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THE 1977 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS BEFORE THE JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES NINETY-FIFTH CONGRESS FIRST SESSION

PART 4 INVITED COMMENTS

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THE 1977 ECONOMIC REPORT OF THE PRESIDENT

The following nine organizations and individual were invited by the Joint Economic Committee to submit their views and comments on the 1977 Economic Report of the President: American Bankers Association, American Council of Life Insurance, Chamber of Commerce of the United States, Federal Statistics Users' Conference, Machinery and Allied Products Institute, National Association of Manufacturers, National Farmers Union, New York Chamber of Commerce and Industry, United States Savings and Loan League, and Mr. Jerry Voorhis.

The statements received in response to this invitation were considered by the Committee in the preparation of its annual report to the Congress and are printed here as part of the record of the Committee's hearings on the 1977 Economic Report of the President. The text of the Committee's letter of invitation appears below:

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., February 18, 1977.

DEAR _____: Under the Employment Act of 1946, the Joint Economic Committee has the responsibility of filing each year a report containing its findings and conclusions with respect to the recommendations made by the President in his Economic Report. Because of the limited number of days available for hearings, the Committee is requesting a number of leaders of business and finance, labor, agriculture, consumer, and environmental organizations to submit statements for the record on economic and energy issues facing the Nation. These statements will be made a part of our hearings on the Economic Report in a printed volume containing such invited statements.

Accordingly, as Chairman, I invite your comments on the economic issues which concern the Nation and your organization. Under separate cover I am sending you a copy of the 1977 Economic Report of the President, filed January 18, 1977.

We would like to distribute copies of your statement to members of the Committee and the staff, and would therefore appreciate your sending 30 copies by Monday, March 21, 1977, to Milton Tillery, staff assistant, room G-133, Dirksen Senate Office Building, Washington, D.C.

Sincerely,

RICHARD BOLLING, *Chairman.*

AMERICAN BANKERS ASSOCIATION

ECONOMIC POLICY RECOMMENDATIONS

We appreciate this opportunity to present our views on the important economic issues facing the nation today. Although there are many important issues that require attention, we would like to focus on the fiscal stimulus package recently proposed by the Carter administration and now under consideration in Congress.

The Carter administration has proposed an economic stimulus package which would provide about \$30 billion in stimulus over a 2 year period. This package includes about \$11 billion in personal income tax rebates, about a \$7 billion reduction in personal income taxes, and over \$3 billion in tax credits for business. It also includes over \$11 billion in increased expenditures for public works, public service employment, countercyclical revenue sharing, and training and youth programs.

The administration predicts that this package will result in a 5¼ to 6 percent rate of real growth from the fourth quarter of 1976 to the fourth quarter of 1977. The administration feels that without this stimulus package, real growth during this period would be only 4½ to 4¾ percent. They also predict that the stimulus package will reduce the rate of unemployment to between 6.7 percent and 6.9 percent by the end of 1977. At the same time, the administration hopes to prevent any significant increase in the rate of inflation.

We feel that the administration's goals are desirable. Achieving these goals will help the economy back onto a stable longrun growth path which is essential for the increased well-being of our citizens. An attempt to increase employment more rapidly would lead in the short run to a higher rate of inflation which would, inevitably, reduce the rate of growth of employment.

While we support the economic goals set by the Carter administration, we are concerned about some of the proposed methods of achieving them. For example, we would prefer a permanent tax reduction to the tax rebates included in the Carter proposal. The effect of the proposed rebate would be concentrated in the second and third quarters. Many signs indicate that we will be experiencing a strong expansion during the second and third quarters. Thus, the impact of the rebate could come at a time when it is unnecessary and may even significantly increase the rate of inflation. The size of the permanent tax reduction scheduled for 1978 is only half the size of the 1977 rebate. Thus, although the tax rebate will result in some temporary increase in consumer expenditures, businessmen will recognize this as a temporary increase and will not have an incentive to respond with any permanent increase in production levels. The rebate will do nothing to encourage businessmen to commit additional funds for plant and equipment expansion. Instead of stabilizing the economy and providing a framework conducive to continued expansion, the rebate will merely provide

a temporary spurt which may be poorly timed and will increase uncertainty about governmental economic policy.

We share the administration's concern over the unemployment problem, particularly among those who have remained unemployed for a long period of time. We recognize that special programs are needed to accommodate the large number of women and teenagers who are entering the labor force and to deal with the employment problems of racial minorities. However, where possible we would prefer efforts which create jobs which are likely to be permanent and productive and represent a net increase in employment. We feel that jobs within the private sector are most like to meet these criteria. Thus, it is essential that public jobs programs be flexible enough to be phased out as the recovery proceeds so that longrun growth in private employment is not impeded.

We also feel that any program to facilitate long-run growth must include increased incentives for business investment. Capital formation is the key to an expansion of both productive capacity and employment. Investment decisions hinge on considerations of long run profitability. Thus, investment incentives should be of a long-term nature. Permanent changes in the corporate tax rate will have the most significant impact on the willingness of businessmen to commit funds for capital investment.

The size of the proposed stimulus package may not be sufficient to aggravate inflation at this time. However, most signs point to a resumption in the economic recovery following the brief pause in the third and fourth quarters of 1976 and the difficulties caused by the severe weather in January and early February. Thus, any stimulus greater than that proposed by the Carter administration would risk a significant increase in inflation when the stimulus became effective.

While the budget deficit proposed by the Carter administration may not be excessive under current conditions, this large deficit could make it difficult to raise funds for the investment needed to sustain an accelerated recovery. The moderate pace of the recovery has, until now, prevented the large Federal deficit from interfering with private capital investment. Nevertheless, as the recovery continues it will be necessary to reduce the size of the Federal deficit to prevent such interference. Although the deficit will be reduced automatically as the recovery proceeds, we feel there should also be some flexibility to reduce the size of the spending programs proposed for 1978 if the recovery is sufficiently strong.

We are particularly concerned about the proposals for voluntary wage and price restraint. We view recent U.S. experience with both voluntary and mandatory wage and price controls as a complete failure. In particular, the controls make it difficult to achieve the constant adjustment in relative prices that are necessary for the economy to function smoothly and equitably. In addition, we feel that the controls can only temporarily restrain inflationary pressures created by inappropriate monetary and fiscal policies. Given the recent history of controls, voluntary controls could lead both business and consumers to anticipate mandatory controls and to respond accordingly.

The process of prenotification of price increases recently discussed by the administration and others is particularly disturbing. Pre-notification of price increases for items that can be inventoried would

create pressures for speculative buying that would be confusing to both buyers and sellers. Even for items that are not inventoried, it should be recognized that for a variety of reasons, transactions frequently do not take place at list prices. Thus, it is not clear what would be accomplished by this policy. In addition, the prenotification procedures would affect only a portion of the economy.

Finally, we feel that the record of the last 15 years indicates that frequent changes in macroeconomic policy in an attempt to offset swings in the business cycle, can often have a destabilizing effect. Thus, we would caution against excessive reliance on fine-tuning. Frequent changes in Government policy do not provide the type of environment in which stable, longrun growth is likely to occur.

Again we appreciate this opportunity to represent our views and commend the Joint Economic Committee for providing a public forum for the discussion of these important issues.

AMERICAN COUNCIL OF LIFE INSURANCE

This statement is submitted on behalf of the American Council of Life Insurance, a national trade association with a membership of 444 life insurance companies which account for 90 percent of the legal reserve life insurance in force in the United States. At the end of 1976, the total assets of the life insurance business aggregated close to \$320 billion, representing the funds that have been entrusted to our business by millions of individual policyholders and employee benefit plans. We appreciate the invitation of the Joint Economic Committee to present the views of our business on the serious economic issues that confront the Nation and affect the well-being of our policyholders.

RECENT TRENDS AND THE ECONOMIC OUTLOOK

Economic developments in 1976 were disappointing in several ways. The pace of economic expansion slowed markedly in the latter half of the year and real growth declined to a 2½ percent rate in the final quarter. The unemployment rate, after touching a post-recession low of 7.3 percent last May, reversed course with a rise to 8 percent in November. At the same time, the inflation rate, measured by the GNP price deflator, renewed its upward climb to more than 5½ percent in the fourth quarter of 1976.

The opening weeks of 1977 witnessed still further difficulties for the economy, largely brought on by severe winter weather, producing major cutbacks in industrial production, retail sales, housing starts and employment. Much of this lost ground will doubtless be made up in the coming months. But the effect of cold weather and drought conditions on the prices of farm products and fuel supplies is likely to be felt through the remainder of 1977.

Even without the damaging effects of abnormal weather, pressures toward higher rates of inflation have been clearly visible to economic forecasters, who have widely predicted that the year-over-year inflation rate would rise to 5½ to 6 percent in 1977, against a 5.1-percent price advance last year. As shown in Fiscal Year 1978 Budget Revisions presented in February by the Carter administration, the official Government forecast in 1977 is for an increase of 5.6 percent in the GNP price deflator. The recent problems with food and fuel prices have led many forecasters to raise their estimates to 6 percent or more for the current year. Indeed, the inflation rate is widely expected to reach a 6½-percent annual rate by the closing months of 1977.

We in the life insurance business are particularly sensitive to the persistence of high rates of inflation and to a renewal of forces that could push up prices at an even faster rate. Our policyholders and pension beneficiaries are directly affected by the continuing erosion of the purchasing power of the dollar, since their insurance protection and pension payments are based almost entirely on fixed-dollar

amounts. Beyond these considerations, we share the concern of all thinking citizens who recognize that constantly rising price levels disrupt the efficient functioning of our economic system and detract from the well-being of every segment of our society. Its impact is particularly devastating on the elderly and low-income groups least able to escape from or offset the impact of rising prices on their limited incomes and their savings.

STIMULATION THROUGH FISCAL POLICY

In examining the prospects for economic activity in the period ahead, it is evident that some measure of Government stimulus to the economy is needed to improve the pace of economic expansion. In our view, the overall dimensions of the fiscal stimulus package presented to the Congress by President Carter represent an appropriate degree of economic stimulation. However, we should like to offer our comments on certain aspects of the administration's proposals.

We are in general accord with the emphasis by the Carter administration on a direct attack on the structural unemployment that plagues our economy. We have long favored specific and limited programs to improve employment opportunities among the unskilled, among younger workers, within minority groups, and in our central cities where unemployment rates are especially high. A direct approach to these problems, if properly administered, should prove more effective and far less costly than a massive fiscal thrust designed to boost total demand in the economy to a point that would eliminate structural unemployment. The basic objective of our national employment policies should be to enlarge the number of permanent jobs available in the private sector, backed by special programs to alleviate structural unemployment within our potential work force.

The new administration has proposed a program of tax rebates for individuals to provide a prompt though temporary boost to consumer spending power and to thereby stimulate production and employment. We endorse this concept in the original form proposed, namely, a \$50 payment to each taxpayer and his or her dependents and to social security beneficiaries. There has been some recent discussion about limiting such payments to those with incomes below a certain level, on the grounds that those with higher incomes might not spend the rebates immediately and the impetus of the intended economic stimulus would thus be diminished. However, it should be recognized that those tax rebates that go fully or partially into some form of saving are equally beneficial to the economy, by providing a greater volume of available investment funds through savings institutions and other financial intermediaries. Tax rebates that are not immediately spent would not be lost to the economy; they would funnel instead into greater supplies of home mortgage credit and job-creating business capital investment.

The administration's proposals for business tax relief would provide an option of (1) an income tax credit equal to 4 percent of social security taxes paid by employers, or (2) an additional 2-percent tax credit for new investments in equipment or machinery. We believe that the option of the credit against social security taxes would represent an undesirable precedent for using general revenues to support

the social security system. Employers would no longer be subject to the full cost of their social security tax contributions since a part of this cost would be offset by the Federal Government through the proposed 4 percent income tax credit. In this respect, the proposed credit would be equivalent to the interjection by the Federal Government of general revenue funds into the social security system, since the result would be the same as if the employer's social security tax were reduced directly and the Government contributed to the social security trust fund an amount equal to the revenue loss due to the credit.

In our view, a preferable approach would be to give first priority to business tax relief through an additional 2 percent on the investment tax credit, in order to encourage a faster rate of capital formation that is so badly needed in our economy to improve productivity and enlarge output. An even better approach would be to give business tax relief through a lower corporate income tax rate, possibly 46 percent instead of the present 48 percent. This latter approach would have a longer-lasting and broader-based benefit in stimulating capital investment, research and development expenditures, and creation of permanent new jobs.

The administration has indicated that its fiscal package is primarily designed to provide an immediate stimulus to consumer spending and jobs, with more permanent reform measures in our tax system to be recommended at a later date. We urge that the main thrust of such permanent changes should be aimed at encouraging business capital expansion over the long run. Studies indicate a clear need for increasing the proportion of our GNP devoted to capital investment in order to attain faster growth in productivity and to provide the new jobs and environmental improvements needed in the years ahead. While the proposed package of fiscal stimulus should meet the immediate needs of our slow-growth economy, greater attention should be paid to the effect of our tax system in hampering or helping to meet our long-range needs. Among those areas that deserve careful review are possibilities of a reduction in the corporate income tax rate—as mentioned above—and relief from the double taxation of corporation dividends. We believe the investment tax credit should be made permanent, to make it an effective incentive in long-range planning by business. In the individual income tax area, attention is also needed on the effects of inflation in pushing taxpayers into progressively higher brackets, thereby reducing their real disposable income and limiting their capacity to provide the private savings that underlie capital formation in our economy.

FISCAL STIMULUS AND INFLATION

While we endorse the magnitude of the administration's fiscal package and its mix of job-related spending and tax reductions for individuals and business firms, we are deeply concerned over the possibility that Congress may choose to enlarge the package in a substantial degree through greater spending on public works and perhaps other programs.

In our view, the administration's original fiscal package would not add significantly to inflationary pressures in the economy if it is limited to approximately \$15 billion in fiscal 1977 and a similar or smaller amount in fiscal year 1978. However, we note that the projected total

for Federal Government expenditures in fiscal 1977 would rise to \$417 billion, an increase of 14 percent over fiscal year 1976. It is our belief that total Government spending, including outlays of the "off budget" agencies, should not be allowed to increase at a rate faster than the growth of total GNP. If such restraint is not exercised, the U.S. economy is faced not only with greater inflation, but also with enlargement of the public sector at the expense of the private sector.

Including the fiscal effects of the administration's stimulus package, the Federal deficit for fiscal year 1977 is presently projected at about \$68 billion, against \$66½ billion in the fiscal year 1976. For the fiscal year 1978 beginning in October, a Federal deficit close to \$58 billion is indicated under the administration's proposals. If the net outlays of "off-budget" agencies are included, the Federal deficit would amount to nearly \$79 billion in fiscal year 1977 and \$66 billion in fiscal year 1978. A major consequence of these huge deficits is the very substantial amount of Treasury borrowing that would be required, estimated at \$75 billion or more in calendar 1977. There can be little question but that Federal financing of this magnitude will bring pressure on the financial markets, particularly if private borrowing needs also increase over the course of the year.

In this setting, congressional enlargement of the fiscal stimulus package would translate into an even bigger Federal deficit, heavier Treasury borrowing pressure on financial markets, and a consequent upward push on interest rates. In addition, the very prospect of higher Federal deficits can be a damaging factor to business and consumer confidence since big deficits are identified by the public with greater inflation ahead. Fortunately for the Nation, the Congress has established a means for guiding and controlling the fiscal magnitudes of spending, taxation, and Federal deficits through the procedures under the Budget Control Act of 1974. We urge the Budget Committees of the House and Senate, exercising their special responsibilities, to resist an enlargement of the administration's fiscal stimulus package in the interests of restraining inflation and holding down added borrowing pressures in our financial markets.

