end of this session, Congress is expected to complete action on three major pieces of employment-related legislation: H.R. 14232, the Labor-HEW appropriation bill which contains funding for Titles I and II of the Comprehensive Employment and Training Act (CETA); H.R. 12987, authorizations for Title VI of CETA; and H.R. 15194, the appropriation bill for emergency public works jobs and countercyclical grants to State and local governments.

Title I of CETA provides for a varied set of employment and training services. These include testing and placement, classroom and on-the-job training, work experience programs, support services, and limited transitional public employment programs for the economically disadvantaged. In fiscal 1975 and 1976, Title I was funded at a $1.58 billion level. The President's budget recommended the same level of funding in fiscal 1977. The congressional conference committee agreement on H.R. 14232, which contains Title I funding, proposes to increase the fiscal 1977 level to $1.88 billion.

Title II of CETA primarily provides public service jobs in areas of high unemployment (those with unemployment rates of 6.5 percent or more for at least three months). In fiscal 1975 and 1976 $400 million was appropriated for 60,000 jobs. For fiscal 1977 both the Administration and the Senate-House conference committee have recommended continuing the appropriation at the $400 million level, which would fund about 56,000 jobs.

In the case of Title VI of CETA, the temporary emergency public jobs program, the President's recommendations differ sharply from those contained in the Congressional Budget. In fiscal 1975 and 1976, Title VI was funded at $875 million and $1.625 billion respectively. The Administration wishes to phase out the public service jobs created under Title VI beginning in January 1977. However, H.R. 12987 authorizing the continuation of Title VI has passed both Houses by substantial margins and has been reported out of conference. The Second Concurrent Resolution on the fiscal 1977 budget allows for $3.5 billion to create roughly 500,000 jobs, in contrast to the current level of 260,000 jobs. However, the actual appropriations bills have not reached the House or Senate floor.

Finally, the emergency public works appropriation bill would also provide a substantial number of jobs. Conferees have agreed on a $3.7 billion appropriation: $2 billion for Title I, public works projects to be approved by the Secretary of Commerce through the Economic Development Administration; $1.25 billion under Title II, countercyclical grants to State and local governments; and $480 million under Title III for waste water treatment. Estimates of the number of jobs that would be created under this legislation vary widely, from a low of 160,000 jobs estimated by the Administration to 400,000 jobs claimed by the bill's sponsors. Although the President vetoed the public works authorization bill, that veto was overridden by substantial margins.

In sum, congressional action could create more than 700,000 jobs in fiscal 1977 which would not have been created if the President's budget were enacted: 500,000 jobs under Title VI of CETA plus a conservative estimate of roughly 250,000 jobs under the emergency public works bill.[1] There is no disagreement between the Administration and Congress on Title II of CETA, which funds slightly more than 50,000 jobs, so that these would be available in any event.

*Prices and Incomes.*—Real income grew only modestly during the year ending in the second quarter of 1976. This undoubtedly has contributed to the present slowing of the economic recovery.

As shown in Table 3 real hourly earnings grew only 1.4 percent from the second quarter of 1975 to the second quarter of 1976. Real disposable income per capita grew 1.6 percent. In the previous 12 month period, real hourly earnings fell, but due to the boost provided by the spring 1975 reduction in personal income taxes, real disposable income per capita rose 2.7 percent.

TABLE 3.—CHANGES IN WAGES, PRICES, AND PRODUCTIVITY (PERCENT CHANGE FROM FOUR QUARTERS EARLIER)

| | 1974: II | 1975: II | 1976: II |
|---|---|---|---|
| Output per hour [1] | −3.2 | 1.5 | 4.5 |
| Compensation per hour [1] | 9.1 | 10.5 | 8.0 |
| Unit labor costs [1] | 12.7 | 8.9 | 3.3 |
| Wholesale Industrial Prices [2] | 21.9 | 11.1 | 6.2 |
| Gross National Product Deflator | 9.5 | 9.8 | 5.6 |
| Consumer Prices: All Items [2] | 11.0 | 9.3 | 5.9 |
| Food [2] | 14.7 | 8.8 | 3.7 |
| Nonfood commodities [2] | 10.6 | 9.3 | 5.1 |
| Services [2] | 9.3 | 9.8 | 8.3 |
| Hourly earnings index: | | | |
| Current dollars [2] | 7.8 | 9.1 | 7.5 |
| 1967 dollars [2] | −2.5 | −0.6 | 1.4 |
| Real disposable income: | | | |
| Total | −1.4 | 3.5 | 2.4 |
| Per capita | −2.1 | 2.7 | |

[1] Private nonfarm business sector.
[2] Percent change during 12 months ending in June.

Source: Department of Labor, Bureau of Labor Statistics.

The modest growth of real income during the past year compares with a trend growth rate of slightly over 2 percent per year during the 1950s and 1960s. At least part of the explanation for these limited income gains lies in the continued advance of prices at a rate considerably in excess of unit labor costs. As also shown in Table 3, unit labor costs rose only 3.3 percent in the year ending with the second quarter while consumer prices rose nearly 6 percent. Such a pattern is not necessarily unusual for a recovery period, when productivity gains are strong and producers are seeking to restore profit margins wiped out during the recession. During the coming year, it is reasonable to expect a closer correspondence between changes in unit labor costs and in prices. Based on the pattern of past recoveries, however, prices may continue to rise somewhat faster than unit labor costs. If

[1] Senator Proxmire states, "On the basis of the hearing record before the Housing and Urban Development Subcommittee of the Appropriations Committee, it seems extremely doubtful that most of these jobs would be available in fiscal 1977."

the average rate of wage increase remains in the 7 to 7½ percent range established in recent quarters and if normal productivity gains are realized, this suggests a rate of price increase of about 5 percent.

Of course, labor costs are not the only determinant of price increases. In 1977, however, other major influences may be roughly offsetting. Energy price increases will continue to place upward pressure on the overall price level, but the expected good crop year should help hold the rise in consumer food prices somewhat below the overall rate of price increase.

The expected pattern of employment growth and wage and price changes would lead to growth of total real disposable income in the neighborhood of 4 percent next year. The increase in real before-tax wage and salary income would be larger, but because of the progressivity of the personal income tax, effective tax rates will rise as money incomes grow. Also the growth of transfer payments will diminish slightly due to the expected small drop in unemployment.

Growth of real consumer spending in line with this rate of disposable income growth would be adequate to sustain an economy already at full employment but it will not provide the extra boost needed to narrow the present gap between the actual and full employment levels of output. A reduction in the personal savings rate would produce somewhat faster consumption growth. As described below, our forecast assumes some drop in the savings rate.

## THE OUTLOOK FOR 1977

At present, 1977 appears to offer little prospect of adequate progress toward the higher levels of resource utilization and lower unemployment which we have recommended. As already noted, real output may grow about 4½ to 5 percent next year, and this would produce only a small drop in unemployment. This assessment assumes continuation of current policies. New policy initiatives, if adopted promptly, can bring about a significant improvement in this outlook.

In understanding the causes of this slower pace of recovery, it should be remembered that much of the strong growth of the past year has been caused by the swing from inventory reduction to inventory rebuilding. Of the 7.0 percent growth of real output during the past four quarters, 2.6 percentage points, or about one third, came from this swing in inventories. As shown in Table 4, the growth rate for final sales (that is, all components of gross national product other than changes in business inventories) has fluctuated within the rather narrow range of 3.7 to 4.9 percent during the past four quarters. It seems reasonable to expect growth of final sales to continue in this range over the next year. However, without the extra boost which has been temporarily provided by inventory rebuilding, this growth rate is simply insufficient to achieve reasonably rapid reductions in unemployment.

TABLE 4.—COMPONENTS OF REAL GROSS NATIONAL PRODUCT

[Billions of 1972 dollars; quarterly totals at seasonally adjusted annual rates]

| | 1975 | | 1976 | |
|---|---|---|---|---|
| | III | IV | I | II |
| Personal consumption expenditures | 775.3 | 783.9 | 800.7 | 808.6 |
| Percent change | (4.1) | (4.5) | (8.9) | (4.0) |
| Business fixed investment | 110.1 | 110.5 | 112.6 | 114.9 |
| Percent change | (−1.8) | (1.5) | (7.8) | (8.4) |
| Residential construction | 39.6 | 41.9 | 44.1 | 45.7 |
| Net exports | 22.8 | 23.1 | 16.6 | 16.0 |
| Federal, State and local government purchases | 262.4 | 265.2 | 261.9 | 263.6 |
| Total final sales | 1,210.2 | 1,224.7 | 1,235.9 | 1,248.8 |
| Percent change | (4.1) | (4.9) | (3.7) | (4.2) |
| Change in business inventories | −1.0 | −5.5 | 10.4 | 11.1 |
| Total real GNP | 1,209.2 | 1,219.2 | 1,246.3 | 1,260.0 |
| Percent change | (11.4) | (3.3) | (9.2) | (4.5) |

Source: Department of Commerce, Bureau of Economic Analysis.

It should also be noted that the government sector, which has sometimes been the leading growth sector of the economy in past recoveries, is no longer playing that role. Combined Federal, State, and local government purchases have grown scarcely at all in real terms over the past four quarters. As discussed in more detail below, this pattern is expected to continue.

Thus, if there is to be strong growth over the next year without a change in policy, it must come from final sales in the private economy. While an extraordinary surge of new strength in the private economy is not impossible, it presently seems rather improbable. The outlook for the major sectors of the private economy is discussed below.

*Personal Consumption.*—The weakness in retail sales in the past few months is surprising, and we regard this as at least partially a temporary phenomenon. Over the next year personal consumption spending may well grow slightly faster than disposable income, producing a small drop in the personal savings rate.

Savings rates of about 6 percent were typical in the 1950s and 1960s but during the first half of the 1970s the personal savings rate has averaged 7.4 percent. The 7.0 percent savings rate of the first half of this year is already below the average for this decade. Some further reduction in savings can be expected as fears of runaway inflation diminish, but a dramatic shift seems unlikely. As discussed above, real income gains in recent months have been quite modest, and no marked pickup seems in prospect. Hence there are limits on the rate at which personal consumption spending can reasonably be expected to rise.

*Business Investment.*—A strong recovery in business investment could produce a stronger overall economy next year. Thus far, this recovery has failed to materialize. Business investment normally lags behind a general upturn in the economy, but the current lag already has become the longest of any post-war economic recovery. Table 5 compares recent investment performance with investment behavior during previous recoveries.

Two interrelated questions need to be examined: why has investment growth been so slow in the current recovery? Does this represent a postponement of investment or a lowering of the trend? Unfortunately the answers to these questions are not clear.

Economic indicators which normally improve preceding an upturn in investment include such things as corporate profits. availability of credit, and new orders. All of these indicators have improved significantly in the past year without having the expected impact on business investment. New nondefense orders for capital goods have shown an unusually strong 25 percent increase in the past year, but so far this has not been fully reflected in increased investment. If investment simply has been postponed, it should pick up sharply next year, and our forecast for next year assumes that a strong pickup takes place.

TABLE 5.—CHANGE IN REAL NONRESIDENTIAL FIXED INVESTMENT IN 5 QUARTERS FOLLOWING ECONOMIC TROUGH

[In percent]

| Period | Total real nonresidential fixed investment | Structures | Producers durable equipment |
|---|---|---|---|
| 1954:2-55:3 | 15.1 | 8.9 | 19.9 |
| 1958:1-59:2 | 2.0 | −2.9 | 6.2 |
| 1961:1-62:2 | 11.4 | 4.1 | 17.8 |
| 1970:4-72:1 | 6.9 | −.2 | 11.4 |
| 1975:1-76:2 | .4 | 1.1 | .1 |

Source: Department of Commerce, Bureau of Economic Analysis.

The other possible explanation for the lag in investment spending is that trends in investment have changed. The 1973–75 recession may have been so severe that it has altered perceptions about the need to invest and has shaken confidence in our future prospects for growth. The high cost of credit and the high rates of inflation throughout the recession coupled with a sluggish recovery performance may have severely depressed businessmen's expectations about future profit levels. Throughout 1975 profits increased rapidly—over 53 percent from the first quarter of 1975 to the first quarter of 1976. Even so, although corporate cash flow is high, it is only within the past year that profits (including inventory valuation adjustment and capital consumption allowances) have exceeded their 1973 level in current dollars. When adjusted for inflation, profits are still below 1973 levels. Further, in the second quarter of this year profits after tax showed virtually no improvement over the first quarter.

If this possibility that the investment trend has been lowered proves correct—and it is still too early to tell—it could have severe consequences for our economic future. In order to restore full employment and to continue enjoying the productivity gains necessary for rising standards of living, the capital stock must grow faster than the labor force.

The latest Commerce Department survey of business spending plans for the current year, conducted in late July and August, shows little change from earlier surveys. In current dollars, business spending for new plant and equipment is expected to average 7.4 percent higher this year than last. If the relatively low rate of price increase of the past six months can be sustained, this implies an increase in real investment of between 2 and 3 percent. The Commerce Department survey has proved quite accurate in the past. Thus the evidence now seems

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fairly conclusive that no strong pickup in business investment will occur before next year.

*Residential Investment.*—Housing starts should continue at a rate of approximately 1.5 million for the rest of this year and rise modestly to an average of perhaps 1.7 million next year. High housing prices, high mortgage interest rates, and the absence of a strong recovery in multifamily construction will continue to act as depressants on the pace of the housing recovery. These factors will limit the recovery in real residential investment and further delay progress toward meeting our national housing goals.

*Foreign Sector.*—The strong U.S. trade balance produced by the recession has been diminishing steadily in the last four quarters. Both exports and imports fell in real terms during the recession and rose during the recovery, but, as shown in Table 6, the swing in imports was by far the more dramatic, producing major shifts in net exports. During the next several quarters, exports should continue to grow fairly steadily, reflecting the continuation of economic recovery abroad and strong demand for agricultural exports. Given our expectation of only a modest pace of expansion in the United States, import growth should slow to a rate about equal to export growth. This will produce an approximate balance between exports and imports (measured in current dollars) in 1977.

TABLE 6.—CHANGES IN EXPORTS AND IMPORTS

| | 1974: II | 1975: II | 1976: II |
|---|---|---|---|
| Percent change from 4 quarters earlier in real volume of: | | | |
| Exports | +14.5 | −11.1 | +8.8 |
| Imports | +4.1 | −24.3 | +25.2 |
| Net exports (billions of current dollars) | $3.9 | $24.4 | $9.3 |

Source: Department of Commerce, Bureau of Economic Analysis.

*The Federal Government Sector.*—As shown in Table 7 the actual Federal deficit for fiscal year 1976, which ended June 30, turned out to be approximately $10 billion less than had been anticipated by either the Administration or the Congress. This shortfall, which was due largely to lower than expected spending, has at least temporarily moved fiscal policy in an unintended restrictive direction. Two reasons for this lower than expected spending have been suggested: (1) a change in the timing of spending due to the new October 1 starting date for the fiscal year and (2) a reduction in the actual rate of spending. The relative importance of each of these two factors has not yet been determined.

It is not unusual for the rate of Federal spending to increase as the end of the fiscal year approaches. Often the authority to spend funds expires at the end of the fiscal year and monies which have not been spent revert back to the Treasury. Because the starting date for the fiscal year was changed from July 1 to October 1, spending authority for fiscal year 1975 and the transition quarter was passed at the same time. This means agencies in effect have a five-quarter year. Much of the spending increase which normally occurs in the final quarter of the fiscal year probably has been pushed into that fifth quarter—the transition quarter. However, because this timing change is a one-time

event, there is no way to anticipate accurately the extent to which this has occurred.

In mid-September, Congress approved the Second Concurrent Resolution of the 1977 budget. This resolution establishes legally binding totals for Federal receipts and expenditures. The totals, which are little changed from the preliminary targets set last May, provide for outlays of $413.1 billion and receipts of $362.5 billion. This will produce an estimated deficit of $50.6 billion. As discussed below, this deficit will result entirely from the reduced receipts and extra outlays associated with continuing high levels of unemployment.