SETTING OUR ECONOMIC GOALS

The new administration has indicated that it intends to achieve a balanced Federal budget within the next 4 years. We applaud this goal as a needed condition of economic stability and balanced growth by the end of this decade. Another announced goal of the administration is to reduce the unemployment rate as rapidly as possible toward the 4-percent level as representing a "full employment" rate. We believe that the 4-percent goal is both unrealistic and inconsistent with the present composition and structure of our labor force. Studies by the Council of Economic Advisers have indicated that a more realistic measure of the "full employment" unemployment rate is closer to 5 percent under today's conditions. It would be unfortunate indeed if the pursuit of an unrealistic goal for unemployment were to lead to Government policies which brought about more inflation by overreaching the bounds of manpower efficiency and industrial capacity.

One critical economic goal that is notably absent from the stated objectives of the legislative or executive branches is a target for the inflation rate. After the recent experience with double-digit inflation, reduced currently only to a 6-percent range, the intolerable effects of inflation on every segment of society should be clearly evident. Concern over unemployment, which effects a fraction of the working population, should at least be matched by a concern over high and persistent inflation rates which adversely affect the entire population—the poor, the elderly, and working people at all income levels. There is no trade off between the goals of price stability and unemployment, since the achievement of both goals is interdependent. If we are to increase the output of goods and services and reduce unemployment, we must make further progress in reducing inflation.

Announcement of a specific inflation target, actively pursued through ongoing public policies, could do much to improve public confidence in the long-range prospects for reasonable price stability and a return to conditions in which decisions about spending, saving, and investment can be made with less uncertainty.

WAGE AND PRICE CONTROLS OR GUIDELINES

With inflationary forces still very evident in the economy, the possibility that wage and price controls might be reimposed remains an issue of active discussion and great concern in the business world. While the administration has indicated that it will not seek such authority, there have been suggestions that some system of guidelines or Federal surveillance or prenotification of wage and price increases might come into more active use. We are opposed to such measures as a means for resisting inflationary trends.

Past experience has demonstrated the many ways in which controls or other restraints have led to shortages and distorted economic decisions among producers and buyers alike. Controls, in whatever form, merely cloak the symptoms of inflation without going to the root causes of inflation. We believe that public policy to restrain inflationary forces should be focused on responsible management of Government spending within the framework of available revenues, together with a flexible monetary policy that is free to counter inflationary pressures that may arise from the financial side of the economy. A greater sense of public responsibility by both business and labor can help to hold back inflation, and the many activities of the Federal Government itself can also be an important factor. We applaud the recent declaration by President Carter that Cabinet officers will evaluate continuously the inflationary impact of their departments' programs and regulations.

MONETARY POLICY

Over recent months, the Federal Reserve has pursued a policy of accommodating credit needs in a degree sufficient to foster expansion of the economy. This policy has been appropriate to a period in which real growth has lagged, unemployment has remained high, and the economy has run below its potential. In the coming months it may

prove necessary for the Federal Reserve to move away from its present accommodative posture toward a middle ground that will restrain inflationary pressures but will not check the pace of business expansion.

Closely related to future Federal Reserve policy is the inflationary potential of an enlargement by the Congress of fiscal stimulus beyond the moderate sized package that the administration has proposed. If Federal spending is raised further, the inflationary consequences could lead the Federal Reserve to move toward restraint in monetary policies, with an accompanying rise in interest rate levels that could serve to hold back economic growth. Fiscal and monetary policies are inevitably intertwined, and excesses on the fiscal side would require correction through greater restraint on the monetary side, if we are to achieve sustained real growth and avoid higher rates of inflation.

We continue to support the independence of the Federal Reserve System from policy encroachments by either the legislative or the executive branch. Toward this end, we are opposed to proposals that would make the term of the Federal Reserve Chairman correspond to the term of office of an incumbent President. We also believe that the effectiveness of the Federal Reserve would be seriously impaired by such measures as setting of monetary growth targets by the Congress, appropriation of Federal Reserve operating funds by the Congress, or audits of the policy positions of the Federal Reserve by the General Accounting Office. Our position in these matters is based on the belief that an independent and objective Federal Reserve System is an essential ingredient in the policy apparatus needed to avoid inflationary excesses and achieve balanced and sustainable growth. While the record of recent years in attaining these goals has been far from satisfactory, we would believe that a subservient and politically controlled Federal Reserve System would have led to even poorer results.

NATIONAL ENERGY POLICY

The problems of energy output and pricing have come to the forefront in recent years in our economy, leading not only to rapid changes in energy costs to consumers and business but also to major disruptions in the supplies of fuel sources available to the public.

The new emergency legislation on natural gas prices has eased the recent critical shortages in certain States and regions. The situations that developed in late January illustrates some of the adverse effects that regulation can produce on the supply side, when price ceilings limit the ability of the market system to adapt to changing circumstances. However, the recent natural gas legislation is temporary in nature and longer range solutions will obviously be required.

We welcome the emphasis that the new administration has been giving to formulation of a national energy policy which would encompass the interrelated problems of different energy sources. A comprehensive policy statement has been promised for presentation in late April.

We are hopeful that energy policies to be presented by the administration and reviewed by the Congress will recognize the need for gradual deregulation of energy prices, in order to remove barriers to efficient marketing and development of energy resources. There are

many ways in which we will have to adjust to higher energy costs, and greater reliance on competition and market forces should be a part of a comprehensive energy policy. Higher prices for our limited resources would, in a very tangible way, encourage conservation of energy by the public at large, in contrast to practices of earlier years that now seem highly wasteful in the light of our current situation.

SUMMARY REMARKS

In summarizing the views set forth above, we should like to re-emphasize the following points:

1. Inflationary forces remain very much alive in the U.S. economy today. The prospects in 1977 are for a rising, rather than a declining, rate of inflation. In this setting, budgetary policies of the Federal Government must be framed with extreme care to avoid adding fuel to the inflationary fire.

2. The \$15 billion fiscal stimulus package of the new administration is appropriate, in our view, providing a needed temporary boost to economic expansion without adding significantly to inflationary pressures.

3. The \$50 tax rebate offers a prompt and simple means of bolstering spending power at a time when faster economic growth is needed.

4. Business tax reduction should be focused on encouragement of greater investment outlays to create more permanent jobs, either through an increase in the investment tax credit or a lowering of the general corporation income tax rate.

5. Jobs programs should be focused on the special problems of structural unemployment. A direct approach to these problems is far preferable to a massive fiscal thrust which would be a much more costly and less effective way of reducing unemployment.

6. Attempts to increase the size of the fiscal stimulus package should be strongly resisted, since larger deficits are likely to have inflationary consequences, bring greater borrowing pressure on financial markets, and result in higher interest rates later in the year.

7. Federal Reserve policy of accommodation has been appropriate to the current needs of fostering more rapid economic expansion. However, a resurgence of inflation, possibly aided by excessive fiscal stimulus as noted above, could prompt the monetary authorities to adopt a more restrictive credit policy that would hold back the pace of economic expansion in the process of fighting inflation.

8. Use of direct wage and price controls, guidelines, or other forms of Federal intervention should be scrupulously avoided, since they merely address the symptoms of inflation without correcting the fundamental causes. Past experience has demonstrated the distorting effects that controls or guidelines can have on business decisions and long-range planning.

9. A coordinated and comprehensive national energy policy is needed to encourage greater conservation of our limited resources and to encourage development of new energy sources. Fundamental to these objectives is a gradual deregulation of energy prices to avoid the distortions and disruptions of the recent past.

CHAMBER OF COMMERCE OF THE UNITED STATES

(By Jack Carlson, Vice President and Chief Economist)

I welcome this opportunity on behalf of the Chamber of Commerce of the United States to comment on the economic outlook as indicated in the Economic Report of the President and the Annual Report of the Council of Economic Advisers.

The chamber's forecast is significantly different from the forecast found in the Ford administration's report and from the Carter administration's forecast contained in the budget revisions, announced February 22, 1977.

The chamber is forecasting a slower growth of the economy, higher inflation rate, higher level of unemployment and higher rate of interest than either the Ford economic message or the Carter budget revisions contained (see table 1).

TABLE 1.—COMPARISON OF ADMINISTRATIONS' AND CHAMBER FORECASTS
[Percent change]

	Actual 1975	Prelimi- nary 1976	Forecast					
			1977			1978		
			Ford	Carter	Chamber	Ford	Carter	Chamber
CNP (real change).....	-1.8	6.2	5.2	5.4	5.0	5.1	5.4	4.5
Consumer Price Index.....	9.1	5.7	5.1	5.1	6.5	5.4	5.4	7.0
Unemployment.....	8.5	7.7	7.3	7.1	7.3	6.6	6.3	6.8
Interest rates (3 mo. U.S. bill rate).....	5.8	5.0	4.4	4.6	+5.0	4.4	4.6	+5.0

These differences occur even though the chamber's forecast has fully adjusted to President Carter's taxing and spending proposals. The Ford fiscal year 1978 budget submission to the Congress has been revised to reflect the \$8 billion spending proposed by President Carter in his economic stimulus message of January 31, 1977 and the \$11.4 billion even higher spending recommendations found in President Carter's budget revisions, February 22, 1977 or a total increase in spending above the Ford proposed budget of \$19 million. Adjustments for the likely additional expenditures originating within the Congress, however, are not included, such as appear in the first resolutions.

The Carter deficit in fiscal year 1977 is likely to be a record \$73 billion and the fiscal year 1978 deficit is likely to be near the same size (see table 2).

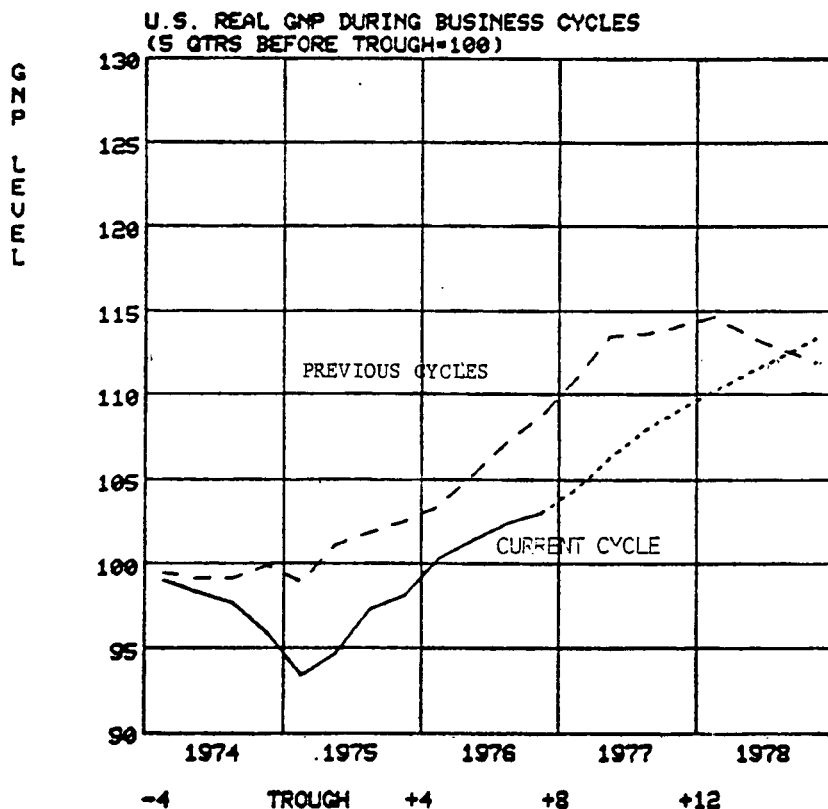
TABLE 2.—COMPARATIVE FORD AND CARTER OUTLAYS, RECEIPTS AND DEFICITS

	Fiscal year 1977	Fiscal year 1978
Ford outlays.....	411.2	440.0
Carter spending increases (stimulus proposal) ¹	1.2	8.0
Carter spending increases (budget revision) ²	5.0	11.4
Carter outlays.....	417.4	459.4
Ford receipts (without Ford tax cuts).....	360.0	409.6
Carter tax cuts.....	10.6	7.9
Carter receipts.....	349.4	401.6
Ford deficit.....	57.2	47.0
Carter deficit.....	68.0	57.7
Carter deficit with chamber forecast.....	73.0	65.0
Congressional deficit with chamber forecast ³	75.0	70.0

¹ Jan. 31, 1977.² Feb. 22, 1977.³ Resolutions and/or legislative action as of Mar. 31, 1977.

The chamber forecast and the recovery from the 1974-75 recession can be compared with past recoveries. Real GNP exhibits and will continue to exhibit a recovery less than in previous cycles until near the end of 1978 (see chart 1).

CHART 1

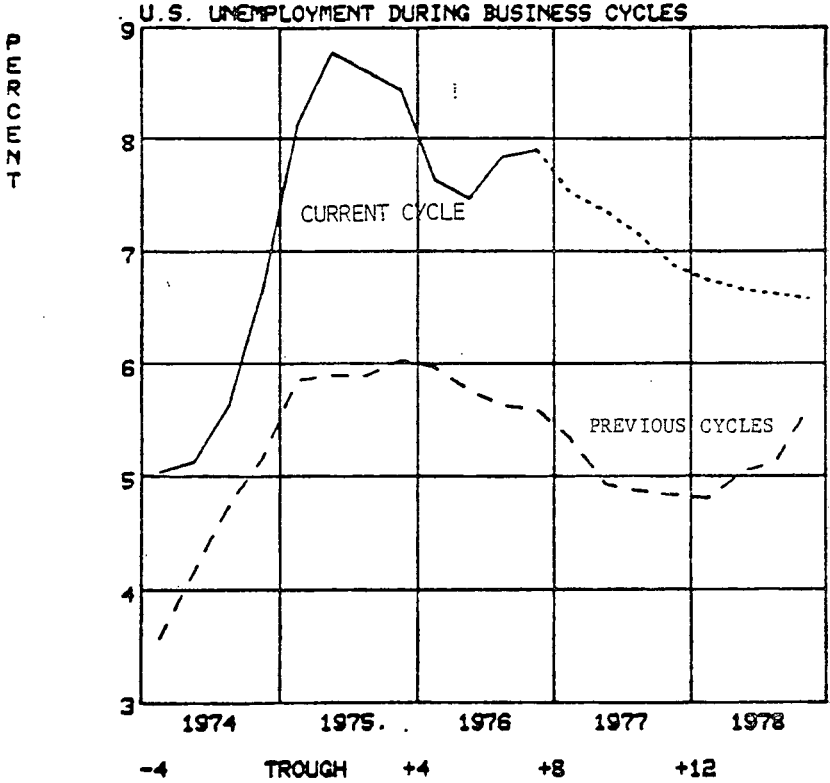


Source: Forecasting Center, Chamber of Commerce of the United States;

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Both the deepness and slower recovery is mirrored in the higher level of unemployment experience throughout this recovery and forecast to continue through 1978 (see chart 2). However, the growth of employment has been comparable to past recoveries.

CHART 2

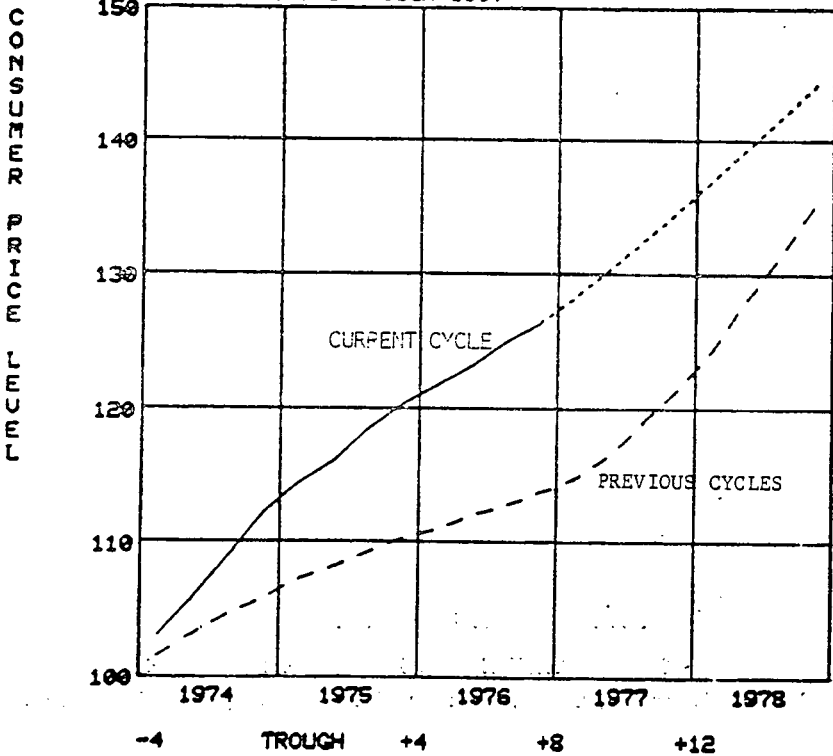


Source: Forecasting Center, Chamber of Commerce of the United States.

Consumer price increases have been greater throughout this recovery period compared to past recoveries and promises to remain so during the next 2 years. Unfortunately the best of price performance during this recovery is likely to be behind us. Consumer prices increased by 4.8 percent from December 1975 to December 1976. They are likely to increase 6½ percent annually during the next 2 years (see chart 3).

CHART 3

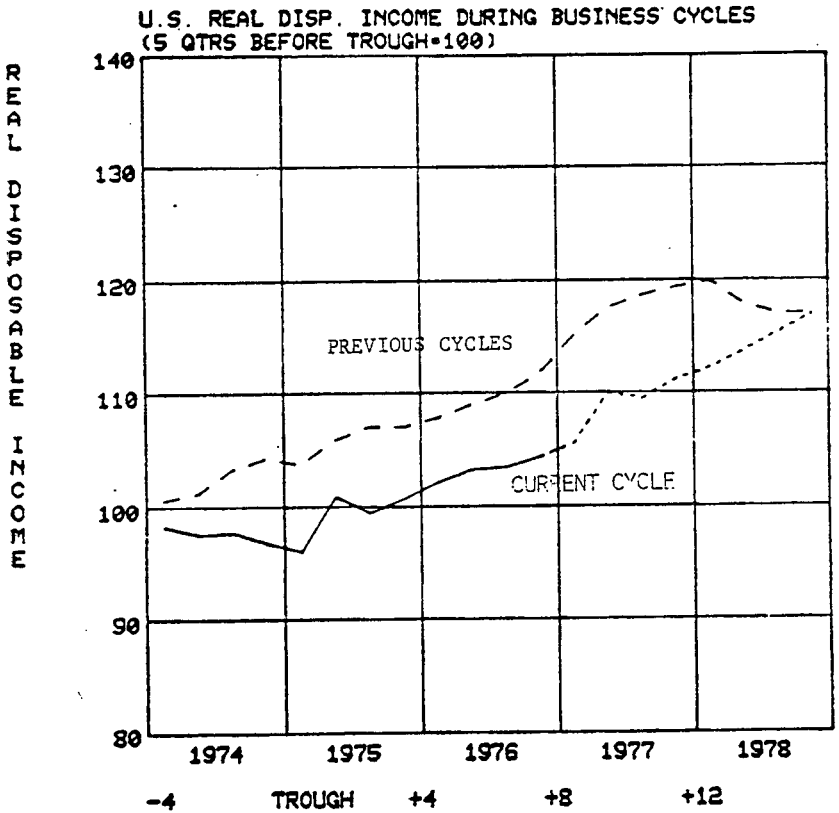
U.S. CONSUMER PRICES DURING BUSINESS CYCLES
(5 QTRS BEFORE TROUGH=100)



Source: Forecasting Center, Chamber of Commerce of the United States.

In spite of the high rate of inflation, real disposable income has suffered much less than investment and Government sectors and will likely improve by the end of 1978 to match the performance in past cycles (see chart 4).

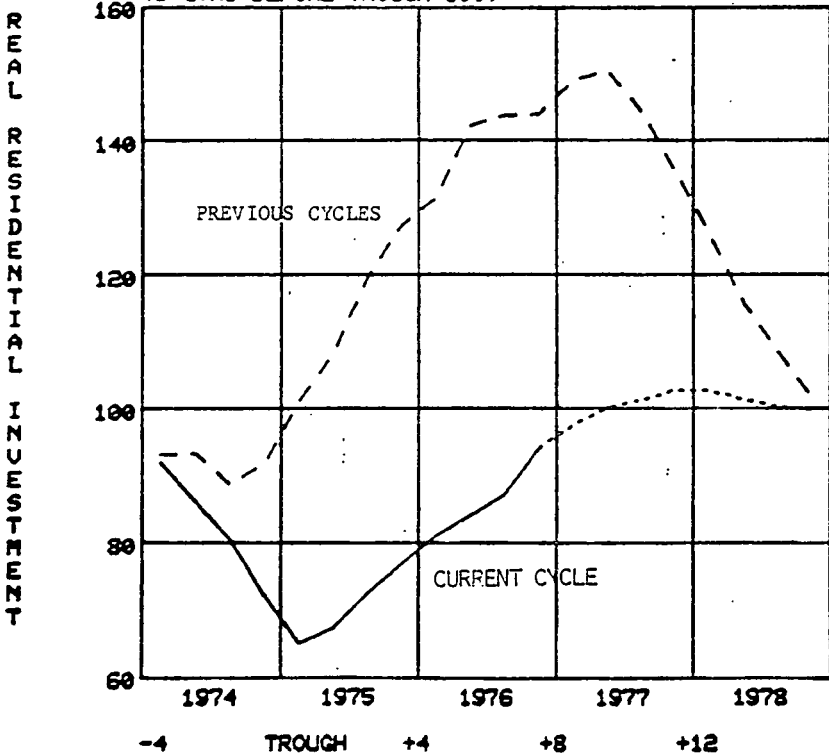
CHART 4



Although residential investment was slow to recover from the 1974-75 recession it has improved significantly during the last 2 years. However, residential investment is likely to peak near the end of 1977 and drift downward through 1978. This is likely to occur because of an increase in long-term interest rates and increase in cost of construction material (see chart 5).

CHART 5

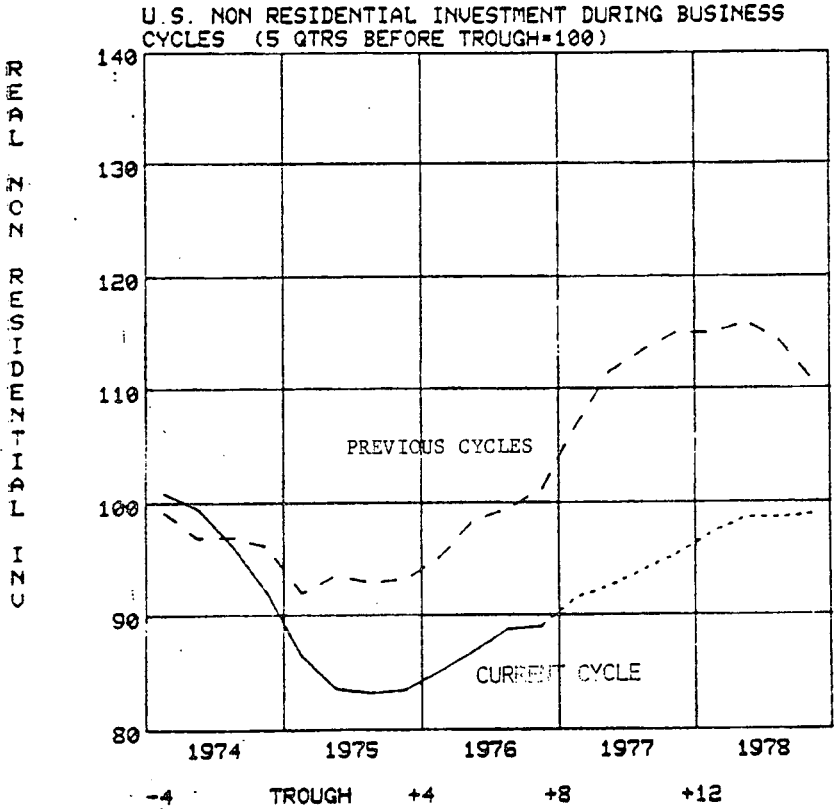
U.S. RESIDENTIAL INVESTMENT DURING BUSINESS CYCLES
(5 QTRS BEFORE TROUGH=100)



Source: Forecasting Center, Chamber of Commerce of the United States.

The greatest disappointment in this economic cycle has been and continues to be the weakness of nonresidential investment. Non-residential investment has been much lower than capacity utilization, availability of loanable funds, and interest rates would indicate that it should be. Clearly the risk of investment has increased and caused businessmen to hesitate more than during previous recoveries (see chart 6).

CHART 6



Source: Forecasting Center, Chamber of Commerce of the United States.

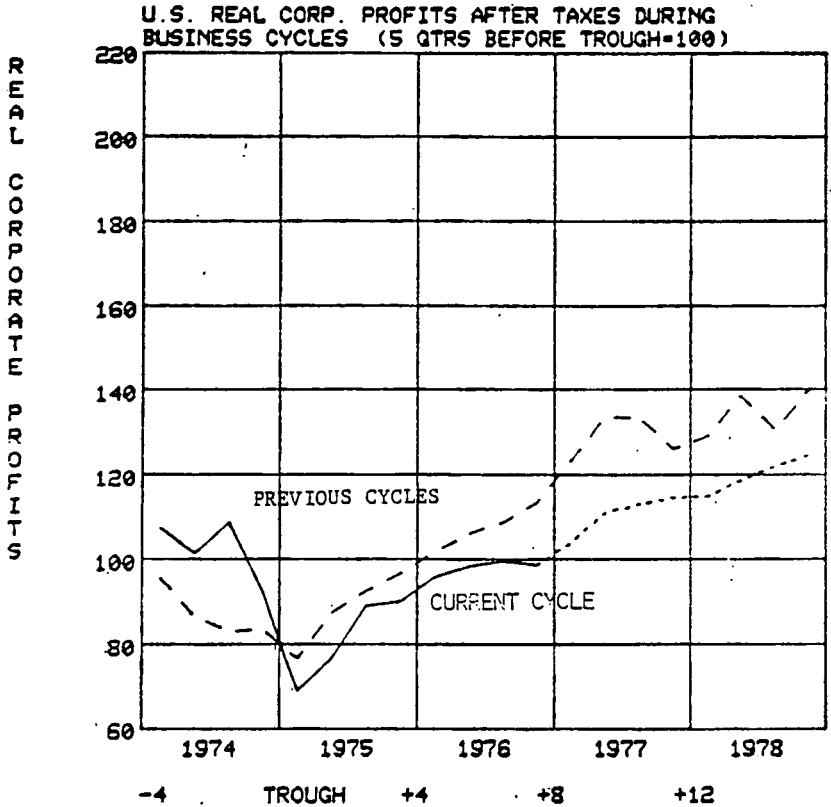
The policies of the Federal Government have been a major cause of the greater risk of investment. Business is fearful that Government spending is accelerating and will become an engine for inflation as evidenced by the fiscal year 1978 stimulus proposals for public works spending, the large spending add-ons found in the Carter budget revisions, congressional actions to ratchet-up spending even higher, discussion of new wage and price controls, changes in air quality policy, and changes in taxes on investment and business.

Unfortunately, the needs for encouraging investment are not fully appreciated. President Carter's stimulus provides only about one-tenth of the total dollar amount of his stimulus package for encouraging investment in equipment. No stimulus is provided for encouraging investment in structures. The Senate Finance Committee has generally accepted the administration's investment tax proposal. However, the House of Representatives provided no encouragement for investment for either equipment or structures. In marked contrast, the stimulus provided by the Congress and the administration in 1975 and 1964 provided twice the proportion proposed by the administration and the Senate Finance Committee. Yet the shortage of capital is much greater today than in 1975 and 1964.

Although encouragement of demand growth is important, lowering the cost of plant and equipment would provide investment on a more timely basis. It would offset the increasing cost and risk of investment—much of which has been created by Government policies. This is the greatest shortcoming of the economic stimulus program and could cripple an orderly recovery to full employment. The economy could return to double-digit inflation as unemployment declines below 6 percent unless the tools for the larger work force are available. This will require increasing the rate of investment by one-fifth—from 9½ percent of GNP to 11½ percent.

In the future, especially in 1978 and beyond, sources of funds for making private investments will become critical. Loanable funds are plentiful now and demand for loanable funds is what is missing. When the demand for loanable funds increases even modestly, available funds for business will be strained, especially if the Federal Government continues to run high deficits that are financed with the increasingly scarce loanable funds. Depreciation allowances have not and are forecast not to cover replacement costs. Equity markets—stocks and bonds—are only modestly healthy for providing additional funds. Real corporate profits have recovered more slowly during this economic recovery and are forecast to remain below previous economic cycles and thus will be an unsatisfactory source of investment funds, as well as signaling caution to investors (see chart 7).

CHART 7



Source: Forecasting Center, Chamber of Commerce of the United States.

Beyond the next 18 months, during 1979 and 1980, the likelihood of a recession is high. An abnormal swing in inventories partly because of erratic Government policies, such as the yo-yo effect of a temporary tax (rebate) instead of a permanent tax cut, could add to the likelihood of a recession. Historically recessions have occurred by the fifteenth quarter after previous recessions. The fifteenth quarter will be the end of 1978. Based upon historical data and risks observable now, a recession or a marked slow down in the growth of the economy is likely by 1979 or 1980.

The Chamber of Commerce applauds and will work to help President Carter achieve his economic goals. However, policies being created by the Congress and in some cases recommended by the President, will make it very difficult to achieve them (see table 3):

TABLE 3.—PRESIDENT CARTER'S ECONOMIC GOALS

[In percent]

	President's	Chamber
GNP growth.....	6.0	4.3
Unemployment.....	4.5	6.5
Inflation rate.....	4.0	6.5
Lowest Federal deficit.....	0	(¹)
Federal Government/GNP.....	21.0	+23.0

¹ \$30,000,000,000.

Source: Forecasting Center, Chamber of Commerce of the United States.

Although the administration and the Congress are intent on stimulating the economy during the second quarter of 1977, an argument can be made to delay the major part of the stimulus until the obvious boom conditions of the second and third quarters are behind us. Such a position is taken by Chairman Burns of the Federal Reserve Board. If, however, a stimulus is desired it should not add to the temporary and unsustainable boom but the stimulus should be evenly and continuously applied during the second and third quarters and thereafter. A permanent tax cut should be used instead of a tax rebate. A permanent tax cut would provide more permanent jobs than will a tax rebate (see table 4).