TABLE 7.—FEDERAL RECEIPTS AND OUTLAYS, FISCAL YEAR 1976

[Unified basis, billions of dollars]

| | Administration estimate, January 1976 | Congressional 2d concurrent resolution for fiscal 1976 | Actual |
|---|---|---|---|
| Receipts | 297.5 | 300.8 | 300.0 |
| Outlays | 373.5 | 375.6 | 365.6 |
| Deficit | 76.0 | 74.8 | 65.6 |

Sources: Budget of the U.S. Government, fiscal year 1977; 2d Concurrent Resolution on the Budget; Final Treasury Statement of Receipts and Outlays of the United States Government for fiscal year 1976.

Table 8 presents estimates of the full employment budget, that is, of the receipts and spending which would occur if the unemployment rate could be held constant at 4 percent. The estimates of actual spending contained in the Second Concurrent Resolution have been used as a basis for this table. The table further assumes, as does the Second Concurrent Resolution, that the tax legislation agreed to by the Conference Committee on the Tax Reform Act of 1976 becomes law. This legislation is estimated to increase receipts by $1.6 billion in fiscal 1977. Congress is also considering legislation which would increase unemployment taxes and reduce the current deficit in the trust funds. The bill passed by the House of Representatives would increase revenues $0.4 billion in fiscal 1977; it has not yet been considered by the Senate. The receipt estimates shown in Table 8 should be adjusted upward by this amount if the bill becomes law.

Having considered all of the factors noted above, these estimates show that, if we were at full employment, the budget would be approximately in balance throughout fiscal 1977, compared to a deficit of about $4.5 billion in the last half of fiscal 1976 and the transition quarter. Thus, following a small move toward restriction, congressional budget policy will be approximately neutral during the course of fiscal 1977. That is, the Federal Government will provide neither stimulus nor restraint to economic growth. This assumes, however, that actual spending is at Budget Resolution levels. If spending drops below these levels, as in fiscal 1976, budget policy would unintentionally become more restrictive.

*State and Local Government.*—State and local government purchases of goods and services should continue to grow at an annual rate of 2 to 3 percent in real terms. Several factors are responsible for holding growth to this modest rate. Real State and local government con-

struction expenditures should remain constant or decline slightly as the demand for highway and educational facilities stabilizes. Expenditures for employee compensation will expand modestly as State and local government employment grows slowly and salaries stabilize. Taxpayers are increasingly unwilling to support State and local tax increases that are required to finance larger increases in State and local purchases of goods and services.

TABLE 8.—FULL EMPLOYMENT BUDGET

[National income accounts basis, billions of dollars, seasonally adjusted annual rate]

| | Fiscal year 1976 2d half | Transition quarter | Fiscal year 1977 | |
|---|---|---|---|---|
| | | | 1st half | 2d half |
| Receipts | 367.1 | 383.6 | 403.4 | 426.4 |
| Expenditures | 371.7 | 388.0 | 403.1 | 427.0 |
| Surplus (+), deficit (−) | −4.6 | −4.4 | +0.3 | −.6 |

Source: Joint Economic Committee.

*Summing Up The Outlook.*—The forecast we have presented makes relatively optimistic assumptions for all sectors of the private economy except residential construction, the continued sluggishness of which is now apparent. As noted, even using these optimistic assumptions, the prospect is for only a small reduction in unemployment next year.

Should consumers decide to raise rather than lower their savings rates, should business investment fail to pick up strongly or should exports grow more slowly than we have assumed, a situation could emerge in which unemployment actually rises further. Unfortunately, this is not a prospect which can be dismissed as implausible, even improbable.

We have already indicated that policy measures to strengthen the economy are needed. The questions are how strong these measures should be and what form they should take. The options which merit prompt and serious consideration are discussed in Chapter III.

## FULL EMPLOYMENT BY 1980: THE DIMENSIONS OF THE CHALLENGES

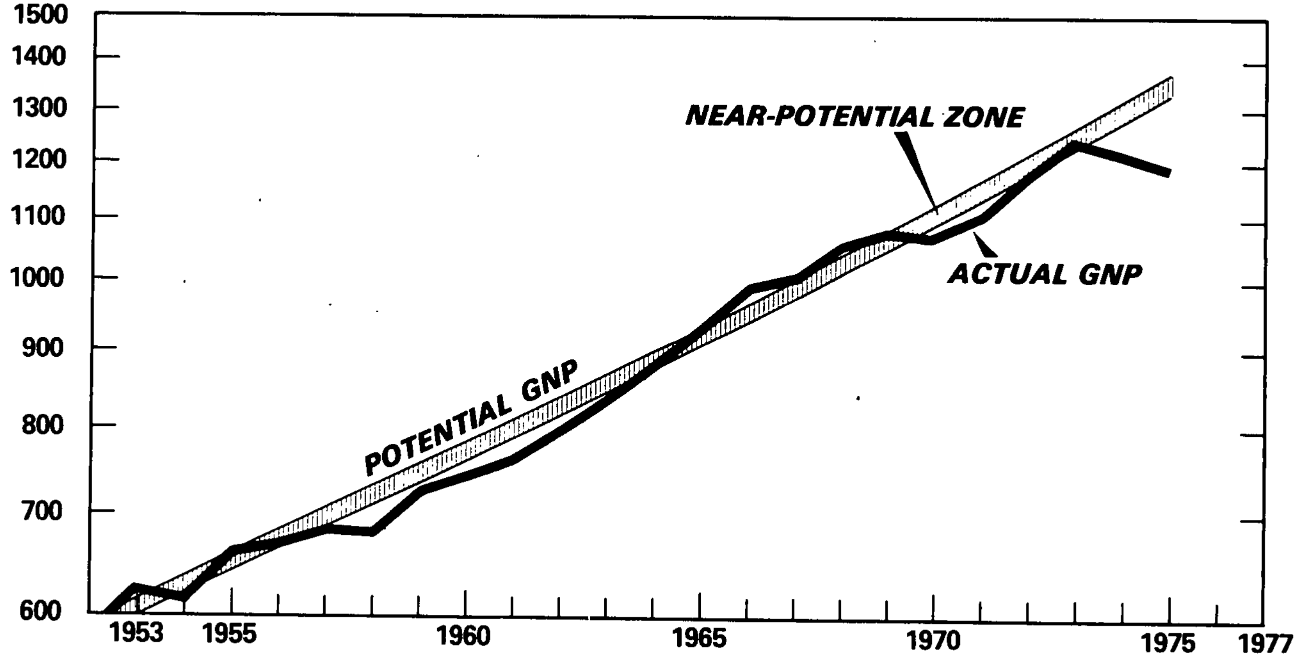
The 1974–75 recession created a mammoth gap between actual and potential output. As shown in Chart 2, no other recent recession approached similar dimensions. The shaded portion of Chart 2 depicts the zone in which output levels are within 3 percent of potenial; that is, the zone associated with an unemployment rate between 4 and 5 percent. Prior to 1974–75, the largest departures from this zone were in early 1958 when actual output fell 7.8 percent below its potential and in early 1961 when the gap reaches 7.5 percent. In early 1975 output sank 13.9 percent below potential.

A gap of this magnitude, at best, can be closed only gradually. In previous reports, we have recommended that policy be directed toward bringing the economy into its potential zone before 1980. To do so will require that the economy grow more rapidly over a sustained five-year period than at any time in our postwar history. Given the present extent of unused capacity, however, this should be an achievable goal.

CHART 2

# ACTUAL AND POTENTIAL GROSS NATIONAL PRODUCT

Billions of 1972 Dollars




Sources: Department of Commerce and Council of Economic Advisers

It may seem strange that a gap which developed so quickly can be closed only over a period of years. It must be understood that the productive potential of the economy is growing all the time due to growth of the labor force and gains in productivity. From 1975 to 1980 employment will need to expand by about 12 million jobs—or about 14 percent—if both new labor force entrants and those thrown out of work by the 1974–75 recession are to have jobs. Average output per worker is expected to rise about 20 percent over this period, and total output will have to grow 35 percent, or an average of about 6 percent per year, if reasonably full employment is to be achieved by 1980. The strongest previous five-year period of economic growth since World War II occurred between 1961 and 1966 when output grew 30 percent, or about 5.4 percent per year.

It would not be desirable for the economy to grow at a steady 6 percent rate throughout this period. Rather the aim should be to grow more rapidly now, while the volume of idle resources is so large, and at a more moderate pace toward the end of the decade, thus avoiding inflationary pressures which might be produced by temporarily excessive demands on individual sectors of an economy nearing full employment.

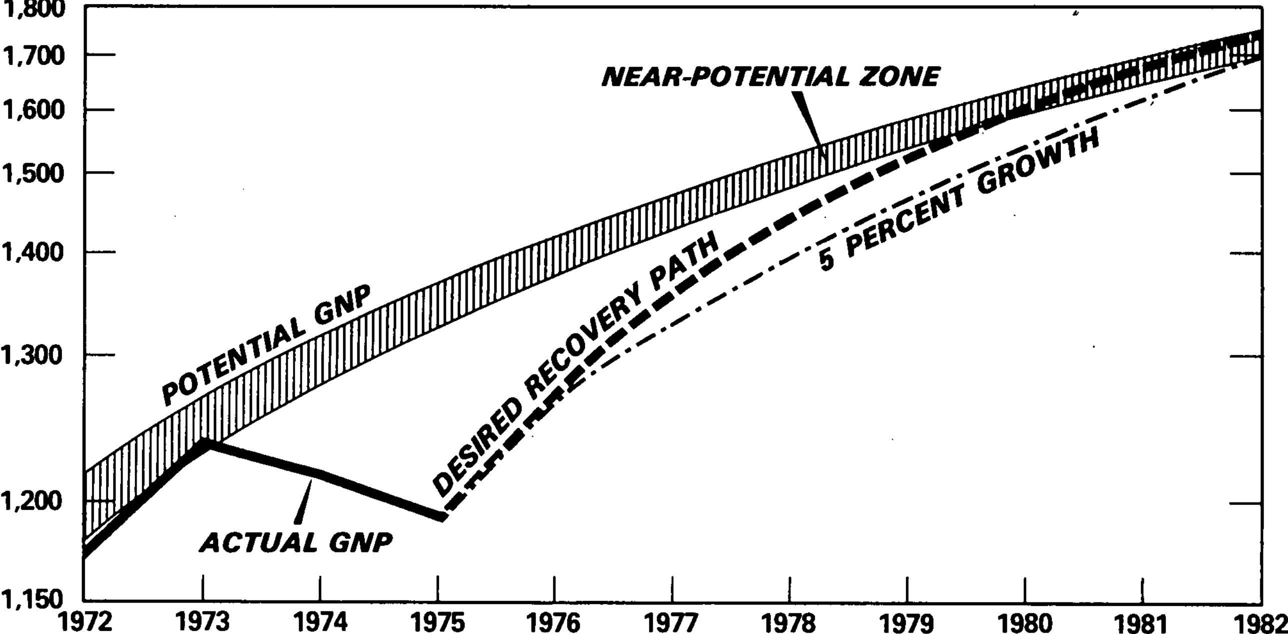
Chart 3 illustrates the desired recovery path, in which output continues to grow at a 7 percent rate through 1977 then slows to a 5 percent rate by 1980 and a 4 percent rate by 1982. After 1982, when the labor force will be growing more slowly, growth rates between 3 and 3½ percent should suffice to maintain full employment.

Also illustrated in Chart 3 is a steady 5 percent growth path. Such a path, which presently appears to be the best that is in prospect for

CHART 3

# ALTERNATIVE RECOVERY PATHS

Billions of 1972 Dollars




Sources: Council of Economic Advisers, Joint Economic Committee

1977, would leave the unemployment rate still at about 6 percent in 1980.

Even if our recommended growth path is achieved, enormous income losses, totaling about $600 billion at 1976 prices, will be incurred during the 1976–1980 period—an unavoidable consequence of the recession which has already taken place. If growth falls below this path large additional losses of output and income will occur. Dropping to the steady 5 percent growth path would enlarge these losses by 40 percent, bringing them to about $850 billion. In other words, during the five-year period 1976–1980, our recommended recovery path would provide an average of over $1,000 more public and private goods and services for each individual in the United States than would the 5 percent growth path.

Obviously, the 5 percent growth path is far from the worst possible case. Indeed, it would be a good performance by historical standards. Should the average growth rate be only 4 percent, another $195 billion would be added to the cumulative loss of output, and the reduction in unemployment would be almost nil, with the unemployment rate still above 7 percent in 1980:

> Steady progress toward full employment should be an urgent goal of national policy over the next four years. Real output growth of about 7 percent in the near term, tapering to about 5 percent by 1980 is needed to bring the economy into the zone of sustainable full employment operation within this period. The losses of output and income which will result if the economy falls short of this objective should not be tolerated.

The present Administration has rejected the policies necessary to produce the desired growth path. Indeed, the President recently met with other heads of government in Puerto Rico to urge a coordinated strategy of slower growth. This caution has been motivated by a belief that faster growth inevitably entails more inflation. However, neither historical evidence nor common sense supports the theory that there is always a "trade off" between unemployment and inflation. A much more sophisticated understanding of the relationship between unemployment and inflation is required.

At times when the overall economy is at or near full employment, rapid growth can produce shortages of particular resources or products, thus permitting inflation to take hold. A recent example of this is found in the period from the third quarter of 1972 to the first quarter of 1973. During this period real output grew at almost a 9 percent annual rate at a time when the economy was already close to full utilization of its capacity. Excessively rapid growth was not the only cause of accelerating inflation in 1973, but it was a major factor.

By contrast, at a time when every major sector of the economy is operating far below capacity, rapid growth can actually reduce inflationary pressure. Such is the case at the present time. As Table 9 indicates, unemployment rates remain extraordinarily high in every major industry. In wholesale and retail trade, unemployment is higher now than it was during last year's recession trough. As shown in Table 10, every avialable capacity utilization measure indicates the widespread availability of unused plant capacity.

In these circumstances, rapid growth will contribute to price stabilit yin the following ways:

(1) Productivity gains will be higher as plants are brought closer to optimum utilization rates. This has been demonstrated during the past four quarters when productivity (output per worker hour) rose 4.5 percent for nonfarm business as a whole and 9.1 percent in the important manufacturing sector. Productivity fell far below trend during the recession and at least one more year of unusually strong productivity gains is both possible and desirable in order to restore output per hour to its trend growth path.

TABLE 9.—UNEMPLOYMENT RATES BY INDUSTRY

| | October 1973 (prerecession low) | May 1975 (recession peak) | August 1976 (latest) |
|---|---|---|---|
| Industry: | | | |
| Construction | 8.9 | 20.9 | 17.1 |
| Manufacturing | 4.1 | 11.9 | 8.2 |
| Transportation and public utilities | 3.0 | 6.3 | 4.7 |
| Wholesale and retail trade | 5.2 | 8.8 | 9.0 |
| Finance and service | 4.1 | 7.0 | |
| Government | 2.7 | 4.8 | 4.4 |

Source: Department of Labor, Bureau of Labor Statistics.

TABLE 10.—CAPACITY UTILIZATION

| | Prerecession peak [1] | Recession low [1] | Latest [2] |
|---|---|---|---|
| Total manufacturing: | | | |
| Commerce series | 86.0 | 75.0 | (3) |
| Wharton series | 96.4 | 77.2 | [4] 84.7 |
| Federal Reserve series | 83.3 | 67.0 | 73.0 |
| Materials: [5] | | | |
| Total | 93.2 | 69.7 | 81.0 |
| Durable goods material | 92.5 | 64.1 | 77.4 |
| Basic metals materials | 97.8 | 66.3 | 80.9 |
| Nondurable goods materials | 94.7 | 67.9 | 86.1 |
| Textile materials | 95.0 | 58.7 | 84.6 |
| Paper materials | 100.5 | 71.8 | 92.3 |
| Chemical materials | 93.8 | 64.7 | 83.8 |
| Energy materials | 94.6 | 82.7 | 83.5 |

[1] The peaks and lows are specific to each series and may have occurred in different quarters or months.
[2] 2d quarter for total manufacturing, July for materials.
[3] Not available.
[4] Preliminary.
[5] Federal Reserve series.

Sources: Department of Commerce, Federal Reserve Board of Governors, Wharton School of Finance.