Economic stimulus that relies on an increase in spending should be discouraged in preference to tax cuts, especially increases in spending that lead to a ratchet-up in the rate of Government spending in future years. Such an increase in spending is likely to become the engine of inflationary pressure in future years. This is particularly true for public works projects. Public works projects also have the undesirable feature of stimulating the economy slowly. For example, the public works program proposed by President Carter is likely to only slowly create jobs in 1977 and 1978 (see table 5).

Because business fixed investment is low—9½ percent of gross national product, it would be very difficult for an adequate amount of tools to be available for workers so as to lower the unemployment rate below 6 percent without double-digit inflation within the next 4 years. A 20-percent increase in the rate of investment in plant and equipment is necessary—or 11½ percent of gross national product.

Although an increase in retail sales is very important to encourage investment, direct stimulus of investment is necessary to provide the investment on a timely basis. The increase in the investment tax credit would provide for equipment investment and an increase in the corporate surtax exemptions from \$50,000 to \$100,000 with a 20-percent tax would help to encourage investment in both equipment and structures and be fair to small business.

Various wage subsidies have been proposed. The administration proposes a 100-percent subsidy costing \$8,200 per job in the public sector. The House of Representatives proposed a tax-credit wage-subsidy of \$1,680 for new hires up to an amount of \$40,000 per firm.

The Senate has reduced the tax credit to \$1,050. Others have proposed that a tax credit subsidy be limited to assist the structurally unemployed. These efforts can be useful in creating additional employment and can be particularly useful in overcoming structural unemployment problems.

TABLE 4.—COMPARISON OF A \$10 BILLION TAX REBATE AND PERMANENT TAX CUT INITIATED MAY 1977

[Seasonally adjusted annual rates in billions of dollars, percent, or jobs]

	Real GNP (percent change)		Employment (jobs in thousands)		Unemployment rate (percent)		Federal deficit ¹ (in billions of dollars)		Real disposable income (percent change)	
	Perma- nent tax cut, \$10 billion	Rebate \$10 billion 2d quarter 1977	Perma- nent tax cut, \$10 billion	Rebate \$10 billion 2d quarter 1977	Perma- nent tax cut, \$10 billion	Rebate \$10 billion 2d quarter 1977	Perma- nent tax cut, \$10 billion	Rebate \$10 billion 2d quarter 1977	Perma- nent tax cut, \$10 billion	Rebate \$10 billion 2d quarter 1977
1977.....	0.4	0.8	46	164	-0.1	-0.2	+5.0	+5.3	0.8	1.3
1st quarter.....	0	0	0	0	0	0	0	0	0	0
2d quarter.....	1.1	4.4	0	0	0	-1	+8.4	+33.6	4.3	17.9
3d quarter.....	1.3	1.1	25	101	-1	-3	+6.4	+8.0	.8	-9.6
4th quarter.....	.6	-2.6	135	454	-2	-3	+5.4	+4.2	.5	-9
1978.....	.2	-.9	310	212	-2	-1	+5.3	+2	.3	-1.3
1st quarter.....	0	-2.2	120	-50	-2	-2	+5.1	+8	.0	-1.7
2d quarter.....	-.2	-.8	67	-203	-2	-1	+5.2	-3	-.2	-.8
3d quarter.....	-.3	-.3	45	-82	-2	0	+5.4	-5	-.2	-.3
4th quarter.....	-.3	-.1	14	-111	-2	0	+5.7	-9	-.3	-.1

¹ Increase (+); decrease (-).

Source: Chamber of Commerce Forecasting Center

TABLE 5.—EXPANSION OF PUBLIC WORKS AND JOB CREATION

[Jobs in thousands and dollars in millions]

Fiscal year	Program expansion and date of appropriations						Jobs	Amount spent
	Existing program, \$2 billion, October 1976		Proposed program					
	Jobs	Amount spent	\$2 billion, September 1977		\$2 billion, September 1978			
	Jobs	Amount spent	Jobs	Amount spent	Jobs	Amount spent	Jobs	Amount spent
1977.....	48	\$800	0	0	0	0	48	\$800
1978.....	48	800	48	\$800	0	0	96	1,600
1979.....	12	200	48	800	48	\$800	108	1,800
1980.....	12	200	12	200	48	800	72	1,200
1981.....			12	200	12	200	24	400
1982.....					12	200	12	200
Total.....	120	2,000	120	2,000	120	2,000	360	6,000

	Amount spent (billions)	Temporary jobs created for a year or less
Fiscal years 1977 and 1978.....	\$2.4	144,000
Fiscal years 1979-82.....	3.6	216,000

Source: Fiscal year 1978 budget and appendix p. 196 were used for the timing of the existing program. The same optimistic timing was applied to the proposed program.

Efforts to create jobs in the public sector where 83 percent of all jobs are located are preferable to creating dead-end jobs in the Government sector. Also, job creation in the private sector is less costly for

the Government. A tax credit of \$1,000 to \$2,000 for a job in the private sector will create more jobs than \$8,200 of Government spending in the public sector and, most importantly, the public sector jobs are only temporary and dead-end.

All the efforts of the administration and the Congress to stimulate the economy and to create jobs can be nullified if the minimum wage is increased. If the administration's proposal to increase the minimum wage from \$2.30 to \$2.50 per hour and subsequent changes indexed to maintain 50 percent of average manufacturing wage are accepted by the Congress, about 900,000 full- and part-time jobs will be lost or about the same number of jobs will be lost that are estimated to be created by the administration's and Congress economic stimulus bills. The losers from an increase in the minimum wage are young workers, minorities, adult women, and old men (see table 6). Such an increase would cause average labor costs to increase by 1.3 percent. Higher labor costs will be sustained by small business and businesses located in the South, West, and other nonindustrialized States. Consumers would suffer a 1-percent increase in the prices they pay (see table 8).

If the House Subcommittee on Labor Standards of the Committee on Education and Labor's bill to increase the minimum wage to over \$3 an hour with an index for automatic increases thereafter is passed by the Congress then the job loss would be 2.7 million jobs (see table 7). Consumer prices will increase by 3 percent (see table 8).

We appreciate the opportunity to present our assessment of the economy before the Congress makes changes in spending and taxing policies.

TABLE 6.—THE IMPACT OF A MINIMUM WAGE INCREASE FROM \$2.30 TO \$2.50 ON EMPLOYMENT, UNEMPLOYMENT AND LABOR FORCE PARTICIPATION¹

	Popula- tion	Labor force	Reduction in employment			Percent losing employment	
			Labor force parti- cipation	Unem- ployment	Total ²	Popula- tion	Labor force
Teenagers 16-19:							
Whites.....	14, 272	7, 991	225	67	292	2	4
Nonwhites.....	2, 752	935	103	24	127	5	14
Males 20-24:							
Whites.....	8, 529	7, 369	100	57	157	2	2
Nonwhites.....	1, 353	1, 084	31	17	48	4	4
Males 65 plus.....	8, 049	1, 826	40	-----	29	1	2
Females white 20 plus.....	63, 853	35, 318	147	76	223	1/2	1
Total affected.....	98, 808	50, 483	646	241	887	1	2
Measured change from minimum wage (percent).....			-0.7	-0.3	-1.0		
Measured change from stimulus (percent) ³			+ .6	+ .5	+1.1		
Net change (percent).....			- .1	+ .2	+ .1		

¹ Males 25 to 64 are not included because the effect is small. However, over a long-run time period skilled adult worker employment would modestly increase as a result of the increase in the wage rates of low-skilled workers. Also, more equipment would substitute for low-skilled workers, and total output for the nation would be less.

² The total reduction in employment includes the reduction in part-time employees who average about 21 hr per week in employment. Approximately 1/2 the teenagers would fall in the part-time category.

³ Based on President Carter's Economic Stimulus Message, Jan. 31, 1977, totalling \$15,500,000,000 in each of fiscal years 1977 and 1978.

Source: Calculation based upon Jacob Mincer, Unemployment Effects of Minimum Wages, Journal of Political Economy, vol. 84, No. 4, pt 2, August 1976.

TABLE 7.—THE IMPACT OF A MINIMUM WAGE INCREASE FROM \$2.30 TO \$3.04 (60 PERCENT OF AVERAGE MANUFACTURING WAGES IN 1976) ON EMPLOYMENT, UNEMPLOYMENT AND LABOR FORCE PARTICIPATION)¹

	Popu- lation	Labor force	Reduction in employment			Percent losing employment	
			Labor force partici- pation	Unem- ployment	Total ²	Popu- lation	Labor force
Teenagers 16-19:							
Whites.....	14,272	7,991	686	205	891	6	11
Nonwhites.....	2,752	935	313	77	390	14	42
Males 20-24:							
Whites.....	8,529	7,369	305	173	478	6	7
Nonwhites.....	1,353	1,084	95	51	146	11	13
Males 65 plus.....	8,049	1,826	122	-----	88	1	5
Females white 20 plus.....	63,853	35,318	448	231	679	1	2
Total.....	98,808	50,483	1,969	737	2,672	3	5
Measured change from minimum wage (percent).....			-2.2	-0.8	-3.0		
Measured change from economic stimu- lus ³ (percent).....			+ .6	+ .5	+1.1		
Net change (percent).....			-1.6	+ .3	-1.9		

¹ Males 25 to 64 are not included because the effect is small. However, over a long-run time period skilled adult worker employment would modestly increase as a result of the increase in the wage rates of low-skilled workers. Also, more equipment would substitute for low-skilled workers, and total output for the nation would be less.

² The total reduction in employment includes the reduction in part-time employees who average about 21 hr per week in employment. Approximately $\frac{1}{2}$ the teenagers would fall in the part-time category.

³ Based on President Carter's Economic Stimulus Message, Jan. 31, 1977, totaling \$15,500,000,000 in each of fiscal year 1977 and fiscal year 1978.

Source: Calculation based upon Jacob Mincer, Unemployment Effects of Minimum Wages, Journal of Political Economy, vol. 84, No. 4, pt. 2, August 1976.

TABLE 8.—INCREASES IN PRICES FROM INCREASES IN MINIMUM WAGE
[GNP deflator]

	Assume no effect on other wages	Assume 25 per- cent effect on other wages	Assume 50 per- cent effect on other wages
\$2.30 to \$2.50.....	0.1	0.9	1.8
\$2.30 to \$2.85.....	.5	2.1	3.3
\$2.30 to \$3.04.....	.7	2.9	4.9

Source: Based on Bureau of Labor Statistics "Weekly and Hourly Earnings Data from the Current Population Survey."^a

FEDERAL STATISTICS USERS' CONFERENCE

(By John H. Aiken, Executive Director)

The Federal Statistics Users' Conference appreciates your invitation to comment on the economic issues which concern the Nation and on the recommendations made in the administrative economic reports. Because of our specialized areas of interest, our views and comments are directed to the economic data which provide much of the information upon which the President's Economic Report and the report of his Council of Economic Advisers is based.

First, we wish to extend our congratulations to you as the new chairman of the Joint Economic Committee. We are especially aware of your great interest in economic statistics, particularly because you served as chairman of the first Subcommittee on Economic Statistics of the Joint Economic Committee. This was a pioneering effort that has been most productive over the years, contributing greatly to the further development and improvement of our economic statistics.

Some 20 years ago you and Congressman Curtis from Missouri played important parts in encouraging the formation of FSUC for which we are grateful. FSUC's membership now comprises 204 organizations generally classified as "business firms," "labor unions," "non-profit research organizations," "State and local governments," and "trade associations." Enclosed is a list of our member organizations. As you know, these members have a common interest in encouraging the development of adequate, timely, and reliable information from Federal statistical programs.

The Economic Report of the President and the report of the Council of Economic Advisers are among the most important documents of the Federal Government that are issued on an annual basis. They could not exist without the foundation of a wide variety of sound and reliable statistical information. Too often our statistical resources are taken for granted. These data have not been developed through a haphazard system of evolution, but through the concentrated efforts of dedicated and competent economists and statisticians, both within and without the Federal Establishment, who have recognized data needs for analysis and decisionmaking purposes. These experts have worked vigorously toward the development of a system of appropriate economic data that are comprehensive, based on sound methodology, and adequate to serve the needs of the Nation. However, our economy is not static and neither is our need for economic statistics. There can be no letup in our efforts to develop the kinds of statistical data that are necessary to assist us in assessing and evaluating the state of our dynamic and rapidly changing economy.

In the recent past, there have been only a few occasions when the administration's economic report has focused attention on the adequacy of our economic statistics, or identified areas where improvements are needed. We respectfully suggest that in the future both the

administration's economic report and that of the Joint Economic Committee focus attention on the adequacy of the economic statistical base that serves as the foundation for analysis and interpretations regarding the state of the U.S. economy.

This year, we were pleased to note that one of the President's budget documents, Issues '78, contained a 4-page section entitled "Improving the Federal Economic Statistical System." Although this is a brief, rather generalized statement, it deserves consideration by your committee. Among other things, the statement recommended that strengthening the Statistical Policy Division of the Office of Management and Budget would be an important step toward better Federal statistics and referred to the fact that an expansion of the resources available to SPD had recently been suggested by the Federal Statistics Users' Conference and the Joint Ad Hoc Committee on Government Statistics. The latter committee was organized in August 1975, to examine the state of the Federal statistical system and the data which it produces. The committee consists of 10 members, 2 each from the American Sociological Association, the American Statistical Association, the Federal Statistics Users' Conference, the National Association of Business Economists, and the Population Association of America.

Special analysis G of the President's budget indicates that the Nation will spend \$691 million for all current statistical programs in fiscal 1978. Of this total, \$493.1 million, or 71 percent, will be spent for economic and related statistics. Although these expenditures have more than doubled in the past 4 years, it is indeed a small investment of resources when one considers that it amounts to about one-tenth of 1 percent of the total outlays of the Federal Government. The benefits of this expenditure, in terms of their aid to public and private decision-makers, are immeasurable.

We wish to direct the committee's attention to a subject area breakdown of expenditures for economic and related statistics. Special analysis G shows the following:

[In millions of dollars]

	1977 estimate	1978 estimate	Percent increase
Energy statistics.....	00.6	146.2	45.3
Labor statistics.....	81.7	88.5	8.3
Agricultural statistics.....	47.4	49.8	5.0
Economic and business financial accounts.....	41.7	43.6	4.6
Environmental statistics.....	35.8	43.4	21.2
Production and distribution statistics.....	39.4	40.1	1.8
Prices and price indexes.....	20.4	29.7	45.6
Transportation statistics.....	25.9	27.4	5.8
Housing and construction statistics.....	22.0	24.4	10.9
Total.....	414.9	493.1	18.8

Many agencies are involved in the collection of energy statistics. The total budget for this type of data collection and analysis has grown rapidly and now represents a much greater outlay of funds than for any other broad subject area. In view of these facts, FSUC has been concerned about the possibility that there is a lack of coordination between various statistical agencies and a duplication of effort.

Many new report forms have been developed with a considerable impact of reporting burden upon respondents. So far as we know, there has been no careful examination of the quality of the statistics being produced. Are the agencies involved collecting the right kinds of statistics and do the benefits meet or exceed the costs? These concerns reflect our view that the statistical agencies should utilize the most efficient and economical means possible in the collection of statistical data that are of optimum usefulness to a wide range of users, both within and without the Federal Government. It is our hope that President Carter's plans for reorganization and implementation will deal with these problems and issues so far as energy statistics are concerned.

The trustees of FSUC have carefully reviewed the programs and budgets of the major Federal statistical agencies as summarized and described in Special Analysis G. The board also met with key officials in the major statistical agencies to obtain more detailed descriptions and explanations of proposed programs. In general, the trustees are pleased with the improvements in both data collection and analysis projected for 1977 and 1978.

In particular, the trustees were happy to see the program proposal for fiscal year 1977 supplemental by the Bureau of Economic Analysis for funding to provide for the development of concepts, the statistical methodology, and measures relevant for evaluating changes in the economic and social well-being of the Nation, within the framework of the national economic accounts. It is important that we attempt to assess the quality of life in these United States as well as just the quantity of goods and services available.

The trustees approve the Bureau of Labor Statistics' proposal to initiate a continuing survey of consumer expenditures, and their steps toward revision and improvement of the wholesale price index; we support the Bureau of the Census program to improve the quality of inventory data; and BEA's expansion of its environmental studies program. Each of these will strengthen an area of our economic knowledge which hitherto was admittedly deficient.

We were pleased to note that the BEA budget calls for development and publication of a methodology for the balance-of-payments data, a long-needed development. However, we feel that there is an even more pressing and basic need—that for a methodology on the national income and product accounts. There has been no thorough write-up of gross national product methodology since 1954 and the series has undergone several major revisions since then. At the same time, we applaud the recent issuance, after a gap of 12 years, of the national income and product accounts of the United States, 1929-74.

Many members of FSUC were quite concerned to learn that President Ford's budget provided no funds for continuing the Office of Business Research and Analysis of the U.S. Department of Commerce. The elimination of this Office would cut out many useful statistical and economic products, one of which is the annual U.S. industrial outlook. We have since learned that the Carter budget has restored funds for OBRA, although not as much as has been provided in the past.

Aside from considerations of specific program areas, we are concerned about priorities currently evolving within the Federal statistical

system, and the impact of large scale and expensive mandated programs upon the capabilities of key statistical agencies such as the Census Bureau and the Bureau of Labor Statistics. Our fear is that these types of programs might inhibit or preclude the further development and expansion of economic information of other types.

Two examples are the mandated use of detailed local area statistics in the distribution of Federal funds, now in the neighborhood of \$8 billion, and in administering various laws, such as those on voting rights.

For example, the requirement of title II of the Public Works Employment Act of 1976 requires quarterly unemployment rates for all identifiable local governments. Although estimates are now being made for 4,300 areas, the quality of these figures and the magnitude of revisions are cause for concern. To expand the data gathering sufficiently to provide current figures which are consistent and reliable could be prohibitively expensive. Just to provide good unemployment data for all 50 States, without going to the county or local area level would mean a six-fold increase in costs. To conduct the mandated survey of registration and voting on a county basis rather than by States would boost the cost from \$6 million to \$30 million. Before Congress considers proposals, such as that recently introduced by Representative Michael Harrington for a substantial expansion of the current population survey, the responsible committee might want to consult with agency heads and statistical experts to consider: (1) What are the best criteria for allocating Federal funds that can be delivered by the Federal statistical system with the most efficient trade off among accuracy, timeliness, the size of revisions, and overall costs? (2) Is the increased manpower and expense involved in meeting mandated statistical requirements for Federal programs the most efficient allocation of the resources of the Federal statistical system?

Lest we be misunderstood, we wish to make it clear that FSUC has consistently emphasized the great need for more and better local area information within the bounds of budgetary restrictions, and the capabilities of the agencies involved. In this connection, we wish to commend the Bureau of Economic Analysis for its program of providing local area personal income data.

In addition to these views on programs proposed in the budget, we would like to call the committee's attention to several other areas of interest of FSUC.

In previous statements to your committee we applauded the establishment by the statistical policy division of a gross national product data improvement project in March 1973. The committee is composed of distinguished economists who have labored hard and long in the preparation of a final report. It was originally anticipated that the final report would be issued in September 1975. Because this was such a monumental task the life of the committee was extended. This was understandable and justified. The final report will be issued within the next 3 or 4 months. We look forward with anticipation to that report. It is most important that the report and its recommendations be given widespread publicity and study. In the past several years FSUC has provided its members with progress reports on the work of the committee by presentations at our annual meetings by Daniel Creamer, the committee chairman. We will utilize our resources to

publicize the release of the report to the statistical and economic community, and to establish appropriate mechanisms for study and comment on the report. Recommendations that receive approval and support should be implemented in line with the time frame recommended by the committee report. Adequate funding should also be provided where and when necessary.

We are particularly pleased that legislation has been enacted authorizing the establishing of a new national commission on employment and unemployment statistics. An up-to-date appraisal of these types of statistics by a competent body is much needed and long overdue.

Some members of FSUC are concerned about the recent deletion of statistics on potential GNP and the GNP gap from Business Conditions Digest. Although the estimates are admittedly imperfect, they are considered a valuable tool in measuring changes in the pressures on the economy. Perhaps, since the estimates originate with the Council of Economic Advisers, the proper vehicle for publishing potential GNP would be economic indicators.

In conclusion, we wish to thank the chairman of the committee for inviting our comments and views. We wish to pledge our continued support and cooperation to the work of the Joint Economic Committee.

MACHINERY AND ALLIED PRODUCTS INSTITUTE

(By Charles W. Stewart, President)

Thank you for an opportunity to submit for the record a statement on matters involved in the President's Annual Economic Report.

The institute has recently published four economic essays which I respectfully submit to the Joint Committee if you and your staff feel they qualify to be included as a part of the proceedings. It would be difficult and disadvantageous, in my opinion, in terms of communicating the full thrust of each essay, to summarize them or to excerpt from them. We therefore submit a copy of each and ask that they be included in the record.

These studies are entitled "Unwinding the Present Inflation; Inflation and Profits"; "Social Security—The 'Financial Crisis' in Perspective"; and "The Minimum Tax on Tax Preferences—The Back-Door Route to Federal Tax Increases."

UNWINDING THE PRESENT INFLATION

(By George Terborgh, MAPI Economic Consultant)

Inflation is one of the most complex and varied phenomena known to man. True, the great runaway inflations of history have been due to financing Government deficits with printing-press money. But even when this is not done, a country may be exposed to inflationary pressures from other sources, both domestic and foreign. Notwithstanding a balanced budget, it may generate excess demand internally through an overexpansion of credit to the private sector. It may experience a "cost-push" inflation in the absence of excess demand. It may suffer temporarily from domestic crop failures of other natural disasters. As for foreign-source inflation, the country may monetize a balance-of-payments surplus. Or it may devalue its currency, with a resultant rise in the price of imports and import-competitive commodities. Even without devaluation, it may be affected by disasters abroad, by price runups in imported materials, by the actions of international cartels, etc.

In 1973 and 1974, outside disturbances (notably foreign crop failures and the actions of OPEC) made a major contribution to the American inflation rate, propelling it for a time into the double-digit zone. Since then, their influence has tapered off and the rate has receded approximately to the level supported by domestic factors, currently in the 5-6 percent a year range. Even this rate is unacceptably high, however, and the question of the hour is how to get it down.

It is interesting that some forecasters do not expect it to go down; indeed they project an upward trend. It is interesting also that this dismal prognosis does not rest primarily on anticipation of excessive monetary expansion, the classical generator of inflation, nor on the impact of large federal deficits. What prompts it is the persistence of cost inflation during a deep and prolonged recession.

I. COST INFLATION

Economists distinguish "demand-pull" from "cost-push" inflation, the former arising from generalized excess demand, the latter from cost pressure independent of such demand. The relative importance of the two changes during successive phases of the business cycle, but obviously demand-pull can be dominant only

during a recovery too rapid for the response capability of the economy, or during a boom when its resources are widely strained. It can hardly be invoked as a cause of inflation during the recession from which we are now recovering. For two and a half years, the economy has run slack, with large reserves of unused human and mechanical capacity. What we have now is clearly cost-push inflation. Costs have been rising inexorably notwithstanding inadequate demand. The problem of unwinding the inflation is therefore the problem of unwinding the cost spiral.

The Role of Profits

Before considering this problem, a related matter must first be disposed of. I have made no reference to profits as a factor sustaining the current inflation. This for good reason: profit margins are generally below their pre-recession level. If we take the corporate system (the only sector of the economy for which costs and profits are available separately), the ratio of profits to domestic gross product (value added) was 5.5 percent in 1973, before the recession started, and 4.6 percent in the most recent year, 1976.¹ The remaining 95 percent consisted of costs of one kind or another.² Clearly, there has been no inflationary impetus from profits.

Even if the overall profit margin had risen instead of declining, its share in the value of product was so small that any reasonable increase would have had a negligible effect on the price level. The assault on the present inflation must concentrate on costs or it will get nowhere.

The Real Cost Problem

Of the 95-percent costs component of the corporate product, 70 percent consists of labor compensation (wages and fringe benefits). Wages are thus the overwhelming bulk of the total.³

Not only are they the largest component of costs; they tend to lead, and in some measure to cause, the advance in nonlabor costs—taxes, depreciation, interest, rents and royalties. These tend to respond to inflation after the fact, hence contribute even less to cost-push dynamics than their relative magnitude suggests.

Another point may be noted. There is little that can be done to abate the rise in nonlabor costs except to unwind the inflation that supports it. It is true, of course, that past and anticipated inflation are powerful factors in maintaining the wage spiral as well, but the latter is, in principle, more amenable to correction. In any case, the overwhelming weight of labor costs in the total, and their even greater predominance in cost-push dynamics, makes them the obvious target of disinflationary policy.

Disbelief

Strangely enough, it is still possible to find economists who deny on theoretical grounds that wage-push inflation can exist. Stranger still, this view is entertained by some eminent business journals. The following comments refer to the British efforts to abate the wage spiral:

All of these calculations assume that this kind of compact with the unions will in itself bring about a slower rise in the general price level. We don't believe labor causes inflation; [we believe] that at best all labor can do is cause a temporary change in relative prices. Governments cause inflation through excessive monetary expansion.⁴

This is much too simplistic a view of a complex phenomenon. Since the mix of demand-pull and cost-push inflation varies over the business cycle, no single explanation can be valid for all phases. I am concerned here with the recession phase. The problem is how to unwind a previously-generated inflation that has entered the cost-push stage. In this situation, unwinding the wage spiral is an indispensable condition of success.

¹ After-tax profits with inventory valuation and capital consumption adjustments. Source: Department of Commerce.

² This reckoning counts the corporate income tax as a cost. The fact that it is measured by taxable income does not make it any less a cost than taxes measured by property values or sales.

³ For simplicity, the terms "wages" and "wage rate" will be used to denote labor compensation inclusive of fringe benefits. Departures from this usage will be noted.

⁴ Wall Street Journal, June 4, 1976. The same point was made earlier: "The Wall Street Journal does not agree with the Labor Party that inflation is caused by labor" (Mar. 2, 1976), and was recently reconfirmed: "We are fairly certain that labor unions do not cause inflation. The government does." (Feb. 14, 1977).

II. UNWINDING THE WAGE SPIRAL

It is quite natural for wage rates to rise during the latter phases of economic expansions and during the subsequent boom. It used to be equally natural for the rise to decelerate during recessions. Lately, however, something has happened to reduce, and even to reverse, this decelerative response. Note the following:

AVERAGE HOURLY COMPENSATION, PRIVATE BUSINESS SECTOR—ALL PERSONS¹

Cyclical peak quarter	Percent change		Difference (percentage points)
	From same quarter of the preceding year	To same quarter of the following year	
1948—IV.....	8.5	-0.3	-8.8
1953—II.....	7.1	3.6	-3.5
1957—III.....	6.4	5.3	-1.1
1960—II.....	5.2	4.4	-0.8
1969—IV.....	6.5	7.0	+0.5
1973—IV.....	8.6	10.8	+2.2

¹ This analysis is an adaptation of the 1 presented in the 1965 report of the Council of Economic Advisers (p. 40). The cyclical peaks are those designated by the National Bureau of Economic Research.

Source: Department of Labor.

This shows, obviously, an irregularly diminishing response of wages to recession over the six episodes covered.

The present recession has been an exceptionally long one, and it is appropriate to carry the calculation beyond the one-year period used in the table. In the second year following the cyclical peak (1974—IV to 1975—IV), the gain in average hourly compensation was 7.8 percent. In the third year (1975—IV to 1976—IV), it was 8.2 percent. Thus while the rate of advance retreated from the 10.8 percent attained in the first year of recession, the unwinding has made no progress over the past two years. Indeed, the drift has been upward. (For the most recent quarter, 1976—III to 1976—IV, the annual rate was 8.4 percent.) Thus notwithstanding the depth of the recession and an average unemployment rate above 8 percent, we are back to the pre-recession level. Apparently we are getting nowhere in unwinding the wage spiral.

Outlook

It may be true theoretically that this spiral can be unwound by maintaining a sufficient depth of unemployment over a sufficient period of time, but as a practical matter the social and political price is prohibitive. If two consecutive years of unemployment in the 8-percent range have failed to decelerate the spiral, what can be expected when the unemployment rate declines, as hopefully it will, from here out?

The outlook for price inflation is even more dubious than this suggests. The probability is that the rate of gain in productivity (output per man-hour) will taper off as the recovery proceeds. Last year (1976) the price effect of the wage spiral was cushioned by an above-average rise of 3.3 percent in overall man-hour output.⁵ The average over the past 20 years has been about 2.5 percent. While we may enjoy another year or two of above-average gains, a return to the average, given the present 8-9 percent increase in hourly labor costs, translates into an implicit inflation rate of 5.5 to 6.5 percent. If thereafter productivity gains disappear, as they have done in previous boom periods, the implicit rate will itself be 8-9 percent. If they go negative, as they have also done on occasion, it will exceed this range.⁶

But this is not all. These calculations assume that the wage spiral will remain as at present. If it accelerates, as it normally does when the economy approaches full utilization of its resources, we may well see an inflation rate in the double-digit zone.⁷

⁵ 1975—IV to 1976—IV, Private business sector—all persons.

⁶ They were negative, for example, in 1955—III and IV, 1969—II to IV, 1973—II and III.

⁷ This assumes the substantial neutrality of foreign-source and sporadic domestic influences. To the extent that these are not neutral, the rate will of course deviate from that predicated on the wage spiral alone.

This, then, is where we sit. Unless the wage spiral unwinds itself spontaneously hereafter—a development for which there appears no convincing reason, or unless some new factor is introduced into the equation, the prospect is grim.

III. INCOMES POLICY

The new factor that inevitably comes first to mind is general wage and price controls. This is a desperate remedy of last resort, necessary in war, but with a dismal history under peacetime conditions. It has rarely succeeded beyond a brief period.

It is an axiom of politics in most Western countries, and certainly in the United States, that any attempt to restrain wages must be accompanied by measures to restrain other forms of income. So firm is this dogma, indeed, that if a politician even suspected that wage restraint might be applied alone he would banish the thought for fear of talking in his sleep. Even a hint of such a heresy would be political suicide.

One reason for this political compulsion is evident at a glance. The public is preoccupied with rising prices, rather than with the rising costs that underlie them. It pays prices directly and costs only indirectly. Cost inflation therefore generates far less awareness and resentment than price inflation. Indeed, insofar as it involves wages, it may even be regarded favorably. Since everyone likes higher pay for himself, even though it adds to his employer's costs and prices, this liking engenders an indulgence of increases for others. It is difficult to crank up public enthusiasm for wage restraint. Price control, on the other hand, is widely approved.