(2) Average weekly wages will rise due to longer working hours. This reduces pressure for increases in hourly wage rates. From the recession low of 35.9, average hours worked per week rose to 36.4 in the first quarter of this year in the total private nonfarm economy and from 39.0 to 40.3 in manufacturing. With the weakening of the labor market in the last few months average hours have dropped somewhat. They remain well below pre-recession levels, indicating the opportunity for considerable increases over the coming year.

(3) Workers have greater opportunity to sustain and enhance their skills when job opportunities are expanding.

(4) Expansion of business investment will be stronger as utilization rates for existing capacity rise. This expansion is needed to avoid future inflationary bottlenecks.

(5) Needed structural reforms, such as reduced import barriers, regulatory reform, more efficient government procurement practices, and greater equality of employment opportunity meet with far less resistance in a strongly growing economy.

> A more rapid expansion of output in the near-term future poses no danger of worsened inflation and, indeed, would help reduce inflationary pressures. Misinterpretation of the relationship between unemployment and inflation should not be used as an excuse for tolerating a sluggish recovery.

## III. Policies to Strengthen the Recovery

Major initiatives in economic policy must await the completion of the Presidential election campaign and the convening of a new Congress in January. The intervening months offer a valuable opportunity to develop and refine the policy proposals which will require speedy consideration and action next year. This chapter presents the policy alternatives which we feel deserve the most serious consideration. During these months of discussion and debate there are, of course, important actions that the President can take under existing legislative authority. Monetary policy also will continue to be of crucial importance to the shape and strength of economic recovery.

### FISCAL AND MONETARY POLICIES

When Congress passed the Congressional Budget and Impoundment Control Act of 1974, it was fully anticipated tthat changes in the budget resolutions might be needed to adjust for unexpected changes in the economy or other factors. The Conference Committee Report on the Act states:

> The managers expect that in addition to the two concurrent resolutions required in May and September, Congress may adopt at least one additional resolution each year, either in conjunction with its consideration of supplemental appropriations or pursuant to the issuance of updated figures for the current fiscal year in the President's budget. Furthermore, whenever there are sharp revisions in the revenue or spending estimates or major developments in the economy it is expected that Congress would review its latest budget resolution and consider possible revisions.

The procedures for adopting a new concurrent resolution are the same as those used in adopting the mandatory resolutions.

In their respective reports on the Second Concurrent Resolution, the House and Senate Budget Committees have noted their intent to consider an additional resolution early next year if the economic recovery is not proceeding satisfactorily at that time. If more stimulative policies are adopted early next year, the results could be felt beginning by midyear. Since available forecasts indicate a slowing of

the rate of expansion during the course of 1977 and a weak economy in 1978, this timing of new support for the economy could be very appropriate.

*Tax Reduction.*—The tax reduction enacted in the spring of 1975 was a major factor in halting the recession and initiating recovery. Additional tax reduction in 1977 could add new strength to the recovery of the private economy. If properly designed, a tax cut could also have direct anti-inflation effects.

In past reports the Committee has recommended that Congress give careful consideration to allowing a refundable income tax credit for some portion of the social security taxes paid by employers and employees. This proposal would help employees by increasing their after-tax takehome pay. Low-income workers who owe less in income tax than the full amount of the credit would receive the balance as a cash payment. Such a credit also would benefit businesses by reducing their labor cost, thus stimulating employment and helping to restrain price increases. A recent study prepared for the Senate Budget Committee lends support to our recommendation. That study concludes that in addition to curbing the increase in business costs and prices, a reduction in the employer's share of social security taxes would reduce the unemployment rate by roughly twice as much as an equal reduction in personal income taxes. This tax change could be accomplished through the income tax system and would therefore have no effect on social security trust fund revenues.

Various proposals have been made recently for corporate tax reduction. Many factors must be considered in any evaluation of the corporate profits tax. Obviously the statistics on profits and tax liabilities need to be clearly understood. A first examination of corporate Federal tax liabilities shows that they declined from 45.4 percent of profits in 1970 to 37.8 percent in 1974. The decline was reversed in 1974, and the effective rate has risen slightly since then.

Looking behind the published statistics shows a different pattern. The published National Income Account estimates of before-tax corporate profits are net figures after deducting the losses incurred by some businesses. An increase in such losses would cause an increase in the apparent effective tax rate calculated from the National Income Account statistics, even in the absence of any actual change in the effective rate on taxable profits. Large increases in business losses for 1974 and 1975 have created such a distortion; estimated losses in 1976 are not yet available. When allowance is made for the large losses some businesses have suffered during the recession, for the widespread change in the accounting practices for inventories, and for recent tax law changes, it is not clear that the effective tax rate paid by corporations has risen since 1974.

Should investment continue to lag, reductions in corporate taxes may be an appropriate tool to spur business confidence and investment, but it is unlikely that a change in corporate taxes would have a rapid effect on either business investment or the general economy. Other factors such as stronger product markets and credit availability would have a more immediate impact. Changes in corporate taxes should be regarded as a long-term measure designed to create a more favorable environment for business activities.

Congress also should give careful consideration to the corporate profits tax structure. The tax code already contains a significant investment tax credit which encourages investment in equipment. This credit, which is extended through 1980 in the Tax Reform Act of 1976, biases investment in favor of equipment and against investment in human capital, structures or research and development. The bias may have unwanted effects on overall productivity. If corporate profits taxes are to be reduced, a change in the overall tax rate instead of increases in the investment credit or other specialized preferences would avoid aggravating such biases.

*Federal Spending.*—The adoption of permanent new Federal programs purely for the purpose of providing temporary support to a weak economy would be ill-advised. However, programs which can be triggered on and off in response to changing economic conditions are an important part of a comprehensive antirecession strategy. This Committee has advocated such programs in past reports and continues to do so.

Congress has recently enacted a program of counter-cyclical assistance to State and local governments triggered by changes in the unemployment rate.[2] Our Committee first recommended this program in 1971 and has repeated its recommendation many times. Naturally we are pleased to see the adoption of this recommendation. This legislation was vetoed twice by the President and has become law only because of the success of Congress in overriding the second veto. This is only one example of the friction between Congress and the Executive which has hampered the timely execution of countercyclical budget policy in the past few years.

The main possibilities for additional temporary spending programs to support recovery fall within the area of employment and training policy. These are described in the next section of this chapter.

*Monetary Policy.*—So far this year short-term interest rates have remained fairly stable, and this has been helpful to the economic recovery. For reasons not yet fully understood, only moderate growth of the monetary aggregates has been required to finance a rapid expansion of current dollar GNP at stable interest rates. From the second quarter of 1975 to the second quarter of 1976, GNP in current dollars grew about 13 percent, while the narrowly defined money supply (M1) grew 5.6 percent and the more broadly defined money supply (M2) grew 9.6 percent. Considering the uncertain strength of the recovery at present, continued stability in short-term interest rates is desirable. Since the velocity of money is unlikely to repeat its rapid increase of the past year, it is likely that more rapid money supply growth will be required. It is important that the Federal Reserve allow the monetary aggregates to expand enough to maintain reasonably stable interest rates even if this means revising the monetary targets. More rapid money supply growth poses no inflationary threat at a time when resources are seriously underutilized and the economy's momentum appears to be weakening.

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[2] Senator Proxmire states: "I did not support this legislation because I do not believe this mechanism will create jobs quickly enough to be an effective countercyclical device."

## EMPLOYMENT AND TRAINING POLICIES

There is general agreement among policy makers inside and outside of government that the bulk of new job creation should be in the private sector. In the next several years, however, we face the prospect of a rapidly increasing labor force. As discussed earlier, even if the strong economic growth we recommend is achieved, several years will be needed to bring the economy close to a full-employment level of operation. This means several years of unemployment rates well in excess of those traditionally regarded as acceptable in the United States.

Faced with these very high unemployment rates for all major labor force groups and with the prospect that these rates will decline quite slowly, policymakers have three principal alternatives; aggregate fiscal and monentary stimulus to increase the rate of economic growth and thereby reduce the unemployment rate; job creation and training in the public sector; and direct stimulus to job creation in the private sector. None of these three alternatives used in isolation is likely to produce a sustainable combination of full employment and reasonable price stability.

While the economy remains well below the zone of potential GNP, exclusive reliance on overall macroeconomic stimulus will leave us with an unacceptably high unemployment rate. Substantially higher rates of growth than now appear to be likely would be valuable in creating permanent jobs in the private sector. But increases in real GNP beyond those recommended in this Report could lead to supply shortages and regenerate inflationary expectations. Furthermore, even with very high rates of growth, if these could be sustained, a sizable number of workers with minimal skills and work experience would be bypassed, while the wages of very skilled workers would be bid up at an increasing rate.

Likewise, neither would exclusive reliance on direct job creation solely in the public or solely in the private sector be adequate. For individuals with serious educational deficiencies or other such disadvantages, supervised training and work experience in a government program may be desirable prior to entering a private sector job. For individuals who already have adequate basic education but need specialized skill training, publicly subsidized on-the-job training in private industry would be a more economical and effective use of public funds.

It is important that job training and placement programs, however designed, operate in a context of economic growth. In the late 1960s, just as newly trained workers were coming out of skill development programs, the labor market softened considerably with the start of the 1969–1970 recession. Many critics of employment and training programs seized upon the inability of some trainees to find jobs as evidence that these programs had failed, when in fact fewer jobs were available. In making employment policy for the rest of this decade, a combination of overall economic growth and special employment and training assistance is required.

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sector; that jobs do not go to those most in need of work. These criticisms have some validity as they relate to past public employment programs.

Having made these criticisms, some would suggest that we abandon public employment as a countercyclical tool. The Committee rejected this view as unnecessarily pessimistic. The targeting of Federal expenditures to create a large number of temporary jobs continues to offer a means of using Federal funds efficiently to deal with the high unemployment resulting from last year's recession.

Careful structuring of jobs and projects to be undertaken can meet most, if not all, of the deficiencies in past employment programs. The Committee recommended in March that additional jobs, created to meet the current recession-induced jobs gap, be in: "special projects lasting from one to two years and having a useful and identifiable output. The jobs should be clearly temporary and should make use of skills which the participants already have."

We envisaged that the jobs created under such a program would consist of special projects which would not otherwise be undertaken, and therefore which would be less subject to the problem of substitution of Federally funded workers for existing State and local employees. The short duration of the employment would reinforce the countercyclical nature of the employment. Equally important, local selection of work projects would help insure community support for the projects. Such projects might include rehabilitation of housing occupied by low-income persons, construction of bicycle paths, care of parklands and public spaces, and construction of recreational facilities.

The Joint Economic Committee recently published a study of job creation under CETA in New England which utilized this project approach. The study, entitled "Job Creation: The Project Approach in New England," found that a number of communities used CETA funds to rehabilitate low-income housing and housing for the elderly. As a result, vacancy rates in public housing projects were reduced and vandalism declined.

The authorization bill for Title VI of CETA, H.R. 12987, explicitly adopted some of the recommendations made by the Joint Economic Committee. In the report which accompanied the Senate bill, the Senate Labor and Public Welfare Committee specified that any jobs created above the roughly 300,000 now in existence go to the long-term unemployed (those unemployed at least 15 weeks) and that the new jobs be in projects of no more than 12 months' duration. The Labor Committee report urged that:

> Prime sponsors subcontract a substantial portion of the new jobs to nonprofit agencies so as to meet a wide variety of needs. . . . The purpose is to ensure that real, new jobs are created so as to minimize the substitution effect and so as not to increase unnecessarily direct State and local government employee payrolls, except when necessary, of course, to provide essential services.

The report repeatedly emphasized that net new employment be in special projects which are locally initiated. This approach has been

preserved in the bill recently approved by a House-Senate Conference Committee.

Such a restructuring of additional temporary public jobs will eliminate a substantial number of deficiencies. This approach should provide the model for any further expansion of countercyclical public employment. In the event that the growth in real GNP during the next two quarters is insufficient to bring a steady decline in unemployment, one of the policy options which Congress should consider is a further temporary increase in the number of short-duration project-type public jobs. Local administrators were quite successful in quickly filling the jobs created at the beginning of 1975 under Title VI of CETA, and it is likely that a further expansion of public jobs which incorporated the changes suggested above could similarly be implemented in a very short period of time.

*Assisting the Disadvantaged.*—The Federal Government's major vehicle for providing training and work experience for the disadvantaged is Title I of CETA. In addition, some work experience is provided under Title III of CETA for special labor force groups (Indians, migrants, farmworkers, and youth), and supplemental training and development of work habits are funded under the Job Corps (Title IV of CETA) and the WIN program.

During this recent period of overall high unemployment, local prime sponsors have chosen to allocate about half of their Title I funds to work experience, which effectively increases part-time jobs as well as helps to maintain or develop work habits. However, as a long-term policy tool for permanently increasing the earnings potential of the disadvantaged, work experience has not been as effective as classroom and on-the-job training. Both a Congressional Budget Office review of recent studies and a 1973 study prepared for the Joint Economic Committee concluded that training, classroom and on-the-job, has a more permanent and greater positive effect on the earnings of participants than other programs. As the unemployment rate declines, prime sponsors may shift more of their Title I funds from work experience to training. Congress also may want to consider expanding outlays for classroom, vocational, and on-the-job training as part of a package of policies to increase overall employment. Without stimulus to the overall economy and special stimulus to job creation in the public and private sector, increased funding for training would have the same effect that it did in the 1969–70 recession—to prepare the disadvantaged for jobs that do not exist.

In addition to considering additional funding for skill training as part of a larger package, Congress should be aware of the severe management problems which prime sponsors face when funding levels are still undetermined as the fiscal year is about to begin. In the [illegible] past, employment and training legislation has been subject t[illegible] threat of veto more often than other programs, increasing funding uncertainty and damaging smooth program operation and effectiveness.

*Youth Employment Policies.*—Unemployment among youths has shown almost no improvement in the current recovery. After reaching a peak of 20.7 percent in June of 1975, the unemployment rate for teenagers has declined only to 19.7 percent in August 1976, the most

recent month for which data are available. For black teenagers, the situation is much worse—in August, their unemployment rate exceeded 40 percent and in some inner cities was even higher. There are many reasons why teenagers experience higher-than-average unemployment. These include poor job counseling, lack of work skills and work experience, weak attachment to the labor force, and the large influx of the post-war baby-boom into the labor force in recent years. While these factors explain some of the difficulties of youth in finding employment, poor economic conditions have exacerbated greatly the job search and placement problems of young people.

One means of improving the labor market information available to young people would be the creation of a youth employment service. Such a service, established within the United States Employment Service, would bring professional job placement and job counseling services to youths while they are still in school or when they are first entering the labor force. In a comprehensive examination of the employment difficulties of youths, Congress also should consider programs which would improve the transition from school to work. One tool for accomplishing this would be special employment projects of the type described earlier, which could be funded under Title III of CETA. Such projects would be easily adaptable to the desire of many teenagers for part-time work.

Another alternative is the expansion of apprenticeships in the private sector. These could be Federally supported through wage subsidies or employment tax credits. Such an approach is attractive because the training is conducted by the employer who knows which skills he needs and because training is likely to be followed by permanent employment in a productive job in the private sector. In addition, the direct costs to the Federal Government can be lower than those incurred through reliance on public sector jobs.

One major problem which Congress should consider, however, is how to target these jobs so that funds will be effectively distributed to support jobs that would otherwise not have been created. One way of doing this is to limit the application of such a wage subsidy or employment tax credit to the hiring of individuals with characteristics not normally attractive to private employers, for example individuals drawn from high-unemployment inner city areas and lacking adequate education and experience. Another way of increasing the potential effectiveness of such a scheme is to limit participation in the program to firms which have increased employment above the normal trend. In devising this type of program, Congress would have to tread a fine line between making a subsidy program as effective as possible by limiting it to *net* additions to employment, and holding down the regulations and paperwork involved so as not to discourage the cooperation of business. Such a program need not be limited to young people, but might well include older unskilled workers.

In summary, the employment problems which Congress must deal with during the rest of this decade are extremely diverse and require both macroeconomic and targeted approaches. Promoting a path of strong sustained economic growth will be enough for many adults and young people who have skills, experience, or both. Until the economy returns close to its potential growth path, however, there will be a sub-

stantial jobs gap that can be partially filled by short-duration public job creation. Finally, there are those with moderate to severe labor market disadvantages, primarily but not exclusively young people, who can benefit from a combination of training and subsidized employment in the public and private sector.