Effects of Price Control

General price control, continued beyond a brief interval, can bedevil the economy on a massive scale. It triggers the disappearance of low-margin production, resulting in shortages and constrictions of supply. It interrupts the smooth flow of materials, parts, and components so essential to efficient production. It slows the response of supply to increased demand. It leads to rationing and allocation by sellers, with favoritism to established customers, and makes it difficult for new companies to get into business. It generates product deterioration, under-the-counter deals, and black markets. These interferences with the functioning of the economy can easily raise costs (and hence prices) by more than any benefit from the reduction of profit margins.

I refer to the reduction of profit margins because price control inevitably turns into profit control. It normally starts with a brief freeze period. In this phase, it is what it purports to be. But when the freeze gives way, as it must, to the process of relief and adjustment, whether by bureaucratic decision or by self-administered formulas, the transition to profit control begins. For the basic criterion of adjustment is the profit position of the product, product line, company, or industry concerned. This is equally the criterion for pricing new or altered products, custom work, and the output of new companies entering the market without a price history.

Is It Needed?

As noted earlier, profits last year were less than 5 percent of the corporate product, an extraordinarily low level, contrasting with 10 percent a decade earlier. Further erosion would have a devastating impact on business capital formation, already deplorably low, on which the country relies for job creation.⁸ In the present situation the United States needs general price control as it needs the plague. It does, however, need general wage restraint.

That we are not alone in this situation is confirmed by a recent editorial in the *London Economist*:

Countries will cure high unemployment only if they remove all price controls but continue with some sort of wage restraint. It is no good saying "price controls in Britain affect very few firms because most firms are below their profit reference level." Companies considering investment should do, so because they hope in the future to go well above their profit reference level, and they need to be assured today that they will not be curbed.⁹

⁸ See "The Sad Story of Corporate Profits," MAPI, March 1976, and "Inflation and Profits," MAPI, October 1976.

⁹ Issue of January 15-21, 1977, p. 13.

If we do not need general price control, but do need general wage restraint, the question arises whether the latter can be attained by voluntary means. Is it possible to succeed by persuasion?

Voluntary Wage Restraint

Many Western countries are trying to do so, though with varying degrees of success. The most common approach is to negotiate an agreement with organized labor to limit wage demands.

It is taken for granted in this approach that collective bargaining plays the leadership role in the escalation of labor costs and that if the organized sector of the labor market can be persuaded to moderate its demands, wages in the unorganized sector will follow suit. It is true, of course, that the organized sector of the labor force is relatively larger in most of these countries than in the United States (where it runs around one-quarter), and that the assumption of union wage leadership is correspondingly stronger. I believe, however, that it is valid here as well.¹⁰

Suggestive evidence of this leadership in recent years is provided by a study for the Council on Wage and Price Stability, which traces the differential between union and nonunion wage rates in the same employments. Here are the overall results:

*Average Union/Nonunion Wage Differentials, All Workers*¹

	[Percent of nonunion rates]
1973.....	14.8
1975.....	16.8
1976.....	² 18.1

¹ Orley Ashenfelter, "Union Relative Wage Effects," August 1976. The comparison is controlled for differences in sex, education, experience, marital status, size of city, region, occupation, industry, and parttime work. It relates to wage rates only, exclusive of fringes. With the latter included, the differentials would probably be higher.

An earlier study from a different source found a 1973 all-worker differential of 12 percent (wage rates only). Paul M. Ryscavage, "Measuring Union-Nonunion Earnings Differences," *Monthly Labor Review*, December 1974. Another study, this time of differentials in weekly earnings, came up with margins for 1974 much higher than indicated by either of the hourly-wage investigations. Thomas F. Bradshaw and John F. Stenson, "Trends in Weekly Earnings: An Analysis," *Monthly Labor Review*, August 1975.

² My estimate, based on the new Employment Cost Index of the Department of Labor, which covers the period 1975-IV to 1976-IV. Over this 12-month interval, union wage rates (exclusive of fringes) rose 8.1 percent, against 6.8 percent for nonunion. Employment Cost Index, February 1977.

Note that the average differential increased during the current recession from 14.8 to 18.1 percent, strong evidence of union leadership.

If this inference is valid, the place to begin in unwinding the wage spiral is with collective bargaining agreements. Even if the effect of such agreements on nonunion rates is less prompt and pervasive than believed, organized labor has clearly outpaced the unorganized sector of the labor force during the current recession, and a failure of the latter to respond to union leadership—improbable in my opinion—would do no great harm pending the adoption of the more comprehensive approach than would then be necessary.

Even if it were possible to get by voluntary agreement between unions and government a gradual tapering off or new collective bargaining settlements, and even if the response of the unorganized sector were prompt, unwinding the wage spiral would be a slow process. Union contracts, average more than 2.5 years in duration, and are usually revised only on termination.¹¹ Moreover, the process would start from a high level. While there are no comprehensive data on union wage settlements, it is evident from the tabulation of contracts covering 5,000 or more workers (the only ones for which fringe benefits are included) that those negotiated in 1976 will involve an annual increase of hourly wages, averaged over

¹⁰ See "Control of Home-Grown Inflation," MAPI, August 1974, p. 9.

¹¹ The average for 1976 contracts covering 1,000 or more workers was 32 months.

the contract life, in the 8-9 percent range.¹² Even if this were worked down by one percentage point a year, it would take six years to reach the 2.5 percent average rate of productivity gain, the target for noninflationary wage behavior.

Obstacles to Voluntary Agreement

What are the chances of getting such a gradual tapering off of collective bargaining settlements? Unfortunately, they are far from encouraging.

One reason is the structure of the American labor movement. Several powerful independent unions divided the field with the dominant AFL-CIO. Moreover, the latter is merely a federation of craft and industrial unions, each of which retains full sovereignty over its own bargaining operations. There is thus no overall organization with which a voluntary agreement can be negotiated.

A second reason is the ideology of the labor movement. It has apparently not progressed beyond the classical maxim of business unionism: "More, and more, and more." There has been no public recognition of the problem of wage inflation, or any acknowledgment of the right of the government to intervene on behalf of moderation. The ideological foundation for voluntary agreement does not exist.

It is not surprising that the organized labor movement has not taken the initiative in proposing wage restraint. After all, it is the responsibility of labor leaders to deliver the loaves and fishes regardless of the impact on inflation.¹³ What is surprising is that there has been no initiative from the government. The silence of politicians on this subject has been deafening. Whether this is due to the political and economic power of organized labor, or rather to ignorance, I leave to others. In any event, we have remained up to now in a state of political paralysis.

IV. VOLUNTARY PRENOTIFICATION

There are indications, however, that this situation may soon change. In his message to Congress on February 1, 1977, the President stated:

I will soon announce a substantial strengthening of the Council on Wage and Price Stability. The Council will analyze the supply and demand trends in particular industries, so that we can spot bottlenecks and potential shortages and try to prevent them. It will also perform a more active job of monitoring wage and price developments. I believe that both business and labor will be willing to cooperate by giving us voluntary prior notice of important wage and price increases.

He later reaffirmed this position in his press conference of February 23.¹⁴

The Question of Sanctions

Apparently what is contemplated is voluntary prenotification and voluntary acquiescence in whatever "jawboning" the Council on Wage and Price Stability sees fit to exercise. But what if prenotification is neglected, or if the Council's recommendations are disregarded? The temptation will be for the government to

¹² The reported figure for 1976 was 6.6 percent, but this does not allow for cost-of-living escalation, the amount of which is of course unknown when the contracts are costed out in advance. In view of this increased prevalence of escalation in the 1976 contracts, and its retrospectively determined effect in prior contracts, it is necessary to add 1.5 to 2.0 percentage points to the reported figure, giving a range of 8.1 to 8.6 percent. (Since the contracts are heavily front-loaded, the range for the first year is higher, 10.0 to 10.5 percent.) Source: Department of Labor. It may be, moreover, that some of the 1976 contracts have been undercosted by the Department. See, for example, the comments of the Council on Wage and Price Stability on the automotive industry settlements, January 14.

¹³ This proposition implies no criticism either of these leaders or of the rank and file. Unions can hardly be blamed for taking advantage of the power that is lawfully theirs.

¹⁴ An address by Secretary of the Treasury W. Michael Blumenthal on March 3 seemed to suggest that the Administration is backing off from the voluntary prenotification scheme:

"Nor do I believe that it is useful to waste our energies on fruitless arguments about the pros and cons of unprecise concepts such as 'prenotification' on wages and prices—voluntary or otherwise."

Since the President has not confirmed this apparent backoff, I shall discuss the proposal as presented. Most of my comments will apply equally to the less formalized procedures adumbrated by Mr. Blumenthal as the likely alternative.

reach, particularly on the price side, for indirect means of coercion. This temptation has not always been resisted. I have commented on the subject in connection with the application of the Kennedy-Johnson "guideposts":

I have cited the guidepost system as an example of the hortatory approach to wage and price restraint, but in candor it should be added that it has not always been applied in the genteel fashion suggested by the official account. On the side of industry, the record discloses occasional resort to crude coercion—bitter denunciations in the press, threats of antitrust action, threats of the withdrawal or withholding of government business, countervailing stockpile releases, restrictions on exports, etc. There is an element of duress in the arm-twisting of large public corporations even when it is done with more subtlety.¹⁵

As for applying comparable duress to recalcitrant labor unions, the guideposts experience is disheartening. In the few confrontations with unions under that program the government took a beating. The fact is that its only real leverage in the arm-twisting game is on the industry side. Organized labor is too powerful for the technique to succeed. If I am right that the main problem today is wage dynamism, the prospects for restraint through voluntary prenotification and voluntary obedience must be rated poor. If the Wage and Price Commission is to have powers of selective intervention, it will need authority to enforce its decrees.

I would say this even if its powers of informal coercion were better balanced as between industry and labor. It is demeaning, and offensive to the dignity of government, to resort to the kind of crude bludgeoning that went on under the guideposts program, and that would almost certainly recur under the proposed voluntary arrangement.

The need for mandatory powers is made more obvious by the complete rejection of the President's proposal by the AFL-CIO. Witness the recent blast against it by George Meany.¹⁶ While the President still hopes for a reversal of this rejection, his chances of getting it appear dubious to say the least.

The Selective Approach

The theory of the prenotification proposal appears to be that if unjustifiable wage and price increases can be prevented in "important" situations, inflation can be contained and (hopefully) reduced.

On the wage side, the selective approach is essentially defensive. It might prevent "breakthrough" wage settlements and thus avoid breaches of the prevailing pattern, but it would offer little promise of reducing that pattern itself—little promise, that is to say, of unwinding the already-existing wage spiral. What is needed to that end is a more aggressive policy providing for the gradual reduction of the spiral. It is difficult to see how this can be achieved merely by preventing out-of-line settlements.

This is not, however, to disparage the approach entirely. If it were to do no more than forestall further acceleration of the spiral, it would still be an anchor to windward. For as things now stand, the country remains at the mercy of powerful unions able to exact pattern-setting breakthroughs that would launch it on the inflationary glory road. Protection against such a contingency is not to be sneezed at.

Whatever its limitations, the selective approach to inflation control should be tried before comprehensive measures are considered. If it can hold the wage spiral at its current 8-9 percent a year rate, implying an average inflation rate from this source of 5.5 to 6.5 percent, it is preferable, bad as this rate is, to the nightmare of general wage and price controls. Desperate remedies should be reserved for desperate conditions.

Selective Price Restraint

Although there is presently no widespread overpricing in the economy (as noted earlier, the average profit margin is far below normal), it is politically unrealistic to assume that selective wage interventions could be carried out without selective price restraints.

The latter would have a less pervasive influence, however, than interventions on the wage side. Prices are far less subject than wages to contagion and imitation. A major wage breakthrough can affect settlements across the entire economy; a

¹⁵ "The Inflation Dilemma," MAPI, 1969, p. 40.

¹⁶ Reported in the press on February 21. Mr. Meany has since demanded the abolition of the Council on Wage and Price Stability itself.

price increase, on the other hand, has a limited and localized effect. There is no national "pattern" to which price changes conform. Restraints on particular price increases have, accordingly, a relatively narrow impact.

In any event, the inevitability of sporadic price interventions, if we go the route of selective wage restraint, is a factor that must be weighted in arriving at a policy judgement. Would the authorities concentrate, as they did in previous selective programs, on a relatively small list of basic-industry whipping boys (steel being the outstanding example), or would they broaden their coverage? Would their price-restraining operations take cognizance of the gross overstatement of profit margins resulting from inflation? Would their margin squeezing further erode the already inadequate profitability of the business system? These and other issues are vital to the decision.

V. CONCLUSION

Up to now government policy has rested on the hope that if the recovery from the current recession is held to a moderate pace, giving time for the necessary adjustments as it goes along, and if it is prevented in its later stages from developing into a boom, the problem of wage inflation will go away. As we have seen, it has shown few signs of doing so, and we are nearing the end of the period most conducive to this response. The policy of hopeful waiting appears to be played out.

I may add that the policy of holding recovery to a moderate rate and avoiding a subsequent boom can by no means be taken for granted. The massive federal deficits projected for the next few years, concurrent with rising requirements for capital by the private sector, may force a rate of monetary expansion incomparable with this policy. In that case, we will have a "demand-pull" component added to the cost-push that now bedevils the economy. The latter will remain, however, even if this contingency is avoided.

The United States is the last of the major Western industrial countries to recognize this fact. The rest have acknowledged the strategic role of wage dynamism in maintaining inflation, and the necessity of doing something about it. Note, as one example, the recent admission of the British Chancellor of the Exchequer Denis Healey, that high unemployment cannot be counted on to restrain inflationary wage gains:

In a developed modern industrial society, many small groups of workers have the power to demand very high wages and to obstruct the economy, almost irrespective of the level of activity.¹⁷

With all the Western industrial countries wrestling with the same problem, it is devoutly to be hoped that viable solutions short of general wage and price controls will emerge. If they do not, and if the wage spiral does not miraculously unwind itself, we will face the dilemma of continued, and probably worse, inflation. Should it get much worse, we will confront the need for desperate remedies.

INFLATION AND PROFITS

(By George Terborgh, MAPI Economic Consultant)

The effect of rising price levels on the accounting of profits is not a new subject. During the sharp postwar inflation of 1946-48 it generated a lively discussion in accounting and management circles. This was revived, on a lesser scale, by the price runups of 1950-51 and 1956-57. But under the relatively stable price level of 1958-64 interest waned. It was widely believed that inflation was a thing of the past, that the aftereffects of earlier inflation would gradually wear off, and that no corrective action was needed. This proved to be an illusion. By 1965 inflation was underway once more, and it has continued at a distressing pace ever since. It is now high time to take another look at the problem.

The Principle

The overstatement of profits during and after a period of inflation arises from the practice of charging only the historical cost of physical asset consumption (fixed assets and inventory). When the purchasing power of the dollar is shrinking,

¹⁷Quoted in the Wall Street Journal, Dec. 17, 1976.

the charging of historical costs—reflecting earlier, and hence lower, price levels—is insufficient for the restoration of real assets used up in production. A proper reckoning requires the restatement of previously incurred costs in the dollars of realization, that is to say, in the revenue dollars against which they are charged. Only when costs and revenue are measured in the same dollars can the difference between them (profit) be correctly determined.

It follows that when the real cost of physical asset consumption is undercharged the shortfall is accounted as profit. It follows also that this much of the reported profit is fictitious, representing simply the understatement of costs.