## POLICIES TO ACHIEVE PRICE STABILITY

As discusssed in the previous chapter we expect that prices may rise about 5 percent next year. Obviously this would be a great improvement relative to 1974 and 1975 when prices (as measured by the GNP deflator) rose about 10 percent per year. Nonetheless, it would remain a far from satisfactory performance. During the entire period from 1949 to 1969 prices rose an average of only about 2.5 percent per year. Surely our objective should be to do as well in the future as in the past.

Furthermore, much of the recent and anticipated improvement in price performance reflects the vagaries of the agricultural situation. Poor harvests contributed to the inflation of 1974. A good harvest is expected to help hold down inflation this year and next.

The objective of policy should be to work toward a situation in which reasonable price stability is an expected norm, not an accidental occurrence dependent on an unusually good crop year or some other happenstance.

The basic of an overall strategy for returning to price stability is to provide productive employment for all those able, willing, and seeking to work so that the ratio of efficient producers in society to total consumers is maximized. Hence, well-designed employment policies are also anti-inflation policies. These employment policies have been discussed in the previous sections of this chapter.

In addition, there are a number of specific actions which can and should be taken to achieve more efficient product markets and to help dispel self-reinforcing inflationary expectations. Among the more important of these are the following:

The President should carefully monitor the price and wage decisions of large firms and major unions and speak out and mediate as necessary to achieve voluntary pricing decisions consistent with national anti-inflation goals.

Food reserves should be established and utilized to moderate fluctuation in prices of basic food crops. Reduced price variability is in the interest of both farmers and consumers.[3]

Federal rules and regulations which impose unnecessary costs on private business or on the Government itself should be modified. Needed changes include reform of Federal regulatory agencies, reduction of the paperwork burden imposed on small business, greater efficiency of Federal procurement procedures, and the introduction of effective cost controls in Federal programs such as medicaid.

The potential inflationary consequences of any major new legislative proposal should be thoroughly analyzed and debated. It is often assumed that the inflationary impact of a

[3] Senator Bentsen does not agree with this recommendation.

government program can be measured simply by estimating the total cost of the program. This is not the case. Often far more important is how the money is spent and whether Federal purchases in particular markets will have the effect of pushing prices of that particular product or service up or down, and by how much.

The above list is not exhaustive, but it is familiar. Recent failure to control inflation effectively may stem in part from bad luck and imperfect understanding of the inflationary process, but it stems also from failure to take actions long recognized as necessary. Dealing with inflation requires continuing hard work in a variety of areas, and at times it requires the courage to act despite the strong resistance of powerful and important groups.

In carrying out actions such as the above, the President will require the assistance of a strengthened Council on Wage and Price Stability, or a successor agency. The Council has made a valiant and valuable effort since its creation two years ago. However, it has been handicapped by inadequate funding, limited powers and, most serious of all, by lack of strong Presidential backing.

We are confident that action such as the above, coupled with steady progress toward full employment, can produce a sustainable situation of reasonable price stability by the end of this decade. This objective can be achieved without resort to mandatory price or wage controls. We are opposed to such controls and do not foresee the emergence of a situation in which resort to controls would be necessary, desirable, or likely to occur. It has been suggested that some recent price increases reflect business anxiety regarding possible future controls. Such anxiety is misplaced. If such thinking has in fact motivated recent price increases, it would be in the interest of both the general public and the individual firms concerned to withdraw these increases.

*Structural and Cyclical Unemployment.*—In recent years there has been a great deal of discussion about the fact that we now face more difficulty in reaching our full employment goals because of the greater number of women and teenagers in the labor force. Many analysts have tended to lump all unemployed new female and teenage entrants to the labor force into a single category loosely referred to as the "structurally unemployed."

Structural unemployment more properly refers to unemployment due to (1) lack of geographic mobility, (2) changes in skill requirements, or (3) social and educational disadvantages. By this definition, a formerly highly paid aeronautical engineer or a worker in a shoe manufacturing plant in New England could be structurally unemployed, while a young college graduate or a woman with secretarial skills returning to the labor force after her children enter school may not be structurally unemployed but unemployed due to inadequate overall demand.

During the most recent period of extremely high overall unemployment, some have confused the general lack of jobs with structural unemployment. While we must not minimize the very real labor market problems of the economically disadvantaged, who form the bulk of the structurally unemployed, neither should we make the mistake of lumping all new entrants and most other unemployed women and teenagers into this category. Broadening the classification of structural unemployment indiscriminately makes the employment and training problems we face appear to be much greater than they actually are and also makes it more difficult to identify and help the truly disadvantaged. For example, in a rapidly expanding economy, many of the adult female entrants to the labor force would have no difficulty in finding jobs. Many of these women are well educated and have strong incentives for seeking work. A recent Labor Department study shows that 70 percent of the women in the labor force are single, widowed, divorced, or living with husbands who earn less than $10,000 per year. The fact that women's employment has increased substantially more than that of men in the past year gives the lie to the prevailing argument that a large bulk of women entrants are structurally unemployed. The fact is that if jobs were available, many of these women have the basic skills and work experience to fill productive jobs in the private sector. The same is true of many young people graduating from either high school or college. The scarcity of jobs, rather than lack of skills, accounts for much of the unemployment that young people face.

*The Role of the Public Sector in Improving Skills and Creating Jobs.*—In its annual report to the Congress in March of this year, the Joint Economic Committee recommended expansion of public jobs as a temporary measure to help fill the gap between the number of new jobs created in the private sector and the number of persons seeking work. At that time, the Committee reviewed many of the criticisms that have been made of public employment: that there is a high substitution rate as State and local governments use Federally funded workers in place of regular State and local employees; that public service employment creates the expectation of permanent public employment among those who can and should seek jobs in the private

# MINORITY VIEWS ON THE 1976 MIDYEAR REVIEW OF THE ECONOMY

## I. Economic Outlook

Midyear forecasts of economic growth for the remainder of 1976 have been strengthened considerably since the January outlook. Official government estimates include a 6.8 percent real GNP growth rate in 1976 (up from 6.2 percent). The forecast of a 5.7 percent increase in 1977 remains unchanged. Expectations for reduced inflation rates also have improved.

While the above estimate for this year's growth rate is at the upper range of most other forecasts of major private and public institutions, differences between the official estimates and others lie chiefly in the pattern of growth expected in the last months of 1976 and early 1977. Several private forecasters now call for the possibility of an expansionary period stretching into the later part of 1977 and 1978.

The unemployment outlook is not clear. Although the unemployment rate estimate was lowered to a 7.3 percent average in 1976 (from 7.7 percent), recent monthly statistics make improbable substantial improvement over the earlier forecast. With regard to 1977, the official forecast is 6.4 percent; however, private estimates call for stickier progress. A large part of the problem comes from the unexpected number of labor force entrants (2.4 million persons from August 1975). While the growth in the labor force is not expected to continue at such a rapid pace, present entrants will be absorbed into jobs only gradually, and consequently, the unemployment rate could remain high.

Present estimates for consumer price increases indicate only 5.0 percent for 1976 (end of year comparisons) and a 5.7 percent increase for 1977. The GNP deflator, an aggregate price measure, (end of year comparisons), is forecast at 5.1 and 6.2 percent in 1976 and 1977, respectively. The range of price increases in 1976 by private forecasts is quite similar to the official estimates but the range is considerably higher in 1977.

Inflationary concerns have subsided considerably after seven months of moderate price behavior. Aggregate wholesale price increases have been dampened by continuing decreases in the volatile farm and food sector. There have been worrisome price rises in industrial commodities but other materials indices such as crude and intermediate materials have not maintained a consistent uptrend.

Upward price movements by business are usual in an expansionary phase as businessmen try to recover higher costs incurred during the recessionary period. However, unsuccessful recent attempts to raise prices, for example, by the steel industry demonstrate that many commodity markets are still soft. Wage settlements to date have been reasonable and analysts do not expect settlements for the rest of 1976

to initiate any excessive cost-push spiral. Moreover, the extremely high rates of productivity (8.3 percent in manufacturing in the second quarters in the first half of the year have moderated the impact of rising labor costs substantially.

Consumer food prices, a major item in the household budget, have been stable, and future moderation of food prices has been suggested by the large declines in the farm and food component of the wholesale price index. As a result of generally high production, food prices are expected to rise only 3 or 4 percent in 1976, and around 5 percent in 1977. In view of the above considerations, the overall price expectations of 5½ to 6 percent this year seem well-founded. That is still a higher rate than has been considered desirable historically. Inflation is still a threat. The fires have been banked but the coals still glow.

Major question marks remain for the economic performance in the three crucial areas of business investment, inventory building and consumer spending. Hopes have cooled for a further resurgence in home building in 1976. Housing starts have recovered to an anemic 1.5 million units as compared to the former 2.0 million unit rate a few years ago. While single family dwellings have shown the greatest improvement, construction of multi-unit housing has remained in the doldrums. A large part of the difficulty stems from the past overbuilding that took place in the South and West. Builders also maintain that increased rental income is necessary before further investment will take place.

Inventory investment also is not expected to spur additional economic growth. Accumulation was unexpectedly strong in the first half of the year after the rapid rundown during 1975. However, with sluggish sales growth and the new-found caution of businesses in inventory acquisition, additional accumulation is expected to be quite moderate. The fear of price increases and/or material shortages later in the recovery period might spur some stock building but currently businessmen are being cautious and are trying to maintain a favorable stock/sales ratio.

Perhaps no sector has been watched with as much attention by analysts as the consumer sector. While a strong growth in personal consumption expenditures contributed significantly to the initial recovery phase, consumer confidence waned and retail sales have been sluggish. (July retail sales declined.) This behavior is puzzling in view of various positive factors. Consumer installment debt, especially for automobile purchases, has grown steadily for almost a year. Personal income has recorded steady upward gains. The relative moderation of consumer prices so far this year should have served to ease concern over another bout of inflationary price increases. Employment has grown by 3.9 million since its March 1975 recession low. Although recent unemployment figures have been exceedingly disappointing, some of the additions to the number of unemployed have been labor force entrants—the latter encouraged enough by market conditions to start job seeking.

Moreover, the rise in consumer sales for August may have signaled an end to the recent flattening of consumption. Preliminary data for retail sales showed a 2 percent gain over July figures. Automobile demand in the last few months has been slowed only by production

limitations (although strike activity may dampen sales in the near future). The widespread sales gains this month may indicate that other consumer sectors are participants in renewed consumer interest.

In view of the mixed economic picture, three alternative possibilities are present. The first and most pessimistic is that the recovery has faltered and expansion has ceased. This would result in not just a slower growth rate but a deterioration in economic progress. The second alternative is that the period of recovery has been pushed into 1977, in which case a strong growth spurt would occur in the first half of next year. The third and most likely possibility is that the third quarter slowdown will prove to be a temporary hesitation—and the fourth quarter will be a continuation of moderate non-inflationary growth.

There are some tentative signs that some pickup in business activity is taking place. New orders for non-defense capital goods have increased for seven consecutive months. The Conference Board's survey on capital appropriations showed a 13 percent increase in appropriations by manufacturers in the second quarter following a first quarter decline. Excluding petroleum companies, the survey noted a strong 31 percent increase after a modest 2 percent rise in the first quarter.

The latest Commerce Department study on capital spending reported mixed results. Businessmen have not changed their spending plans appreciably since the Spring survey—an increase of 7.4 percent in 1976 over 1975. Since the increase in actual spending in the second quarter was lower than earlier projections, businessmen must speed up investment in the third and fourth quarters to achieve the latest annual outlay estimates. Projected spending for the third quarter is a 4.1 percent increase and the fourth quarter projection has been raised 2 percent (from 1.1 to 3.3 percent). This evidence taken together with new orders for non-defense capital goods suggests that the long-awaited strengthening in plant and equipment spending is taking place. The amount of real thrust from this sector also will be determined to the extent spending translates into actual capacity expansion versus modernization of existing plant capacity and pollution control expenditures. Business plant and equipment spending now should start to bolster the recovery in conjunction with rising personal consumption.

## II. The Budget and Fiscal Policy

This year the debate on the budget is once again centered on its size and its deficit. The Minority Members support the President's efforts to reduce spending and to work toward a balanced budget as soon as feasible.

There is little doubt that a major cause of our recent serious recession was the unbridled inflation of 1973–74. And yet, the Congress seems intent on pursuing the same policies that could set the stage for another recession.

The Second Concurrent Budget Resolution for Fiscal 1977 embraces a spending level nearly $19 billion above that requested by the Administration last January. The Resolution calls for a one-year spending increase of $47 billion to a $413.1 billion outlay in Fiscal 1977, com-

pared to $365.6 billion last year and $394.2 under the Administration's original proposal.

In addition to the larger spending totals, the mix of expenditures and tax proposals in the Concurrent Resolution will result in a greater drain of resources from the private sector than under the Administration's budget. This means a transfer of resources to a generally less efficient sector of the economy—the Federal Government.

The federal deficit in Fiscal 1977 would be $43 billion as a result of the Administration's program proposed last January, and $51 billion as a result of the Second Concurrent Budget Resolution just enacted. Either figure is an improvement over the $66 billion deficit of Fiscal 1976. But we are still well into the stratosphere of excessive federal spending and deficits. We should be working toward lower figures and toward reduced budgets.[1]

This will not be an easy fight since so much of each year's federal budget is locked in by previous congressional commitments. For example, over 75 percent of the Fiscal 1977 budget is relatively "uncontrollable" under federal law. Most of the "controllable" portion is in defense spending where deferrals are legally possible, but often not prudent.

Years of congressional budget mismanagement and spending excesses have caused the economy severe problems and it will take several years of sound policies to restore sustained noninflationary growth.[2] Certainly the Congressional Budget and Impoundment Control Act of 1974 was an important and major step in the right direction, and the budgeting procedures of that Act are now fully operational. The Minority now urges Congress to enact "sunset" legislation to close out unneeded federal programs and to work toward the more restrained and economically sensible Administration budget proposals.

## III. Taxes

The American taxpayer is greatly overburdened. The average family paid 22.7 percent of its income in Federal, State and local taxes in 1975. This is double the level of 1953 when the ratio was only 11.8 percent. What this means is that, theoretically, the average family spends nearly three months of the year supporting the government and nine months earning funds for its own sustenance.

Congress has been laboring all summer on a mammoth complicated tax reform package. This is all well and good but the JEC Minority believes that real tax reform should center on three simple fronts:

(1) Increase the personal exemption from $750 to $1000 per person as proposed by the Administration. Such a cut in taxes will continue

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[1] Representative Rousselot states: "I completely concur with the above mentioned ill effects of persistent deficit spending of the type which has been indulged by Majority controlled Congresses over the last several years. In an effort to reverse this trend and to attain substantially lower levels of Federal outlays in the coming fiscal year, I introduced amendments to bring expenditures in line with anticipated revenues in both the First and Second Concurrent Budget Resolutions. While both amendments were defeated, support has grown from the 93 "aye" votes which were cast at the first time I introduced such an amendment in the spring of 1975 (for fiscal year 1975's budget) to the 111 affirmative votes which the zero add-on deficit received during the recent consideration of the Second Concurrent Budget Resolution for fiscal year 1977."

[2] Senator Fannin states: "I have advocated a balanced federal budget ever since I came to the Senate and have reminded my colleagues of my concern over the present and future financial integrity of this country. The giant spending machine that the majority in Congress has promoted has reached the point of being almost uncontrollable. This is a position in which Senator Taft, Congressman Clarence J. Brown nad Congressman Garry Brown completely concur."

to stimulate economic growth and help assure the continuation of the recovery from the recent recession.

(2) Take the sting of inflation out of taxes by an indexing procedure. The individual income tax brackets, the standard deduction and the personal exemption would be adjusted annually by the amount of increase in the consumer price index. Without such adjustments, a worker who has a wage increase that simply matches increases in the cost of living may actually lose money because he takes a cut in take-home pay as a result of being pushed into a higher tax bracket by his higher nominal wage.

Indexing the tax system would require the Congress to show the political courage to vote directly any tax increases required to pay for federal programs. As it now stands, the government gets windfall revenues from inflation which government itself helps to create.

(3) Provide tax relief to millions of families struggling to send their children to college and post-secondary vocational schools. Increased education has been one of the major deteriments to growth, productivity, and increased standards of living in the United States in this century.

The Minority Members of the JEC recommend legislation which would provide tax credits to pay for post-high school educational expenses—tuition and books.[1] There should be no restrictions on who should receive the aid, but scholarships and other aid (except loans) would be partially deducted in arriving at net expenses.[2]

The foregoing are the types of tax reform that can contribute in a constructive way to the advancement and economic well-being of our nation.[3]

However, the Minority does not advocate the above tax cuts or tax credits in a vacuum. Such reductions should be tied to reductions in federal expenditures to offset the reduced revenues. This is to avoid fanning the fires of inflation.

## IV. Monetary Policy

The Minority supports the Federal Reserve's current monetary targets and the recent slight reduction in the target rate of growth of the monetary aggregates.[1] The growth of the money supply, as determined by the Federal Reserve, has fueled a recovery that is strong through its first five quarters. The average rate of growth in the GNP for these five quarters has been 6.8 percent, which is a higher rate than that of the previous two recoveries, while the rate of inflation has been cut in half.

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[1] Senator Percy prefers the tax deferment approach to tax credits.

[2] Senator Taft supports legislation to permit credits at the secondary and elementary levels as well.

[3] Representative Clarence J. Brown states: "The Tax Act recently passed by Congress should be identified for what it is: Legislation to increase the burden on some taxpayers in order to reduce taxes slightly on others. The net effect is to continue taxes in past patterns of encouraging consumption and not savings. But, more than that, the treatment of the cost basis for capital gains taxes on inherited property is undesirable. Though the new law properly raises the estate tax exemption from $60,000 to $175,000, that still is not enough to meet cost of living changes since 1942 when the $60,000 limit was established. Furthermore, the Act requires inheritors to pay capital gains (in addition to inheritance taxes on any inherited property sold) from a basis of the descendant's acquisition cost after January 1977. This will discourage savings and investment. It is a new unfair tax, worse than the original one, and again it fails to index the estate tax exemption."

[1] These are reductions of earlier targets to 4½ to 7 percent for M1, 7½ to 9½ percent for M2, and 9 to 11 percent for M3.

The second quarter's growth of GNP slowed to a rate of 4.3 percent, but the Minority does not feel that the monetary aggregates should be increased to further help stimulate the economy because the rate of rise in inflation has slowed. It is not unusual for a slowdown in economic growth to occur occasionally during a recovery.

The velocity of money has remained sufficiently high to allow the recovery to take place within the Federal Reserve's money targets without raising interest rates or restricting the economy. Indeed, interest rates have declined substantially as inflationary expectations have diminished.

Moreover, the private sector, and particularly business, has not put a large demand on the money and credit markets in this recovery due to generally healthy liquidity positions and because of restrained business spending on plant and equipment.

Business real investment for new plant and equipment in 1976 is estimated to increase by 2 to 3 percent over 1975. This slow recovery in real investment is not unusual. Business generally waits for unused capacity to be utilized beyond pre-recovery levels and for profits to improve before committing itself to new capital spending.

Credit appears adequate. With the temporary receding of inflationary fears there has been a reduction in the inflation premium built into interest rates. The money aggregates, therefore, seem to be targeted correctly so as not to stimulate a new round of runaway inflation, which would force up interest rates.

## V. Unemployment

The 7.9 percent rate of unemployment in August 1976 is a reminder that the nation has not yet solved this thorny problem. The economy has come a long way toward recovery since the peak recession unemployment rate of 8.9 percent posted in May 1975. But, much is left to be done.

One of the causes of the much-publicized .6 percentage point increase in the unemployment rate in the past three months is the record rise in the labor force over the past year, and particularly since May. It is difficult to absorb this record number of new workers fast enough to reduce the overall rate of unemployment.

There are more people at work today than ever in our history, 88 million, which is 2.7 million more than in August 1975. Since May of this year the labor force has risen by 930,000 of which 667,000, or more than two-thirds, were adult females. The average rise in the labor force over the past three months was 310,000, compared with an average of 212,000 for the 17 months of the current recovery.

It would be most unusual for the labor force to increase at such a fast pace much longer. As the increase of new workers slows, there will be a downward push on the unemployment rate and the expanding economy will begin to absorb more of the unemployed.

Our national failure to solve the problem of unemployment is not for lack of caring—or trying. Six months ago the JEC celebrated the 30th anniversary of the Employment Act, designed to assure full employment. If words and good intentions and laws passed and tax dollars spent since then could cure, there would be no unemployment. The trouble is that so many of the most widely publicized unemploy-

ment programs passed in recent years have amounted to little more than rhetoric and good intentions. Many of them have been predicated on the government doing something about unemployment without bringing into the issue the full effectiveness of the private sector.

We must avoid those solutions that would introduce an all-encompassing governmental economic planning process and that would stifle the ability of the individual units of our free market to make their own natural adjustments. Other employment proposals, such as CETA, attack only cyclical or periodic unemployment on a temporary basis.[1]

If we are to deal effectively with the unemployment problem, we must get to the heart of the problem. The overall unemployment rate of 7.9 percent conceals the seriousness of the problem for certain groups such as teenagers—19.7 percent in August—and blacks and other minorities—13.6 percent. For black teenagers the August unemployment rate was a shocking 40.2 percent. In contrast to these figures the unemployment of male household heads with relatives was only 4.1 percent in August.

We need to attack this hard core unemployment that persists in good times as well as bad; the endemic structural unemployment that is at the root of so many of our other costly social problems—crime, welfare and disease.

There are several initiatives in the legislative hopper and on the drawing boards that attempt to deal with these thorny unemployment problems. Among them are bills to provide systems of employment incentive subsidies coupled with required training programs. Such legislation would help prepare those chronically unemployed to take their places as productive members of the working society. It would provide training priority to classes of workers with high unemployment rates, in labor market areas where unemployment is above the national average, and would encourage their hiring and training by small business firms which can give close attention to new workers.

If we can solve chronic unemployment we will have gone a long way toward solving our total unemployment problem, since teenage, minority, and other endemic unemployment make up such a large share of the total current unemployment.

## VI. Welfare

The welfare system of this country is in need of major overhaul. The best summary of the system is that those who want to work cannot, those who can work do not, those who do work are penalized and those who are most needy suffer greatly.

The system is a maze of contradictions. The greatest contradiction is that some aspects of the welfare rules are a disincentive to work. In addition, the programs, though funded with billions of dollars, often fail to provide for the poorest citizens. The administration of the program involves the use of 140,000 people and yet the average case-

[1] Respresentative Rousselot states: "There are currently 130 other Members of the House (including myself) who are cosponsoring the Jobs Creation Act of 1975, H.R. 13399, originally introduced by Congressman Jack Kemp. This proposal has come to be known to many as the free market alternative to the Humphrey-Hawkins Full Employment bill.

"Through a number of creative tax cuts, increased exemptions and tax credits to individuals and corporations, the Jobs Creation Act provides the private sector with the necessary capital funds to create employment for the nation's jobless while generally invigorating the operation of the free market system and the nation's economy."

worker is so overloaded that he or she is ineffective. The public wants an efficient system, yet the administrators of the program cannot even tell how many people are underpaid or overpaid or guilty of fraud.

The Minority strongly urges that the welfare system be completely overhauled. A system based on a negative income tax is gaining increasing support, mostly because of its reduced administrative requirements and its fairness to welfare recipient and taxpayer alike. The important goal in the welfare debate is that major reform does take place as soon as possible.

Since comprehensive reform will take time, the Minority proposes an interim program to reduce the folly of the present system:

First, the welfare system should have as its backbone a strong incentive to work. This would be accomplished by raising the Work Incentive Program's nontaxable limits from $30 to $60 and decreasing the benefit-loss ratio from 66 percent to 50 percent. These changes would make the difference between earned levels of income and welfare levels of income much greater. Therefore, it is financially more beneficial for the welfare recipient to work than not to work.

Second, there must be a vigorous investigation and revamping of the welfare rolls. Conservative estimates are that 25 percent of all welfare recipients are being paid too much or too little and 5 percent should not receive any payments. These inefficiencies must be ended.

Third, the answer to welfare is not a government dole, and neither is it the establishment of government jobs. The Minority, above all else, believes that the private sector should be the main provider of jobs. In this connection, the Minority would support means such as subsidies, tax credits and the like to stimulate private employment of welfare recipients capable of work. This would reduce benefits for them and facilitate additional benefits for those unable to work. It is time to allow the more efficient private sector to work on the welfare problem.

The welfare system is a national priority that demands action, not rhetoric. The needy have suffered too long and the taxpayers have paid too much to delay any longer.

## VII. Trade and Aid

During the first quarter of 1976, our trade balance swung from a substantial surplus ($8.9 billion) to a position of deficit. The excess of imports over exports during the first quarter was $1.5 billion, at an annual rate, and this number shrank to $1.1 billion for the second quarter.

Volume of both imports and exports are above last year. The record of exports for the first six months of 1976 is up 4.8 percent over the corresponding 1975 period. Imports, reflecting an increased demand for energy products during our economic recovery, rose 16.3 percent over the respective period.

At $791 billion, world exports reached record levels in 1975. The overall figures describe a growing U.S. and world economy, with a healthy international trade sector. But, there are same bad signs that go with these good signs.

Perhaps the most important major component of these trade figures is the level of petroleum imports. In 1974, a total of $23.6 billion, or 22.8 percent of total imports was accounted for by petroleum prod-

ucts. Last year, petroleum imports totalled $25 billion and the percentage grew to 25.5 percent of total imports. These figures reflect a trend which is expected to continue this year.

In fact, the figures reveal a disturbing trend of increased dependence by the United States on imported petroleum. From 1970, when 23 percent of our petroleum needs were fulfilled by imports, imports will account for a projected 41 percent of total supply in 1976; even higher levels are expected next year. That must be a trend to disturb us because of its implications for our national security.

Thus, the Minority believes the conduct of domestic energy policy is the most important ingredient in overall trade policy over the next few years. What we find, however, is a reluctance in Washington to face the facts of our energy situation and to come up with the legislation needed to avoid energy blackmail in the future. As we point out in our section on Energy, we must work harder on the goals of energy independence and price decontrol, leading to conservation of scarce revenues and providing incentives for development of new domestic energy sources.

The international monetary situation this year has been marked by agreement on amendments to the International Monetary Fund charter, confirming the system of floating currency that presently exists, reforming the role of gold in the international monetary system, strengthening the Special Drawing Right (SDR) as a unit of international monetary value and instituting a new facility to channel capital to less developed countries. We support these goals, and share the view of those who believe the floating currency system has been generally well administered. We express concern, however, lest the International Monetary Fund, through its auctions of gold, becomes the agent for substantial fluctuations in the price of that metal.

With regard to foreign aid, we repeat our preference for strengthening multilateral lending institutions rather than engaging in extensive bilateral aid.[1]

We note that the United States ranks 12th among the 17 most industrialized countries in terms of total official aid as a percentage of gross national product. Efforts should be made to increase this figure,[2] [3] [4] although care must be taken to see that this diversion of our

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[1] Representative Rousselot believes that any foreign aid—when deemed necessary to maintain the vital interests of the United States—should come directly through traditional congressional appropriations procedures rather than through multilateral lending institutions over which the United States exercises voting power which is disproportionately small to the amount of financial contributions which it makes.

[2] Representative Clarence J. Brown disagrees with the desirability of increasing foreign aid grants. although under certain circumstances loan programs have merit and the United States and other developed nations should continue to participate in those multilateral programs where benefits and assurances are greatest.

[3] Representative Rousselot believes that efforts should be made to reduce or eliminate rather than increase, our expenditures and grants in the area of foreign aid. He lists the following reasons to reduce foreign aid outlays:

(1) The United States has contributed more than its share over the past several years in the area of foreign aid. Since World War II alone, the American taxpayers have given over $183 billion in economic aid—significantly more than any other developed developed country.

(2) We cannot afford to spend billions abroad when pressing domestic needs go unsatisfied—particularly during a fiscal year which anticipates an add-on budget deficit of $50 billion.

(3) In many instances foreign assistance funds are squandered by recipient governments for questionable political and financial purposes rather than accomplishing any appreciable good for their citizens. American tax dollars used by the Haitian government to build a $150-a-day luxury tourist hotel is only one example of their controverted and misintended use.

[4] Senator Taft prefers to consider foreign aid on a case-by-case basis. Aid should be directed toward friendly nations for the financing of sound investments of continuing benefit to the recipient country, and with the national security interests of the United States in mind. No set formula should apply.

capital resources to developing countries does not adversely affect our ability to accumulate capital at home.

## VIII. Energy

The issue of solving the nation's energy problems needs to be better addressed—and soon. Efforts made by Congress to meet our national goal of energy independence have fallen far short thus far.

First, the nation can reduce its consumption of energy. Conservation would allow more efficient use of the energy we do possess without harming economic growth.

Second, there must be further development of domestic supplies of oil and natural gas, the present base of our economy because they account for almost three-fourths of the energy consumed in the United States.

Third, the nation's ultimate energy survival will require the development of alternative sources of energy since our supplies of oil and gas are limited.

The Federal Government's role in the solution of the nation's energy problems should be fourfold. First, while some progress has been made toward decontrol of some petroleum products and setting a more realistic price for natural gas, further steps need to be taken in the production and distribution of energy. Second, only where the market cannot provide incentives for rational behavior (i.e., production, consumption and conservation) in the national interest, should the government supplement the marketplace. Third, because of the security implications of our growing dependence on foreign sources for our energy, the government should encourage research and development in the energy field through tax incentives to private business or, as a last resort, federal effort. Fourth, the government should discharge its general duty of ensuring the overall economic health of the nation by trying to avoid the economic disruptions of severe shortages of sharp price fluctuations in a need as basic as energy.

Few reasonable men would deny the efficacy of the marketplace in allocating resources to their proper priority value of use. With the energy situation as precarious as it is, the nation cannot afford wasteful government-imposed inefficiencies.

The control of oil prices has little favorable long-run effect.[1] Prices will continue to rise if domestic supplies dry up and the nation's vulnerability to the supply and price whims of OPEC is increased. Even in the short-run, as domestic oil is forced to be cheaper than foreign oil, small oil producers and refiners, who must rely mostly on foreign oil supplies, may be driven out of business.

Similarly, the regulation of the natural gas market has had deleterious effects. Reduced GNP and unemployment would follow from a curtailed supply of gas brought on by unrealistic federally controlled prices. Given the present technological development of our society, a reduced gas supply will force a greater proportion of our energy to come from OPEC oil. And, environmental standards will fall as gas is replaced by dirtier fossil fuels.

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[1] Representative Heckler states: "The current economic forecast in the Northeast indicates that this region of the country could suffer undue hardships if complete oil decontrol were implemented. Therefore, I support oil price decontrol provided that there be imposed a 'trigger ceiling' whereby prices could rise only to a predetermined ceiling before controls would be reinstated."

There is a better method.

Gradual reduction of price legislation in the energy market would bring development of domestic energy supplies, encourage conservation and bring about economic substitution of new energy sources. Domestic deposits of fossil fuels would be exploited. Conservation of energy would take place through decreased demand for higher priced energy. And, development and use of other energy sources, such as solar, geothermal; wind, and tides would become feasible.

Although decontrol of oil and natural gas should be gradual enough to avoid disruption of the market, gas is normally sold by contracts of such long duration, and the cost of gas in the consumer's utility bill is such a small part of the total bill (which includes high distribution costs, etc.) that little disruption of the market would be caused by immediate decontrol of new gas.

The nation's energy problems are aggravated by other government interference in the marketplace. Environmental improvements should not be abandoned, but they must be realistic. Outdated laws and regulations also deter the increase of supply and reduction of demand. For instance, it is contradictory for Congress to roar for conservation of energy and yet allow such regulations as the Interstate Commerce Commission's "empty backhauling" rule to persist.

Congress should get on with the task of finalizing a sound energy policy.