The Project

The foregoing statement of principle refers to the conversion of historical costs into their equivalents in current dollars. This implies the use of an index of the general purchasing power of the dollar. Unfortunately from our standpoint, the official conversions are based on a multiplicity of specific price indexes purporting to reflect the current replacement costs of the individual items or classes of items processed. We refer to the Department of Commerce conversions, which are applied to both fixed-asset consumption (in the depreciation adjustment) and inventory consumption (in the inventory valuation adjustment) by means of such replacement-cost indexes. While we prefer the use of a single comprehensive index of prices, the overall results obtained from a multiplicity of specific indexes are not far different. In any case, we are constrained by the nature of the available data to use the latter, which represents a conversion of historical costs into current-cost equivalents, rather than into current-dollar equivalents.¹

In the project in hand, we propose to compare current-cost with historical-cost depreciation and current-cost with historical-cost inventory consumption. We can then see what difference the conversion makes in the profit figures. The study is limited to the corporate system because profit as such is not available for the unincorporated sector, and more specifically to nonfinancial corporations, the category principally concerned with physical asset consumption. It is limited also to the inflation of 1965-76:

I. FIXED ASSETS

The Department computes annually current-cost depreciation on the fixed assets of nonfinancial corporations, using two writeoff methods (straight-line and double-declining-balance) and a variety of service-life assumptions. It has expressed a preference on service-life assumptions (85 percent of Bulletin F lives), and we shall use that assumption in conjunction with the double-declining-balance writeoff.²

A word on the choice of writeoff. Notwithstanding the Department's use of the straight-line method in the recent GNP revisions, we entertain no doubt that that writeoff is in most applications a grievously retarded measure of capital consumption, and that the double-declining-balance method is in general more realistic. This is not the place to argue the issue, which we have done at length elsewhere.³ Suffice it to say that this writeoff conforms quite well to both theoretical and empirical evidence on the typical course of capital consumption, especially for capital equipment (as distinguished from structures), which accounts for around five-sixths of corporate depreciation.

The following table compares the Department's computation of current-cost double-declining-balance depreciation with its estimate of the depreciation allowed for income tax purposes.

¹ For a discussion of this issue, see "Realistic Depreciation Policy," MAPI 1954, chapter 12.

² The double-declining-balance method is applied with a straight-line switch.

³ "Realistic Depreciation Policy," chapters 3, 4, and 5.

TABLE 1.—COMPARISON OF THE CURRENT-COST DOUBLE-DECLINING-BALANCE DEPRECIATION OF NONFINANCIAL CORPORATIONS WITH THE DEPRECIATION ALLOWED THEM FOR INCOME TAX PURPOSES

[In billions of dollars]

	Current cost DDB	Income tax depreciation	Excess of (1) over (2)
	(1)	(2)	(3)
1965.....	34.9	36.4	-1.5
1966.....	38.7	39.5	-0.8
1967.....	42.9	42.9	.0
1968.....	47.1	46.7	.4
1969.....	52.2	51.3	.9
1970.....	57.8	54.6	3.2
1971.....	62.8	58.7	4.1
1972.....	67.0	65.3	1.7
1973.....	73.7	70.5	3.2
1974.....	86.9	77.8	9.1
1975.....	103.1	85.0	18.1
1976 (1st half).....	112.6	90.4	22.2

¹ Our estimate. All 1976 figures are at seasonally adjusted annual rates.

Note: That the excess of current-cost DDB over tax depreciation has grown from a negative amount in 1965 to \$22,000,000-000 in 1976.

II. INVENTORY

As indicated earlier, the conversion of inventory consumption charges from historical cost to their current-cost equivalent is computed by the Department of Commerce as the "Inventory Valuation Adjustment" (IVA). The calculation allows for inventory consumption presently charged for income tax purposes by LIFO and similar current-costing procedures, and converts only the balance under historical-costing systems. The results follow.

TABLE 2.—Inventory valuation adjustment for nonfinancial corporations

[Billions of dollars]

1965.....	\$1.9
1966.....	2.1
1967.....	1.7
1968.....	3.4
1969.....	5.5
1970.....	5.1
1971.....	5.0
1972.....	6.6
1973.....	18.6
1974.....	39.8
1975.....	11.4
1976—1st half.....	13.1

Here again we have a gradual rise in the excess of current-cost over historical-cost charges, culminating in this case in a sudden surge to nearly \$40 billion in 1974, with a current (first half of 1976) level of \$13 billion.

III. ADJUSTMENT OF PROFITS

We are now ready to put the pieces together and adjust profits as reported for income tax purposes.

TABLE 3.—ADJUSTMENT OF REPORTED PROFITS OF NONFINANCIAL CORPORATIONS

[In billions of dollars]						
	Profits before tax as reported	Income tax liability	Profits after tax as reported (1) minus (2)	Under- statement of costs ¹	Profits before tax as adjusted (1) minus (4)	Profits after tax as adjusted ² (3) minus (4)
	(1)	(2)	(3)	(4)	(5)	(6)
1965.....	\$64.4	\$27.2	\$37.2	\$0.4	\$64.0	\$36.8
1966.....	69.5	29.5	40.0	1.3	68.2	38.7
1967.....	65.4	27.7	37.7	1.7	63.7	36.0
1968.....	71.9	33.6	38.3	3.8	68.1	34.5
1969.....	68.4	33.3	35.1	6.4	62.0	28.7
1970.....	55.1	27.3	27.8	8.3	46.8	19.5
1971.....	63.3	29.9	33.4	9.1	54.2	24.3
1972.....	75.9	33.5	42.4	8.3	67.6	34.1
1973.....	92.7	39.6	53.1	21.8	70.9	31.3
1974.....	102.3	42.6	59.7	48.9	53.4	10.8
1975.....	95.5	39.7	55.8	29.5	66.0	26.3
1976 (1st half).....	122.5	52.6	69.9	35.3	87.2	34.6

¹ The sum of the excesses of current costs over historical costs shown in tables 1 and 2.

² Since this is a retrospective recomputation of profits, it takes as given the corporate income taxes actually paid. If tax liabilities had been figured on the adjusted pretax profits, the after-tax effect of the adjustment would, of course, have been reduced by the tax saving resulting therefrom. But since they were actually figured on the reported profits throughout, there were no such tax savings. Adjusted after-tax profits are simply adjusted pretax profits minus actual taxes on reported profits.

Here is a startling picture. Adjusted after-tax profits started out in 1965 not far below the reported figure. They wound up in 1974 less than a fifth as large as reported. In 1976 (first half), they were still less than half as large.⁴

Restatement of Retained Earnings

An even more startling picture emerges when we subtract dividend payments from adjusted after-tax profits to derive adjusted retained earnings.

TABLE 4.—ADJUSTED RETAINED EARNINGS OF NONFINANCIAL CORPORATIONS

[Billions of dollars]			
	Adjusted after- tax profits	Dividend payments	Adjusted retained earnings
	(1)	(2)	(3)
1965.....	\$36.8	\$17.2	\$19.6
1966.....	38.7	18.1	20.6
1967.....	36.0	18.9	17.1
1968.....	34.5	20.7	13.8
1969.....	28.7	20.7	8.0
1970.....	19.5	19.9	- .4
1971.....	24.3	20.0	4.3
1972.....	34.1	21.7	12.4
1973.....	31.3	23.9	7.4
1974.....	10.8	26.5	-15.7
1975.....	26.3	29.0	-2.7
1976 (1st half).....	34.6	30.1	4.5

¹ Adjusted to eliminate certain abnormalities.

⁴ It should be acknowledged that there is a slight duplication in combining the depreciation and inventory adjustments. Practice differs widely with regard to the treatment of depreciation, some companies charging it into cost of sales, others treating it as an expense. Overall figures on the relative prevalence of the two procedures are not available. To the extent that depreciation is included in the cost of sales, there is of course some duplication of the separate adjustment for depreciation. It is not, however, very important. Even if all depreciation were so charged, it would make up only 5 or 6 percent of the total inventory-consumption charges, and the maximum duplication would therefore be this percent of IVA, a relatively insignificant amount.

Over the past 6½ years adjusted retained earnings have been almost negligible (averaging less than \$2 billion a year). Nonfinancial corporations have been distributing nearly all of their adjusted earnings, their reported savings representing little more than the amount required to cover the understatement of costs.

Adjusted Profits and Retained Earnings in Constant Dollars

To make the horror story even worse, the dollar has been shrinking over the interval and it is necessary to adjust for this by stating the results in constant dollars. We use for this purpose the GNP deflator (1972=100).

TABLE 5.—ADJUSTED PROFITS AND RETAINED EARNINGS OF NONFINANCIAL CORPORATIONS IN 1972 DOLLARS
[In billions of dollars]

	Adjusted after-tax profits (1)	Adjusted retained earnings (2)
1965.....	\$49.5	\$26.4
1966.....	50.4	26.8
1967.....	45.6	21.6
1968.....	41.8	16.7
1969.....	33.1	9.2
1970.....	21.3	-4
1971.....	25.3	4.5
1972.....	34.1	12.4
1973.....	29.6	7.0
1974.....	9.3	-13.5
1975.....	20.7	-2.1
1976 (1st half).....	26.2	3.4

In constant dollars, the adjusted earnings of 1976 are slightly over one-half of 1965. As for retained earnings, the comparison is dismal. Here the 1976 figure is only one-eighth of 1965.

IV. EFFECTIVE INCOME TAX RATES ON ADJUSTED PROFITS

Since the income tax liability (federal and state) is computed on overstated historical-cost profits it is obvious that the effective rate on profits adjusted for the overstatement is higher than the rate reported. The following table shows the difference.

TABLE 6.—EFFECTIVE TAX RATES ON THE PRETAX PROFITS OF NONFINANCIAL CORPORATIONS AS REPORTED AND AS ADJUSTED¹

	On profits as reported (percent) (1)	On profits as adjusted (percent) (2)
1965.....	42.2	42.5
1966.....	42.4	43.3
1967.....	42.4	43.5
1968.....	46.7	49.3
1969.....	48.7	53.7
1970.....	49.5	58.3
1971.....	47.2	55.2
1972.....	44.1	49.6
1973.....	42.7	55.9
1974.....	41.6	79.8
1975.....	41.6	60.2
1976 (1st half).....	42.9	60.3

¹ Col. (2) of table 3 as percentage of cols. (1) and (5), respectively.

It is obvious at a glance that effective tax rates on real profits have moved away from those on reported profits. In 1974 the rate reached nearly 80 percent. For 1976 it is 60 percent.

V. WHAT DOES IT MEAN?

It is clear that American business has not yet learned how to protect itself against inflation. Overall it has been unable to maintain normal margins even in the overstated profits of conventional accounting. In terms of real profits, the shrinkage has been drastic.

It is extremely difficult to protect even nominal profit margins in the face of inflation, owing to the tendency of unit costs to move up faster than realized prices. Under prevailing practice prices are often fixed for substantial periods ahead. Catalogs may be issued only annually or semiannually; seasonal merchandise may be priced months in advance of delivery; long-cycle production may be quoted before work is started; etc. But even where prices are more quickly adjustable there is a general tendency to lag behind the march of costs.

If it is difficult to protect nominal profit margins it is still more so to protect real margins. Since the latter are more adversely affected by inflation their maintenance requires even bolder and more aggressive action, not to mention their restoration after they have been allowed to decline.

The core of this action is of course pricing policy. Management must learn how to price its products in an inflationary economy. This means first of all anticipatory pricing—pricing in anticipation of cost increases prior to sale. It means secondly a proper accounting of costs themselves, especially the cost of physical asset consumption.

It must be acknowledged of course that such a pricing policy may be impracticable for an individual company in a market where the competition is pricing on understated costs. The real remedy lies in the reform of policy across the board. If all competitors are targeting their prices on fully stated costs, there is a better chance that they can make them stick.

Let us add in closing that the present situation is bad not only for business, but for the nation as a whole. Despite the suspicion and disfavor that attach to profits in the eyes of many politicians and of a considerable part of the public, it is vital that they be large enough not only to motivate the expansion of productive investment, but to finance a substantial part of it. It is frightening from the public-policy standpoint that the reinvestment of corporate earnings, realistically measured, has become negligible. If this continues it will cost the country dearly.

Let us add further that the Alice-in-Wonderland accounting of costs and profits that now passes for orthodoxy is a problem not only for business management, but for the accounting profession, the regulatory agencies of the government, and, not least, for the tax authorities. It is high time for concerted action by all concerned.

It is gratifying in this connection that both the accounting profession and governments appear at last to be grappling with the problem. The Securities and Exchange Commission has required large companies to file supplemental statements on the current-cost inventory and fixed-asset consumption. There is much activity on the subject among accounting bodies here and abroad, and in several countries by government commissions.

These are first steps, to be sure, but we may hope that others will follow. We may hope also, and even more fervently, that the tax authorities will not be far behind. For the evils of undercosting are compounded by the present practice of taxing capital consumption as income. No reform of costing procedures can be more than partially successful so long as this practice continues.⁵

SOCIAL SECURITY—THE “FINANCIAL CRISIS” IN PERSPECTIVE

INTRODUCTION

The growth of public and private institutions as a means of providing retirement income is one of the most important economic phenomena of this century. Starting at nearly ground zero, the pension system has mushroomed to such an extent that today over 90 percent of the entire work force is covered by the social security system or state and local government retirement programs, and approximately one-half of the employees in private, nonfarm business establishments are participants in private pension plans.

⁵ See “Inflation and the Taxation of Business Income,” MAPI, January 1976.

But what does the future hold? On the private side, it is probably fair to state that the future is uncertain. This is because of a combination of converging situations. First, the Employee's Retirement Income Security Act of 1974 (ERISA) has brought with it certain clearly identifiable cost burdens, and the threat of further government straitjacketing of the entire private pension and welfare system.

Second, inflation is a problem. Given the likelihood of continued and significant inflation, the private pension system is challenged by a number of concerns, such as increased costs because of a decrease in the value of plan assets, the plight of the private plan retiree whose pension income is being rapidly eroded, and the impact that inflation will have on government requirements under ERISA and the social security system.

Finally, there is the social security system itself. Its future as a retirement program could well retard the growth of private pension plans.¹ Because it is not identical in scope, philosophy, or purposes to the private scheme, it has been impossible to date to balance the two so as to provide complementary programs. Absent universally mandated private benefits, we must face the reality that only a part of the population is covered by supplementary private pensions.

But the same reality indicates that the future growth of the public system could by itself inhibit the growth of the private system since the costs of the two systems are in a major sense substitutes for current wages and salaries. For this reason, the private system has a major stake in the future of the public system. This study comments on what appears to be in the offing, both in the short-term and long-term for the social security system.

SHORT-TERM

For several years, there has been widespread concern about the financial problems of the social security program (the cash benefits of the old-age, survivors, and disability system). The first official hint of this appeared in the 1974 Trustees Report. This report indicated, however, only that the major problems would occur some years hence, particularly after the turn of the century.

The 1975 Trustees Report brought worse news. Not only were there long-range problems, but because of the combined effects of inflation and unemployment, short-range cash-flow difficulties emerged. An ever gloomier picture was presented in the 1976 Trustees Report. (See tables III and IV attached.) It was estimated that the Disability Insurance Trust Fund would be exhausted in 1979 under almost any circumstances. The Old-Age and Survivors Insurance Trust Fund was found to be somewhat better off—its exhaustion date was projected to be 1984.