## IX. Agriculture

The American farmer has never been more important to world food production than he is today. Recent droughts and production problems in Europe and Asia put this country in a pivotal position in world food production.

Fortunately, the American agricultural picture looks encouraging for the present year. Supply is ample enough to aid in meeting world food needs. On the other hand, demand is high for farm goods, thereby ensuring high cash receipts for our farmers. Farm income is expected to be a record $26 billion this year.

The supply picture shows prospects for production records in many crops. Corn production estimates have been reduced due to a Midwestern drought, but the crop still should be a record. Soybean production will be down slightly from last year. As a result, animal feed grain supplies may be slightly tight, but they should still permit an expected 8 percent rise in grain feeding of cattle. The wheat crop should set a new U.S. production record. The supply of livestock and dairy items show increases.

Demand for the products of the American farmer is very strong. The economic recovery that is taking place in this country has led to an increase in food consumption and food expenditures. Foreign demand for American farm products should be high because of the accelerated economic expansion abroad, reduced crop production prospects in Europe, and likely imports by Russia. The Soviet Union will continue to import American grain under the five-year agreement, even though their own wheat production will be near record levels. The value of American agricultural exports is expected to be $22 billion for 1976. And, this is important. In fact, it is U.S. farm exports that have enabled the U.S. to maintain a strong dollar despite the massive imports of oil in recent years.

What agricultural problems we do have are not necessarily the fault of U.S. policy, but the policies and practices of other countries. Sugar is a good example. In this case, there is need to broaden markets and avoid agreements and restrictions that would preclude this.

This overall picture leads the Minority to feel that U.S. agricultural policy is solidly headed in the right direction. Free markets are the best hope for sound agricultural production and distribution. For example, it is possible that by the end of 1977 there may be a soybean shortage. The sure way to have enough soybeans in 1978 is to leave things alone. If we try to adjust policy to compensate for expected shortages next year, there may be such a distortion of market adjustments that there will also be a shortage in 1978 as well.

The free market should be allowed to operate without intrusion of price supports, government controlled stockpiles, international commodity agreements, or embargoes.

Recent history has demonstrated the validity of a free market farm policy. A comparison of average figures for 1966, 1967 and 1968 with the comparable figures for 1973, 1974 and 1975 demonstrates what happens when you remove high internal price supports and policies of production allotments.

The farm output index averaged 99 in 1966, 1967 and 1968 (base: 1967=100), compared to 110 in 1973, 1974 and 1975. Net farm income averaged $12.9 billion in the three sixties years and $28.5 in the seventies years. Government payments to farmers have gone down from $3.3 billion a year in the earlier period to $1.3 billion in the most recent period. Similar figures demonstrate advances in cropland under production, export levels, and per capita farm income as a percentage of per capita nonfarm income.

Based on the evidence, the overriding policy recommendation of the Minority Members of the JEC is to let the free market system do its job with minimal government interference.

## X. National Defense

When discussing national defense spending, it must be remembered that the primary rationale is national security and not economics. A strong defense must be one of the Federal Government's highest priorities.

Obviously, the size of our defense spendnig hinges directly on the state of foreign affairs. For example, it is important to note that the Soviet Union has increased the number of men under arms from 3.4 million to 4.4 million since 1964. During the same period, the U.S. has decreased its uniformed military strength from 2.7 to 2.1 million. Similarly, the Soviet Union has maintained, even increased in recent years, its military spending as a share of national output, while ours has declined. For example, a recently released Brookings Institution study shows that in 1955, after the Korean War ended, U.S. defense expenditures accounted for 11.2 percent of "baseline" GNP (total national output adjusted for recession). By 1965, the ratio was only 8.1 percent. By 1970, it had fallen to 6.9 percent. In the current fiscal year 1977, defense spending will constitute only 5.4 percent of baseline GNP.

Money temporarily saved at the expense of the effectiveness of our national defense could be a transitory gain.

Congress must cease to view the national defense as a chimera. It is not.

First, excessive profits are not rampant in defense contracting. The GAO's Defense Industry Profit Study shows that profits on non-defense commerical work for the firms studied were higher than those on defense work. Also, there is no evidence whatsoever to show that defense R&D in any way detracts from private R&D. It has historically enhanced it. One need only look at the development of U.S. commercial aviation.

Likewise, there is no deleterious connection between defense spending and balance of payments or productivity. In fact, the United States aircraft industry, an industry twenty times more dependent on defense than United States industry in general, has the best balance of trade record of any industry in the country. This industry also has recently had twice as much growth in productivity as the nation's manufacturing industry in general.

It has been argued that defense expenditures are especially prone to inflation. This is not true. According to the Department of Commerce deflators, the Department of Defense inflation rates are beneath those for other federal purchases, and even lower than inflation in local and State government purchases. The rate of inflation is highest in the industrial sectors with least defense participation.

The most common charge leveled at defense spending is that funds are mismanaged and that cost overruns necessarily ensue. Certainly, improvement in the management of defense funds is always worth seeking, and what inefficiencies do exist must be eliminated. But, there is no indication that improved management will save vast amounts of money.

One of the sources of consternation in discussing the defense budget is misunderstanding of concepts. Any increase in actual cost over a long-range, pre-production forecast is a cost overrun. Yet, such overruns are a basic shortcoming in virtually all governmental projects. But, with national defense there is no free enterprise alternative to government undertaking the effort.

In addition, defense contracting by its very nature is very often not susceptible to accurate preproduction cost forecasting. There is no real market system to supply the needs of the military for unique items, the production of which is often contracted while the product or the system is little more than a mere idea of what the item should be to meet the need. Defense projects are often risky ventures on the frontiers of technology in an area where technological excellence is a prime concern.

It must be noted that much of the budget for defense is made up of expenditures designed to "improve working conditions and fringe benefits" for personnel in the defense establishment as a means of competing for talented people. Personnel costs account for 52 percent of the military budget, of which 23 percent is for maintaining reduced numbers of uniformed personnel, and 28 percent is for retirement, family housing civilian pay, and other personnel costs. Procurement

of weapons, operating maintenance and research and development account for a shrinking share of the total military budget, currently 48 percent of the total.

The real crux of the debate on defense spending is the ordering of federal priorities. United States defense spending today is at its lowest share of the total federal budget since fiscal year 1940, shortly before Pearl Harbor. It represents about one-fourth of total federal spending, and yet other areas of federal spending, where massive increases have occurred, are not scrutinized as carefully. Perhaps part of the reason for this phenomenon is the well-publicized, yearly single appropriation for defense. In any event, the strength of our nation's defense should not be compromised for purposes of partisan debate. If national defense is inadequate, no other government program matters very much.

## XI. Research and Development

For fiscal year 1977, Federal Government research and development (R&D) expenditures will increase $8.6 billion over the 1976 level. This figure, representing a total $23.5 billion outlay, disguises the fact, however, that R. & D. spending in real or constant dollar terms is increasing at a much slower pace, and in fact has decreased over the 1969–1975 period. It also disguises the fact that the growth of Federal Government R. & D. outlays in this country is among the lowest among industrialized countries generally.

This situation is reflected in the private sector. Private sector R. & D. outlays rose only 6 percent in the 1969–1975 period, making research and development one of the slowest growth sectors in the economy.

Studies and testimony developed by the Science and Technology Committee of the House of Representatives and by the National Bureau of Economic Research detail the direct connection between R. & D. outlays and productivity growth. While these findings do not compel us to conclude that the Federal Government must immediately institute across-the-board increases in R. & D. spending, they do raise serious questions as to the adequacy of federal policies relating to R. & D. As this report goes to press, the Science Technology Committee will be holding hearings on this subject. We urge the Joint Economic Committee to take the considerable record that will have been produced by this effort and develop its own concrete recommendations for appropriate levels of R. & D. spending in the interest of maintaining a strong national economy.

Research and development is not simply a question of current economics and governmental appropriations. Other federal regulations affect levels of R. & D. spending. Patent policy, in particular, is an area which is ripe for overhaul. There exists at present no truly effective means of transferring to the private sector for development of inventions resulting from federal research. In this regard, we would urge the President to develop recommendations in this area, so that Congress will have the full benefit of the considerable groundwork which has already been accomplished by the Administration on this important subject.

## XII. Revenue Sharing

As this report goes to press renewal of the General Revenue Sharing Program, first enacted in 1972, seems assured. What does not seem assured, however, is a solution to the problems which Revenue Sharing was intended to solve: The inefficient system of categorical grant-in-aid programs; the fiscal crises facing our State and local governments; and the serious mismatch of taxing power versus spending responsibilities in our federal system. The Minority strongly believes that we must renew our dedication to the purposes which Revenue Sharing meant to achieve, through extension of General Revenue Sharing itself and through implementation of other fiscal reforms in the federal system. On the other hand, we are disturbed that renewal of the legislation has become for some an occasion to intrude the Federal Government more deeply into the decisionmaking of local jurisdictions than has heretofore existed in the Revenue Sharing Program.

At the present time, General Revenue Sharing and general purpose fiscal assistance ((block grants) account for approximately 12 percent of all federal grants-in-aid. The other 88 percent consists of the hundreds of categorical grant-in-aid programs which have accumulated over the past several decades. In fact, the annual growth rate in categorical grants-in-aid since the enactment of General Revenue Sharing is the same—14 percent—as the rate for the five years prior to enactment.

Nor are we any closer to any real solution to the fiscal crisis of State and local governments. If the New York City financial situation has taught us nothing else, it has illustrated that local and regional economic decisions are as important as national economic statistics in assessing the health of our nation. State after state has been forced to raise rates or institute new taxes. State and local tax receipts over the past 20 years have climbed significantly faster than federal tax receipts. On the expenditure side, state and local outlays have risen faster than federal outlays by almost any measure (particularly if you exclude such transfer programs as Social Security). Between 1954 and 1974, state and local spending from their own tax sources climbed from 50 percent to 75 percent of domestic federal spending.

Clearly, the chief reason for such dramatic increases in spending is the demand of Americans that local governments provide additional services and solve an increasing range of state and local problems. Solutions to the problems of crime in the streets, urban blight, polluted air and water and poor quality education are traditionally matters of local jurisdiction and local decisionmaking. This is as it should be, and the fiscal system which we establish in Washington should strengthen this traditional division of responsibilities, emphasizing local solutions rather than interfering or competing with them.

These are some of the chef reasons for supporting the General Revenue Sharing program and for our support for further steps to strengthen the federal fiscal system. Among these further steps, we urge the following:

(1) *Enactment of block grant proposals.*—While we recognize the value of categorical grant-in-aid programs for specific purposes where a clear federal interest is present, the overuse of such programs fosters inefficiency and distorts the allocation of resources at the local level. Block grant programs in limited form have been enacted in the fields of community development, law enforcement assistance, and manpower. Administration proposals for major block grant consolidations in the field of health care, education, child nutrition, and community services illustrate other areas where improvements are needed.

(2) *Payment of General Revenue Sharing entitlements at the beginning, rather than the end, of each quarter.*—Such a change, which can be accomplished by Department of the Treasury regulation, would bring the procedure for Revenue Sharing payments back to that which existed in the early months of the program. On an overall basis, such a change could save State and local governments hundreds of millions of dollars in borrowing costs; although Treasury costs would be increased, the total cost to the public (net of taxes) would be reduced by this change.

(3) *Implementation of a taxable bond option for State and local governments.*—The Minority supports giving State and local governments the choice of utilizing the tax exempt market or of entering the taxable bond market for borrowed funds. The latter course would entail an interest rate subsidy by the Department of the Treasury, similar to that which has been proposed by Administration officials in the past. Developments in our capital markets have worked to the disadvantage of State and local governments; the supply of loanable funds in the tax exempt bond market has generally not kept pace with borrowing needs, and borrowing needs in turn have mushroomed due in part to the tax exempt status afforded industrial development and pollution control bonds.

(4) *Congressional initiatives to preserve the "no strings" character of General Revenue Sharing.*—During consideration of the renewal of General Revenue Sharing, proposals were made which would have changed significantly the nature of federal control over local government spending. While these proposals were well-intentioned—dealing chiefly with civil rights and wage standards—their effect would have been to subject virtually every penny of local government spending to Federal Government standards, and to open the entire local government budget to challenge in federal court. Under these proposals, it is conceivable that Revenue Sharing funds could have been held up where a local government's expenditure of its own funds ran afoul of federal standards. Luckily, these proposals were defeated, but they point out the vulnerability of the Revenue Sharing Program. One of the chief arguments for General Revenue Sharing was the freeing of monies from federal controls, and yet these proposals would have done exactly the opposite. And it should be noted that local procedures and rules are frequently more economical and efficient than federal rules—and much more accessible by the citizens working to monitor or change them.

We strongly support the renewal of General Revenue Sharing as a symbol that Congress intends to continue its reform of the federal

fiscal system.[1] But, in truth, General Revenue Sharing at its present level is only a symbol, constituting a small part of total federal aid to State and local governments. Block grants are, of course, another way to improve the relationship between Federal and local governments. Our recommendations point out other needed reforms. Finally, we must point out that the efforts at reform can be set back if attention is not paid to the goals which Revenue Sharing is meant to achieve.

## XIII. Capital Formation

In recent years, new energy requirements, the need for pollution abatement equipment, housing and mass transportation have brought stepped up need for industrial capacity for public purposes. In addition, individual consumers have put a whole range of other demands on our production capacity which call for expansion or change.

Investment in new plant and equipment, housing and public projects directly provides jobs through the production of those facilities. But, more than that, increases and improvements in industrial capacity provide jobs in the production of goods.

Over the long run, economic growth depends on many basic factors, including the size and quality of the labor force, the availability of land and natural resources, increases in output per man-hour (productivity) and many intangibles such as managerial skills, the incentives built into the organization of the economic system, and the nature of the infrastructure of transportation, communication and financial facilities. Land and other finite natural resources are quite inflexible and the labor force usually changes relatively slowly. Therefore, the key to long-run economic growth is increased productivity. This, in turn, depends partly on skills, but for the most part on the supply and utilization of capital equipment.

The problem of the U.S. lag in investment and productivity, compared to other developed nations, was well documented by the Minority Members of the JEC in the 1976 Annual Joint Economic Report. There has been virtually no change in the relative position of the U.S. since that report was released in March.

Where can we get staggering sums needed to provide the capital so essential to our long-run economic growth and well-being? They can be supplied from three basic sources: Savings and profits of cor-

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[1] Representative Rousselot states: "Since the publication of the 1976 Joint Economic Report, several Members of the House have not altered their position on Revenue Sharing. Let me repeat my comments from the previous report (page 185):

"Irrespective of the many arguments surrounding the questionable value and worthiness of the Revenue Sharing Program—and they are considerable—it is my opinion that on the basis of cost alone, General Revenue Sharing should be discontinued. Without denying the good intentions and worthy goals of the program, I believe that we simply cannot afford to "share" revenue that we do not have.

"Compared to the eroding condition of federal finances, the financial status of State and local governments looks remarkably bright. In the aggregate, and on a national incomes accounts basis, State and local governments have continued to run in the black, registering a healthy $6.9 billion surplus for FY 1975, with $12.2 billion and $9.2 billion surpluses for the first and second quarters of 1976, respectively.

"Again, as I summarized in the 1976 Joint Economic Report (page 185):

"'A better program to meet the needs of local governments would be to restore them a substantial part of the tax base which the Federal Government has preempted. State and local governments would then be free to determine their own priorities and policies, and could tax and spend accordingly. The results would be a more responsive government and a healthy diversity, both of which are natural by-products of a dynamic federal system.'"

porations and individuals within the United States; government budget surpluses; and investment in the United States by foreigners. Since there has been only one federal budget surplus in the past 18 years, the government does not offer much hope as a source of capital funds. Investment by foreigners is an "iffy" proposition, dependent upon many political and economic factors. The only sure bet for financing adequate capital formation in a noninflationary way is increased individual savings and increased retained earnings of corporations. Both of these sources can be substantially influenced by government policies. If the government leaves the bulk of profits and earnings in private hands, national economic decisions will be made more freely and more efficiently by individual Americans and private businesses, to the benefit of the economy. On the other hand, if government taxes away individual resources, the decisions will be made by a bigger and generally less efficient government bureaucracy.

The appropriate public policy focus for capital formation is long-run. Basic to the solution is the need to develop policies that will encourage individual savings and investment as opposed to consumption. Inflation control is a *sine qua non* to this goal. Moreover, while some small progress has been made, we must further revamp our tax system in such a way as to make investment in new plant and equipment easier.

Capital investment equals tools and equipment; tools and equipment equal jobs; and jobs equal prosperity. The Minority Members of the JEC urge implementation of this chain of formulas by sound policies to stimulate increased capital investment.

## XIV. Regulatory Reform

The proliferation of government agencies, which started when the government first was instituted but began to proliferate in the 1930's has continued to this day in an effort to solve an increasing variety of problems. However, this effort to solve urgent human needs has often imposed solutions which reduced freedoms, created new problems and mandated excessive costs on our society. Reform of inefficient government regulation should be one of our nation's highest priorities.

The current style of regulation and regulatory agencies, perhaps well exemplified by the Occupational Safety and Health Administration (OSHA), brings with it new problems and dangers. For one thing, although there have been recent improvements in OSHA administration, smaller firms can ill afford the paperwork required. More fundamentally, since this agency is not centered on any one industry, but instead, on limited aspects of all industries, narrow specific interests animate its actions, and often result in insufficient regard for the health of the industry, or even the economy as a whole. As a result, it is not rare for the directives of one such agency to conflict with those of another.

Clearly, excessive regulation causes chronic problems, and to regulate a cure for these problems is merely to induce the same problems on a new plane. Deregulation is the only solution to excessive regulation.

For the regulations that cannot be removed—for political or practical reasons—streamlining should be done. Proposed changes to increase regulation should be made subject to strict cost-benefit analyses.

In the past year, in a cooperative bipartisan effort, the Federal Government has made significant progress toward reform. For example:

(1) The fair trade laws which created artificially high consumer prices have been repealed;

(2) The attempt is being made to reverse the trend of paperwork growth and to reduce regulatory delays;

(3) New competition has been introduced into the setting of stock brokerage fees by reducing regulations;

(4) The amount of Interstate Commerce Commission regulation of railroads has been reduced for the first time since the creation of that agency in 1887.

But, this is only a beginning. We need to eliminate overlapping, contradictory, outdated, or unnecessary regulations. And, we need a better understanding of the overall effect of government regulatory activity on our economy and on our lives.

To these ends, the Minority Members of the Joint Economic Committee endorse the work already begun in legislation proposed by the Administration and by several Members of Congress, including some Members of the JEC.

Most of these proposals would establish a timetable and discipline for reform. They would require the President to submit reform plans for Congress to act on or, in some instances, to become law if Congress fails to act. The plans would be designed to eliminate unnecessary or harmful regulation. They would establish within designated economic sectors more efficient organizational and administrative forms.

We commend such a program to the Congress for enactment. The government should strengthen the marketplace by reducing its regulation.

## SUPPLEMENTAL VIEWS OF SENATOR JACOB K. JAVITS

It is appropriate in a Mid-Year Report, in view of its interim character to touch only briefly on the most important issues specifically, and leave one's detailed comments for the annual report at the beginning of the next year. Therefore, it would not be useful to comment at length about each of the sections of the Minority Report, but I do have specific views on unemployment and welfare which are at variance with the views of the Minority. I find the Economic Outlook section of the Minority Report well-balanced and a thoughtful analysis of our present economic condition. I remain substantially more concerned by the unemployment outlook than is conveyed by the Minority Report, and shall offer my own suggestions for a comprehensive and detailed proposal to deal with the problem.

I am quite troubled by the profound bias displayed by the Minority views against governmental action in any form. At the same time, the Minority views are pervaded by an almost religious devotion to the free market system—in which I believe—that takes little account of the problems and complexities of the American economy. The free market ought to be encouraged wherever possible, but to find in the free market the best protection any consumer could have is a serious misreading of the economic history that has led to demands for consumer protection legislation. Similarly, free markets in agriculture will not solve basic problems of the small farmer, excessive price fluctuations, the vagaries of weather, and the need to balance U.S. and worldwide demand to prevent starvation of portions of the world's population.

I find it unusual that the Minority displays a great concern for federal expenditure on welfare or jobs, but finds the defense budget beyond compromise. Further, the Minority constantly stresses the need for restraints on federal spending, yet seeks federal budget surpluses to free up funds for capital formation. The Minority is willing to suggest two tax proposals, one to index income taxes and the other to allow tax deductions for tuition costs of higher education, costing in the neighborhood of $7 to $8 billion annually. This is an exceptionally large increase in the deficit for the budget-conscious.

I would have preferred a more balanced approach that recognized the need for private initiative wherever possible, but also recognized that a partnership between the Federal Government and private initiative is necessary in many cases because of the magnitude or complexity of the problems we encounter.

### UNEMPLOYMENT

The persistence of high unemployment at this late stage in the economic recovery confirms my concerns that our conventional aggregate economic tools of fiscal and monetary policy alone cannot ensure full employment by 1980. The danger of reigniting inflationary demand

and cost pressures, and thus unleashing another episode of economic instability, suggests that targeted structural unemployment policies are required. I believe we can have full employment and price stability simultaneously. Such a system needs to include a mechanism capable of examining the national unemployment problems in its separate parts and of coordinating the employment and training activities of the Federal Government, with specific reference to its various elements.

I do feel that it is essential to establish the kind of ongoing active labor market policy mechanism essential to the solution of which always will be a multifacted problem. Accordingly I will soon introduce the Federal Employment System Act of 1976, to duplicate in the labor market what the Federal Reserve System has accomplished in the capital and money markets. This bill would create an active labor market policy for the United States by establishing a Federal Full Employment Board, similar to the Federal Reserve Board, to carry out a number of functions and to recommend and coordinate full employment policies. More specifically, the Federal Board could direct federal agencies to implement those programs which it feels are most appropriate in given situations of cyclical, structural, or regional unempolyment.

The legislation also would create ten Regional Full Employment Councils, corresponding in location to the ten regional offices of the Bureau of Labor Statistics, to recommend policies to the Federal Board, to encourage cooperation of private industry and organized labor, and to consult with education and training institutions and employers to devise improved methods of labor market preparation.

Such a broad system is essential, I believe, if the nation is to deal in a comprehensive and yet flexible way with our manifold unemployment problem. Systemic problems require systemic solutions, and a new structure is required to galvanize the efforts and resources of our private and public sectors.

## WELFARE

While I agree with the view expressed in the Minority Report that current welfare programs are far from perfect, I reject the implication that this responsibility—which must be borne by society as a whole—can be handled by the private sector.

There are major injustices in the present system which include:

> Substantially different levels of assistance in different states with the result that those in need gravitate to the higher paying states;
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> The exclusion, in many states, of those truly in need who simply do not fit into certain categories like the aged, blind or under 18;
>
> The simple inadequacy of cash benefits in many states;
>
> The injustice to the working poor who have very little and who bear the tax burden of supporting those on welfare hardly less well off than they;
>
> The lack of incentive to supplement assistance income which not only often disqualifies the family from aid but simultaneously puts them in the less desirable category of "working poor."

I have introduced legislation, S. 3000, which is designed to meet these problems. S. 3000 provides for a system of rebatable tax credits and cash grants, so that all families in the poverty level would be assured a minimum income. As an incentive to employment, these grants would be supplemented by earnings, but with the cash grant reduced by 50¢ for every dollar earned. Other federal assistance programs would be modified or eliminated and assistance levels would be uniform throughout the country.

This approach of reforming and improving our welfare programs must have the highest national priority. It seems to me both more in the national interest and more humane than closing our eyes to the problem, crossing our fingers and hoping that the private sector somehow will provide solutions.

## ADDITIONAL VIEWS OF SENATOR PAUL J. FANNIN

I concur in the views expressed by the Minority but wish to make the following additional comments.

### TAXES

The Tax Reform Act of 1976 passed by Congress on September 16, 1976, is unquestionably one of the more far-reaching pieces of tax legislation adopted by any Congress. It addresses virtually every major area of the Internal Revenue Code.

I believe it is fair to characterize the Tax Act as both tax reform and tax revision. It will assure that all taxpayers pay a reasonable amount of taxes as a result of curbing tax shelter devices and expanding the minimum tax. Vast changes are made in the estate tax provisions which are designed to update that area of vital concern to all American taxpayers. I am pleased that the Congress has agreed with President Ford that significant changes are needed in the estate tax area in order to encourage the survival of the small business and small farm in America.

Of immediate importance to the American taxpayer is the extension of the individual tax reductions and the small business tax reductions. It is my view that the average taxpayer will also be pleased with the job-creating aspects of this bill, such as extension of the investment tax credit and expansion of the employee stock ownership program.

Much of this bill is more accurately referred to as tax revision rather than tax reform. Many of the modifications to existing law were necessitated by changes in contemporary American society. Provisions such as those in the Administrative title and many in the Miscellaneous title are simply a recognition that present tax laws no longer meet present needs.

It is easy to point to good provisions in this bill. I must state, however, that there are several bad ones, too, which most likely will be brought to the attention of the Congress in the immediate future. A particular disappointment to me is the failure to make permanent the surtax exemption for small businesses which desperately need a dependable increase in available capital, the extension of the holding period for long-term capital gains from six months to a full year, the restricting of business deductions for attending foreign conventions and adding to the minimum tax base certain intangible drilling costs. I am also concerned with those sections which restrict the existing DISC provisions and the foreign tax provisions affecting individuals abroad. It is my belief that these and other provisions will reflect negatively on the economy.

It is clearer than ever to me that Congress must more directly tackle our present and future needs for vast amounts of new capital. These needs remain a compelling fact of life and are at the heart of our unemployment problems today.

Although I am violently against the improper use of boycotts, I am strongly opposed to the Arab boycott legislation included in the Tax Reform Act. I feel, as does the Administration, that it is improper to use the Tax Code to affect foreign trade and influence the foreign policy of the United States. Not only is it an improper use of the Tax Code, but it bypasses those Congressional Committees which have jurisdiction over international relations. The Administration is equally concerned that enactment of such legislation would seriously weaken American influence with Arab states and damage the cause of peace. It would make it difficult for American companies to do business with those Arab states and will result in diverting business to other foreign countries. It would therefore have a serious effect upon the American economy, its businesses, exports and jobs. It would damage rather than help our diplomatic posture. This is a position in which I strongly concur.

It is unfortunate that the Congress has been unable to satisfactorily complete real simplification of our tax laws. Only by making it easier for the average American taxpayer to calculate his own taxes can we achieve our real objective of tax simplification.

The failure of Congress to enact the energy provisions which were originally part of the Tax Reform Act of 1976 is a great disappointment and will cause severe economic results in the future. The energy legislation is urgently needed to expand our domestic energy supplies by encouraging conservation and conversion to new energy sources. It is for that reason that a solid majority of the Senate urged that prompt consideration of the energy tax provisions be taken so that separate legislation could be passed this year.

### INFLATION

Each session of the Congress produces government intervention, more control and planning of the entire economy. Each year new regulatory agencies are created. As more taxation is imposed to support these agencies, more deficits are incurred which ultimately increase inflation.

The Washington bureaucracy is infested with social engineers who impose harmful restrictions on business. We have environmental restrictions. We have occupational safety and health restrictions. We have restrictions on mergers that have had devastating effects—a good example is our railroads. We have the call for divestitures of our major industries. We have countless man-hours spent in filling out forms for government regulatory agencies. Certainly, these are man-hours that might better be spent in production to meet the demands of the consumer for goods and services.

Congress has sought to solve economic problems through more and bigger federal programs. But, instead of curing our economic woes, these federal programs for the most part have only added to the problems.

It should now be evident to everyone that those efforts have been and continue to be aimed in the wrong direction. It should also be evident that economic progress and stability cannot be achieved by expanding government at the cost of the private sector. We cannot

continue to introduce and pass legislation that jeopardizes our free enterprise system and imposes more state control on the economy.

While it took 174 years to reach the $100 billion budget level—1963—it took Congress only 8 years to add another $100 billion, and only 4 years more to cross the $300 billion mark a year later.

And all this to have a national debt in 1977 of over $700 billion. The interest alone on this vast debt will be about $45 billion.

We have forgotten the magnitude of a billion.

A billion seconds ago the atomic bomb had not been perfected, much less exploded.

A billion minutes ago our Saviour, Jesus Christ, was living on Earth.

A billion hours ago man was living in caves.

And to think that our governments—Federal, State, local—have spent over a billion dollars in the last 24 hours.

Inflation is the most potentially destructive, the most dangerous problem we face. We owe those on fixed incomes, the elderly, the retired, that they not face a ruinous future. We owe the coming generation that they receive from our hands a country of promise and expanded possibilities, not a land in which all solid values have melted away in the fires of inflation. It is not merely whether prices have gone up or down during the past few months that should engage our attention, it is the overall upward trend of inflation. A Constitutional Amendment to require a balanced federal budget would be a critical factor in reversing the direction of this trend.

## UNEMPLOYMENT

I concur in the comments made by the Minority in this area of our report. I feel, however, that since 85 percent of those employed today are employed by the private sector, we must stimulate the business sector to hire those who make up our unemployed ranks. With a 7.9 percent rate of unemployment, it is time for those who would add more employees to the government roles and then increase our bureaucracy, to join their efforts in getting the private sector stimulated so that we can attack this problem at the most advantageous point.

In order to start in that direction, I introduced the Investment Incentives Act of 1976, S. 2902. This bill is designed to provide the private sector of our nation with the ability to meet our future economic and social needs. Action must be taken immediately to establish federal tax policies which will expand the ability of the private sector to provide new jobs for our growing labor force, increase productivity, improve our environment and working conditions, and achieve energy independence.

The Investment Incentives Act includes tax incentives to promote increased savings and investment by both individuals and corporations. Our present tax structure clearly encourages consumption and discourages investment by placing a heavier tax liability on dollars saved or invested than on dollars spent. This misdirected policy stifles the need for increased capital formation which is the fundamental prerequisite for sound economic growth. A new tax policy must be

adopted to counter this trend and renew the interest and ability of individuals and corporations to invest in our nation's future economic well-being. My bill represents such a new direction.

As if American enterprise were not already stifled enough by the huge government deficits of the past decade, we currently have before us an Alice-in-Wonderland piece of legislation called the Humphrey-Hawkins bill which will create an even greater deficit and could well plunge us into another recession.

This bill would create massive temporary public employment jobs at the expense of the private sector. There is no doubt that it would tip the scales drastically in favor of state control of the economy. It has been opposed by President Ford and has been endorsed either in fact or in principle by every major Democratic candidate who ran for the Presidential nomination this year and is a part of the Democratic platform.

The full implications of Humphrey-Hawkins are not seen by many people at first glance, so eager are they for a quick solution to our national unemployment problem. Let me outline them for you here:

In essence, the bill would require the government to hire unemployed people and pay them by taxing those who are employed. This is what happened in New York City. For over a dozen years, New York added nearly 150,000 public jobs. All along the way taxes rose, productivity fell, and the unemployment rate climbed.

In addition, Humphrey-Hawkins would, if enacted, mean national economic planning on the grand scale, with new layers of bureaucracy created to harass private enterprise even more than is presently the case.

The Humphrey-Hawkins bill's goal is 97 percent employment, but this is unrealistic. Short-term employment, where there is expectation of reemployment in the near future—seems nowhere to be taken into account. The only time we approached such a figure was in 1953 during a period of production to support the war effort when we had an unemployment rate of 3.59 percent. The bill contemplates achievement of this 3 percent unemployment rate within 4 years of the bill's enactment. But, setting such an arbitrary numerical goal and transforming the government into the employer of the last resort will not solve the unemployment problem. The only solution is to create an economic environment in which permanent and productive jobs will be available. Certainly, this can only happen in the private sector since it is there that approximately 85 percent of our labor force is employed.

Under Humphrey-Hawkins, the President of the United States would be required to send to Congress each year a series of plans setting forth specific numerical goals for employment, production, and purchasing power for every part of the economy. Business would also have to submit even more data and reports to aid in this national economic planning effort.

When business decisions conflicted with the government plan, business would be pressured to change its own plans, no matter how meritorious they might be in terms of meeting the real productivity requirements of the economy.

All this, of course, is based on the assumption that government planners have a better grasp of our economic needs than experienced

business leaders, but this assumption is contrary to simple common sense and long-term business interests.

After all, history shows that the free market, does operate according to the rules of logic and common sense. The free market produces to meet the needs of the consumer, not the requirements of government bureaucrats. Under private enterprise, because of the profit incentive, businesses produce the greatest possible amounts of goods and services for the greatest possible number of people. This, inevitably, leads to the maximum expansion in the number of jobs as production is increased and as new techniques are found to refine and improve the product.

However, the concept of government as the employer of last resort, involves a drastic expansion of so-called public sector employment, which has to mean ever-increasing public deficit spending and its partner, inflation. At a time when we are coming out of our recession, it is hardly appropriate to establish programs that will create larger deficits and a resulting inflationary trend. Also, in order to raise revenues to cover even part of such a program, there would have to be major increases in taxation, which would drain available capital from private industry.

The bill's sponsors estimate that, after allowing for deductions in unemployment compensation and welfare, the total cost of carrying out the bill's provisions might well be as high as $27 billion. The U.S. Chamber of Commerce has estimated the aggregate probable cost to be more like $40 billion. Deficits would increase, with a resultant increase in inflation to more than 10 percent a year. This could well result in wage and price controls. Such controls would further stifle business, thereby aggravating still further the unemployment problem in the private sector.

To meet this problem, the planners would propose creation of still more public sector jobs, and the process would begin all over again.

The inflationary problem connected with Humphrey-Hawkins is especially dangerous. The government would put vast numbers of people to work in so-called "public service" jobs; but you cannot increase the buying power of these people without a genuine, corresponding increase in the production of goods and services—not if you want to maintain any sort of price stability.

It is perhaps easy to forget the simple truth that increased demand without increased supply must, of necessity, result in higher prices—something no one can easily afford in these times.

MULTINATIONAL COMPANIES

The provision of the Tax Reform Act of 1976 which affects the United States companies doing business abroad will cause substantial impact on our American businesses so as to make them less competitive with foreign business in countries where they are presently doing business abroad.

There is a myth which has been allowed to engulf our thinking here in Congress that U.S.-based multinational corporations are damaging the domestic economy by exporting jobs to foreign locations where they establish manufacturing operation and by exporting capital

which could have a better domestic impact if invested in the United States. Nothing could be further from the truth.

I believe that the overseas operations of U.S. companies have significantly benefited the domestic economy by creating and maintaining U.S. jobs and by providing sources of capital which otherwise would not exist. The imposition of punitive taxation on such operations would be counterproductive to our own domestic economy and should be avoided. At a time when unemployment is at such high levels, it would be inappropriate for us to tax a segment of our business community which might be forced to close its foreign operation because of failure to compete with foreign companies and thereby force the unemployment of substantial numbers of backup personnel who would not otherwise need to be employed.

Most of the industrialized nations have long recognized the potential problem of double taxation of foreign income and either have instituted a foreign tax credit to solve it or have exempted all foreign source income from domestic taxation.

Until recently, the foreign tax credit was a totally neutral provision of the Internal Revenue Code which was available to all U.S. citizens and domestic corporations for income taxes paid to any foreign country with regard to any foreign source income.

Recent changes as a result of the Tax Reform Act have fragmented foreign source income into different types for purposes of applying different limitations on the amounts and the uses of the credit with respect to oil-related income from foreign sources. Further fragmentation may well destroy the integrity of the credit, complicate the Code and damage the competitive ability of companies in foreign markets so that careful analysis should be made before any further changes are made in this area.

The creation of a Domestic International Sales Corporation (DISC) in 1971 was welcomed by the business community as a belated recognition by the Federal Government of the vast array of direct subsidies, quotas, and other devices used by foreign governments to restrict imports. Since 1971, U.S. exports have increased tremendously. While some of this impact can be attributed to dollar devaluation, much of it is due to the DISC program which has provided thousands of American companies with enough additional cash flow incentive to finance the creation or expansion of foreign markets. For many companies which did not have any export business, DISC has opened altogether new doors. This is particularly true of small businesses which previously did not seriously investigate their export business. DISC has stimulated employment and economic activity both by exporters and by their supply and support industries.

It is difficult to assess the chilling effect that any curtailment of the DISC program would have, but it surely would reduce the ability of many companies to continue their expansion of export markets. I urge that no change be made to further restrict the application of DISC until we have had time to thoroughly evaluate its effect on these businesses abroad.

I am especially concerned with the foreign tax provision of the Tax Reform Act which affects individuals abroad. As you know, Section 911 of the Code permitted previously the annual exclusion of up to

$25,000 of income earned for services performed while living and residing abroad. The incentive of Section 911 is drastically needed to persuade U.S. citizens to work abroad. In developed countries living expenses are very high, and the living conditions often are very difficult. U.S. companies must often provide either by allowance or directly, for the municipal-type services of education, transportation, health, and public safety.

The curtailing of benefits under Section 911 would only add to the cost of present allowances by forcing employers to increase wages to cover the taxes. I opposed such a curtailment since that increase cost would damage the competitive position of U.S. businesses vis a vis foreign competitors, whose own countries generally do not tax income earned abroad.

The debate over oil company divestiture has reached new heights with the introduction of legislation that would break up the nation's 18 largest oil companies vertically into separate production, refining, marketing and transportation units. I believe this would be counter-productive. Divestiture would have a disastrous effect on the oil industry in terms of price and supply stability. It would hardly make the oil industry more competitive, for 18 major companies already operate. And a larger number of smaller corporations would be less able to bargain effectively with the OPEC countries.

The myth of monopoly can be dispelled by looking at the facts. The oil industry is less concentrated than many other industries. In the most concentrated area, refining, the four biggest companies control only 33 percent of sales. Profit gouging, a common indicatory of monopoly market conditions, is not characteristic of the industry. Over the years, profits have averaged roughly 12 percent, on a par with the rate of most manufacturing firms. The number and vigor of the many independent oil companies clearly demonstrates that entry and exit are not barred, and the oil industry is not a monopolistic one.

The vertical integration of the industry enables oil companies to support the less profitable aspects of their business with more profitable aspects. Divestiture would make this practice impossible, at the cost of increased prices to the consumer, curtailed production, and greater unemployment.

Divestiture is merely a placebo for our energy problems. It diverts attention away from the real problems—dependence on imports and the need for conservation. Rather than insuring the continued stability of oil prices and supply, both of which are vital to our economy, divestiture would lead to price increases and supply disruptions.

## ENERGY

Although I concur in the views expressed by the Minority, I wish to emphasize a problem area that has developed as a result of the Tax Reform Act of 1976. The Congress has clamped down on intangible drilling tax benefits which is estimated to cost the industry additional taxes of $82 million in 1977, $60 million in 1978 and $108 million in 1981. This is a severe setback for energy independence and a clear signal to the OPEC producer that America is increasing its helplessness against their scheduled price increase.

In tightening the intangible drilling deduction, the Congress accepted the compromise between the strict House provision that would have hiked the industry's taxes by $223 million in 1977 and the more liberal Senate provision that would have cost the industry $56 million more for that same year.

Under the compromise:

(1) The deduction would be limited to the amount the taxpayer is at risk—the amount of his investment, plus the fair-market value of property used as collateral, or the net of debt.

(2) Intangible drilling costs would be included in the minimum tax base to the extent they exceed the amount of deductions which would be allowed if those costs were capitalized and amortized. However, contrary to the Senate provision, the minimum tax base could not be reduced by the income earned from oil production.

(3) Any gain from the sale of oil and gas properties would be treated as ordinary income to the extent intangible-drilling deductions were taken.

Not included in the compromise was the House provision that no longer would have allowed outside investors to take current intangibles deductions for development wells. Each well would have been treated as a separate property in computing the deduction.

The Congress also increased the minimum tax rate for individuals and corporations to 15 percent from 10 percent. For individuals, the current exemption of $30,000 would be reduced to $10,000 or half of regular taxes, whichever is greater. The deduction from preference income for regular taxes is kept, but it is limited to those not using the $10,000 exemption.

The above changes in this area of the tax laws will affect the 10,000 independent producers who account for 90 percent of U.S. exploratory drilling directed at increasing domestic production of secure energy supplies. The industry has no way of offsetting further tax increases because well-head prices of both crude oil and natural gas are under federal controls. It simply means that the industry will drill fewer wells, find less domestic oil and gas, and further increase our already intolerable dependence on foreign oil. The inclusion of intangible drilling costs as a "preference" item subject to the so-called minimum tax, amounts to trading away bady needed new domestic petroleum supplies for tax dollars.

## REVENUE SHARING

I am most gratified to see the overwhelming approval given by the House of Representatives and the Senate to the extension of General Revenue Sharing for another 3¾ years. The many governmental jurisdictions across the country would experience difficult budgetary problems over the next few years if General Revenue Sharing funds are not made available in an amount at least equal to the current funding level. The bill passed by Congress addresses the immediate problem of extending this funding so vital to State and local governments and with respect to that end, I certainly support an extension.

At this time, the Revenue Sharing Bill is yet to be considered by the Joint Conference and I feel compelled to discuss several aspects of

the House bill which present serious problems. With the exception of the Davis-Bacon Act provision most of these problems were resolved by the Senate consideration of the House bill.

The bill establishes additional eligible units of local government which will create tremendous administrative problems, and there is no compelling explanation why the current law that provides eligible units of local government as determined by the Bureau of the Census with additional units for Indian tribes and Alaskan native villages would not be adequate. To do otherwise would necessitate the creation of new administrative activity with tremendous cost and no perceivable benefit.

The bill requires governmental units to report to the Office of Revenue Sharing on the proposed and actual use of funds, and to hold at least one public hearing for citizen input just prior to the submission of the proposed use report for each entitlement period. This in itself is appropriate and reasonable; but given the fact that the entitlement periods generally coincide with the Federal Government's new fiscal year starting October 1, whereas the fiscal year period for the preponderance of State and local governments begins on another date, some real difficulties are created. Of course, the problem is compounded because the budgetary cycle observed in each governmental jurisdiction is determined largely by the start of the fiscal year.

To avoid this kind of situation (which would be the rule around the nation rather than the exception) it would be far better if local governments were allowed to submit reports on the use of Revenue Sharing funds according to the local fiscal year and local budgetary requirements, rather than to require such reports to coincide with the Federal Government entitlement periods, which have no significance to the citizens or the governmental officials of a locality. If necessary, certification and assurance of compliance could be given by the local government prior to the start of each entitlement period in order to receive quarterly checks, but the reports could follow in a pattern consistent with local budgeting requirements. Not only would that process be more convenient and more understandable to all concerned, but it would be the best way to ensure that the original intent of this part of the legislation—which is to obtain timely and meaningful citizen input—is achieved.

The House bill would require an annual independent audit of all financial accounts of the local governmental unit receiving Revenue Sharing funds. While it would undoubtedly be beneficial to have an annual independent audit, many governmental units are not required by local laws to do so, and these governments have established auditing practices which are considered satisfactory and which are less costly to the taxpayer.

I fully understand the need for and the intent of the auditing provisions, but in order to accomplish the same objective, and yet to avoid undue hardship on jurisdictions which are adequately protected at present, perhaps the requirement could be modified to apply only to jurisdictions which do not currently make provision for outside audits or which do not have auditing capabilities available. At the least, the annual audit requirement should not be implemented immediately, but a reasonable time should be given to comply.

In addition to the above problems which are raised by the House bill on General Revenue Sharing, I am absolutely opposed to continuing the extension of the provisions of the Davis-Bacon Act essentially to local construction projects developed with Revenue Sharing funds. In view of the clear inflationary effect of the Davis-Bacon Act on construction programs, I find it hard to justify its application in a program which is based on meeting financial problems caused by inflation.

In addition to the inflationary impact of the Davis-Bacon provision on revenue sharing funds, there is an even more important reason for us to remove that provision from law, since the application of the Fair Labor Standards Act to State and local governments may, within the intent of *National League of Cities* v. *Usery*, be unconstitutional. The Supreme Court's decision in that case denied the right of the Federal Government to set wage and hour standards for employees of State and local governments. By rejecting the arguments of those who would stretch the commerce clause of the Constitution to cover federal implementation of their social welfare schemes the Supreme Court, in *National League of Cities* v. *Usery*, has not only reaffirmed the concept of States' rights, as set forth in the Constitution and the 10th Amendment thereto, but has struck a blow that will benefit both the American taxpayer and the American consumer.

The significance of *National League of Cities* v. *Usery* stretches far beyond the fact that State and local taxpayers will not have the Federal Government telling them to pay more for State and local government services than they might have to otherwise. The Court's ruling also suggests that legislation to apply the provisions of the National Labor Relations Act to State and local employees would be equally inappropriate. Thus, the threat to the sovereignty of State and local governments—in dealing with their employees—is mitigated if not altogether removed.

Furthermore, it seems to me that if it is unconstitutional to apply the provisions of the Fair Labor Standards Act to State and local governments, it is equally unconstitutional to apply the provisions of the Davis-Bacon Act to State and local governments. Currently, and also in the General Revenue Sharing bill the House passed on June 10th, Davis-Bacon provisions come into play on any project more than 25 percent of which is financed out of General Revenue Sharing funds. Since those projects are State and local government projects financed by the taxpayers of those jurisdictions, having the Federal Government set pay scales for workers on them is just as much an abridgment of States' rights as having the Federal Government set pay scales for workers directly in the employ of those governments.

There will obviously be those who will view the Supreme Court decision in *National League of Cities* v. *Usery* with fear and trepidation. However, when the dust has settled and the smoke has cleared, I think we will find that this decision is going to be a great benefit to the American people. By keeping alive the distinction between intrastate commerce and interstate commerce and by building on the time proven axiom that the level of government best able to solve problems is that closest to the people involved, the ingenious American System of checks and balances can continue to function as it should. If anything, State and local governments should take over more of the responsibility for problem solving from the bloated federal bureaucracy.

## CAPITAL FORMATION

I concur in the Minority view with respect to Capital Formation. I see in this area our most critical problems since the failure to stimulate the private sector is without question at the very basis of our unemployment problem.

It is for that reason that I introduced my Investment Incentives Act of 1976 (S. 2909). That bill would provide for Congress to take steps at once to modify our federal tax policies to direct more financial resources into productive capacity. Any one or a combination of several approaches could be taken, including: (1) Liberalization of the investment credit; (2) liberalization of depreciation allowances; (3) elimination of double taxation of corporate income and stockholder dividends; (4) reduction of corporate income tax rates; (5) more favorable treatment of net operating losses; and (6) tax incentives for personal savings.

These are types of tax incentives that will facilitate capital investment and thereby enhance the ability of the private sector to grow, to provide new jobs, to increase productivity and wages, to help us achieve energy independence, and in general to promote the economic well-being of our citizens.

## REGULATORY REFORM

Experience has shown that government regulation of business is anticonsumer because it drives up the prices of goods and services the people need and results in shortages of essential products that people use.

Congress should take a good hard look at what government agencies and "big brother" bureaucrats are doing. A comprehensive overhaul of our vast government machinery is called for, with a view to abolishing unnecessary agencies and repealing wasteful and costly regulations and programs.

As a fiscal conservative and member of the Senate Finance Committee, I have consistently voted to cut out unnecessary programs and agencies, cut down on federal spending and cut back the inflated bureaucracy.

Recently, I introduced legislation designed to cure the most common problems which consumers and businessmen encounter in dealing with the federal regulatory agencies. My bill, S. 2792, the Regulatory Reform Act, would make every federal agency demonstrate to the Congress that the economic benefits of a proposed rule exceed its costs, require the Congress to review and approve every such regulation, eliminate unnecessary paperwork, report filing and record keeping requirements, and do away with costly red tape delays. In addition, I am pleased to cosponsor so-called "sunset" legislation which would eliminate inactive and overlapping federal programs and require congressional review of government programs every five years.

Regulatory reform is long overdue, in my opinion. The sooner that economic controls are lifted, the sooner power can be returned to the people and we can again enjoy the benefits of our free enterprise system.

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