Quite obviously, with so many beneficiaries depending upon this source of income—about 33 million at the present time—some corrective action must be taken by Congress and fairly soon. Congress, however, has been reluctant to act because of economic conditions and has opted to draw down the trust fund reserves on the theory that a tax increase would be counter-productive to the needs of our economy. But even under the more optimistic views, it is apparent that time is running out. Further, the longer Congress waits, the more drastic the cure becomes. Thus, most observers feel Congress will turn to this problem in the 95th Congress.

Additional financing alternatives.—Additional financing for the system can come from only three possible sources. The first is an increase in the tax rates. Along these lines, the then President Ford on January 4 proposed payroll tax rate increases beginning January 1, 1978.² In brief, the combined rate would increase gradually until 1981 when it would be 15.7 percent, about 1 percent higher than presently planned under the law. (See attached tables I and II.)

Resistance to this approach, i.e., total reliance on a tax rate hike, will come from those who believe an increase in the tax rate worsens the regressive nature of the payroll tax and could increase inflationary pressures in the short run. Proponents will argue, however, that the tax burden on low-income families should be viewed in the context of the total federal tax burden carried by such families and will point to the Earned Income Credit introduced in 1975 which provides direct cash payments to certain low-income taxpayers.

¹ For an earlier MAPI study on this issue, see "Social Security and Private Pensions at the Crossroads: Crisis or Compromise?" (MAPI, 1967).

² President Carter in his budget message of February 22, 1977 "withdrew" the requested social security tax rate increases. The budget message notes:

... Proposals to solve the social security financing problem are being carefully reviewed by this Administration, and recommendations to the Congress will be submitted shortly.

In addition to noting that this credit was designed with the social security tax burden in mind, proponents of this approach will explain that a tax rate hike is less perverse than other forms of adjustment which are possible.

Increasing the taxable wage base.—A second approach is to increase the maximum taxable earnings base to a greater extent than the automatic-adjustment provisions would bring about. Proponents of this approach argue that we still will be within the confines of the payroll tax structure if this is done and will shift the burden to higher wage earners. In this connection, it will be noted that for years the wage base was set at a figure representing the 90th percentile of wages and salaries, but it is well below that now.

Opponents will argue this would place the increased cost burden on only the top 15 percent of the workers and their employers, and would limit the extent to which the private sector can provide economic security. In addition, it will be pointed out that a wage base increase is less efficient than a tax rate increase because it would create entitlement to higher benefits in the future. In fact, these future benefit costs would actually increase the long-range deficit.

Using the general revenues.—A third approach is to inject a government subsidy into the social security system from the general revenues. Its proponents will argue that a very large part of the benefit commitment is not entirely wage-related, but also includes income redistribution from the richer to the poorer participants. Under these circumstances, it is claimed that it is inequitable to support such transfers of income with funds raised by regressive taxes, particularly when higher incomes derived from sources other than wages are not taxed. Opponents will argue the need to preserve the integrity of the present self-financing system and point out that recourse to general revenues will obfuscate upon whom the burden is really falling. In addition, once we rely on general revenue financing for a significant portion of the benefit cost, we may be forced to increase income taxes as a means of paying for the system.

Other solutions.—It is, of course, possible to have a combination of these three alternative methods of financing. Beyond that, Congress might opt for what could be termed a "wrinkle in the wrinkle," such as:

1. The introduction of a bracket system to provide higher tax rates for higher income workers in the income tax system.
2. Removal of the ceiling on the employer's wage base.
3. Provision for a one-time grant from the general revenues and/or emergency borrowing authority from the general fund.
4. Simplification of the benefit formula designed to reduce the cost impact of "double dippers," e.g., government workers, state or federal, having limited covered employment but nonetheless qualifying for a "reasonable" social security retirement benefit. One suggestion for such simplification is to design a final average pay concept such as the 10 consecutive years of highest covered earnings with the benefit produced prorated if the employee has not been covered for at least 35 years.
5. Levy an income tax on one-half the benefits or make F.I.C.A. taxes deductible to the employee on his federal income tax, but in exchange, tax all benefits as income to accompany a shift of part of the financing to the general revenues.
6. Transfer certain of the social security benefits which are basically income transfers from high-wage earners to other public assistance systems paid for by the general revenues.

Although the crystal ball is fuzzy at this point, many observers believe that a combination of the three basic approaches will be adopted by Congress. As to timing, final action is expected to take place no later than early 1978.

A comment on the tax aspect.—There is a dilemma facing Congress regarding the financing needs of the social security system. As noted above, Congress must correct for the unexpected near-term shortfalls of income in order to prevent the trust funds from becoming totally depleted. It could, of course, change the benefit structure, but this alternative is at best remote in light of government's implied promises and the fact that financial plans are based, rightly or wrongly, on the stability of the program. It is when this option is ruled out that Congress faces a dilemma. On the one side, Congress is looking at a substantial "stimulation" package proposed by the Administration to ensure economic recovery which ironically includes—at least as proposed—an option for employers to take a credit against income taxes equal to 4 percent of social security payroll taxes and a \$50 payment to every beneficiary of social security. On the other side, Congress must consider raising payroll taxes at least as one option to adequately finance the social security system, and this would increase the total federal tax burden carried

by families and employers. If on the other hand, Congress relies on general revenue financing for a portion of the benefit cost for the wage-related OASDI system, it will eventually be forced to turn to increased income tax rates as part of the means for obtaining the income needed to provide benefits.

Compounding this dilemma for Congress is the fact that a host of costly benefit improvements in the system are gaining additional supporters. For example, there is an amendment proposed that would end the limitation on income which a person can earn after becoming a beneficiary following retirement. There are also the pending changes that would eliminate alleged sex discrimination in the benefit system. And so on.

In sum, it is no longer possible for Congress to look at social security without reviewing the entire Federal tax picture. Further, absent variable social security benefits, it is not likely that social security tax increases will be synchronized with the general economic needs.³

LONG-TERM

As noted earlier, it was pointed out in the Trustees Report of 1974 that the system has a long-term financing problem, and under the system, long-term is indeed that because the Trustees' forecasts cover 75 years, or until the year 2050. Under the 1976 Report, the magnitude of the problem is spelled out in a variety of ways. Most conservatively, the projection is for an actuarial deficit in the system of 7.76 percent of taxable payroll over the next 75 years. Stated in absolute terms, the deficit is \$4.3 trillion, using an annual interest rate assumption of 6.6 percent. It has also been estimated that there is an unfunded accrued liability of about \$700 billion—the present value of future benefits to 33 million beneficiaries, including benefits “earned” or accrued to taxpayers increases the liability to \$3.1 trillion. All appear agreed that a large long-range deficit appears likely under current economic assumptions.

Causes of the long-term deficit.—Among the major causes of the long-term deficit in the social security system are the changed relationship between increases in prices and increases in wages, a basic flaw in the benefit formula, and changes in the fertility rate.

Increases in wages and prices.—In 1972 when Congress adopted the system of automatic benefit increases, i.e., increases in accordance with changes in the cost of living, it also proposed to pay for the benefit hikes by automatically raising the tax and benefit base in accordance with upward shifts in covered wages. The theory was that for the past twenty years wages had grown almost twice as fast as prices and if that relationship continued, tax revenues would automatically be produced sufficient to support the new benefit level.

Obviously, the projected trend has not materialized. Recently, prices have risen faster than wages and the Trustees in 1976 estimated that over the long term wages will rise at 5.75 percent per year and prices will rise at 4 percent. To avoid deficits if prices rise at 4 percent, wages would have to rise at a rate close to 8 percent per year. Should a higher rate of inflation than that projected become typical, the costs of the system could skyrocket because wages may not rise as fast as prices and clearly not twice as fast.

To date no one is talking about a solution to this problem, in large part because it is not politically expedient to eliminate the automatic adjustment provision for benefits. On the other hand, a lot of talk has taken place over the cure to a second problem—a basic flaw in the benefit formula.

Basic flaw in benefit formula.—It is important to look at this second cause of the long-range cost overrun of the system because major proposals to correct the problem have already been presented to Congress.⁴

The social security benefit computation formula is simply an equation to determine how much of the earnings that were lost by retirement, death, or disability will be replaced by the benefit. To arrive at the benefit amount, it is necessary to determine average monthly earnings covered under the system and multiply those by a now 9-part replacement formula.

³ There is of course the alternative of reducing expenditures elsewhere in the Federal budget as an offset to higher social security benefits, but that is beyond the scope of this discussion.

⁴ The Carter Administration in its budget message of February 22, 1977 notes that “[t]he proposed change to correct certain technical deficiencies in the adjustment of social security benefits is being deferred pending further study.”

The "flaw" present is traceable to the statutory changes in 1972. Under these changes, whenever benefits for those already on the rolls are increased to keep pace with the cost of living, the wage replacement fact is increased by the same percentage (see Table V attached). This assures that every future retiree who has the same average lifetime wage as a current retiree will receive the same benefit. The adjustment or indexing, however, overlooks the fact that average lifetime wages covered by the system are also rising and, therefore, the benefit formula is actually over-adjusted.

Until about 1995, this over-adjustment compensates for a different adverse phenomenon—the lengthening of the period over which wages are averaged. In 1950, the law was amended so that the averaging period includes only those years since 1950. As the averaging period gradually increases, the average lifetime wage will become smaller as a percentage of final wages.

Most proposals for correcting the benefit computation formula would eliminate the indexing of the wage replacement formula by freezing the replacement factors for three categories of earners—low, average, and maximum—and replace this adjustment by indexing the earnings history. "Indexing" earnings history translates each past year's earnings into current year's values by multiplying the past year's earnings by the growth that has taken place in some other economic factor.

The two most popular measures for indexing the earnings history are (a) wages or (b) prices. The difference between them is already an important issue for Congress.

The Ford Administration last June (MAPI Memorandum G-86) suggested wage-indexing the earnings history in order to stabilize the current relationship between benefits and final wages. Under this approach, all prior-year wages would have the same comparative value as wages earned in the year before retirement. This approach would eliminate about half the long-term deficit.

A "Consultant Panel" reporting to the congressional tax committees last April recommended indexing the earnings history by price. Since prices over a long period of time have not risen as rapidly as wages, the relationship of benefits to final wages declines continuously over time. Thus, all other things being equal, price-indexing develops more savings, and it could be employed to eliminate the entire deficit by itself.

The problem is obvious, however; price-indexing would result in an across-the-board reduction in benefit commitments for future retirees. Those who argue for price-indexing contend in this regard that adjustments can be made later by future Congresses whenever they believe it to be necessary.

To sum up, "decoupling," as both of the approaches are called, appears to have support, and it is likely that Congress will act on this in the 95th session. At the moment, it would appear the proponents of wage-indexing are in the majority.

Fertility rates.—The third major cause of the long-range deficit is the demographic shift. Knowledge that those born during the post-war baby boom of 1947 to 1954 will be retiring in the years from 1022 to 2020 has, of course, been built into the long-range projections. In addition, the actuaries have cranked in the fact that improved medical care, diet, etc., have swelled the number surviving to old age, pushing the death rate to new lows almost every year which means a steady expansion of the ranks of the aged.

However, the continuation and depth of the decline in the fertility rate following the baby boom have only recently been introduced as actuarial assumptions. More specifically, for the first 11 months of 1976, the rate was 65.7 births for each 1,000 women in the childbearing ages (15 to 44), down from 66.7 in 1975. At the crest of the post-war "baby boom" in 1957, the corresponding figure was 122.7; the previous low was 75.8 in 1936 during the depression.

Further, for the past several years the "total fertility rate," or the average number of children born to each family, has dropped below the "replacement level" of 2.1. This is the figure at which the population would, after some decades, cease to grow. From 3.7 children for each family in 1957, the total fertility rate fell to 1.8 in 1975. The Trustees have forecast this rate to average 1.9 for the next seventy-five years.

These changes in fertility rates would bring about the lowest ratio of working age population to retired population that the system has ever experienced. The ratio will shift from 30 beneficiaries per 100 workers in 1975 to 50 beneficiaries per 100 workers in 2030. To fund the additional beneficiaries with the smaller

ratio of taxpayers would require an increase of about 20 percent over scheduled tax rates for each worker.

The most commonly cited solution is to extend the retirement age to 68 some time after the turn of the next century. A standard retirement age of 68 would sharply reduce the expected duration of the retirement period for all workers.

One of the interesting sidebar issues raised by the changing demographic make-up is the increasing attention older citizens will receive in the next 30-40 years. For example, there has been a trend toward early retirement and early retirement options in private plans. Counterbalancing this trend, there is now considerable support in Congress to remove at least the upper age limit in the age discrimination in employment law. Thus, instead of a protected group between the ages of 40 and 65, the law would protect people of all ages over 40 against discrimination in employment because of age. Should this change be enacted or should the current law be construed to be a barrier against company-dictated retirement before age 65,⁵ it is possible to envision employees having the best of both possible worlds—able to retire early or to work to age 65 and beyond. In sum, the demographic shift is certain to impact socio-economic priorities and the political responses to these issues.

CONCLUDING COMMENTS

It is fair to say that most observers recognize serious short- and long-range financing problems for social security. It is equally well known that the solutions such as lower benefits and or tax increases are not easy ones. It would appear to be an ideal time to examine the future course of both the public and private systems. While to date, Congress has not shown any real interest in the compatibility of the two programs, it is clear that the problems besetting the system call for Congress to think through a comprehensive set of changes which would be adequate to solve the total financial problem. In this process, a number of structural proposals are bound to be reviewed which could have a major impact on the future of the private system. In sum, it appears that the social security deliberations of the 95th Congress are going to be particularly important to the future of private plans.

TABLE I.—BENEFIT AND TAX PICTURE UNDER CURRENT LAW AND ASSUMPTIONS¹

Year	January tax and benefit base	Current OASDHI tax rate (percentage)	Maximum tax payable for employer and employee each
1977.....	\$16,500	5.85	\$965.30
1978.....	17,700	6.05	1,070.90
1979.....	19,200	6.05	1,161.60
1980.....	21,000	6.05	1,270.50
1981.....	22,800	7.30	1,664.40

¹ Based on testimony presented to the Joint Economic Committee by the Congressional Budget Office; see vol. 122, No. 88, Congressional Record at S 8772, June 9, 1976.

TABLE II.—BENEFIT AND TAX PICTURE ASSUMING PRESIDENT FORD'S RECOMMENDATIONS ARE ADOPTED¹

Year	January tax and benefit base	OASDHI tax rate (percentage)	Maximum tax payable for employer and employee each
1977.....	\$16,500	5.85	\$965.30
1978.....	17,700	6.15	1,088.60
1979.....	19,200	6.45	1,238.40
1980.....	21,000	6.60	1,385.00
1981.....	22,800	7.85	1,789.80

¹ Based on President Ford's tax recommendations to Congress, Jan. 4, 1977; see vol. 123, No. 1, Congressional Record at S 41, Jan. 4, 1977.

⁵ See, for example, *McMann v. United Airlines*, decided by the Fourth Circuit on Oct. 1, 1976. The Supreme Court has agreed to review this case.

TABLE III.—TRUSTEES' PROJECTIONS (INTERMEDIATE ASSUMPTION) OF THE PROGRESS OF THE OLD-AGE AND SURVIVORS INSURANCE (OASI) TRUST FUND FOR FISCAL YEARS 1977-81¹

	1977	1978	1979	1980	1981
Economic assumptions, calendar year:					
Annual increases in wages (subject to social security) (percent).....	8.5	9.4	8.5	7.7	6.7
Annual increase in prices (percent).....	6.0	6.0	5.5	5.0	4.5
Rate of unemployment (percent).....	6.9	6.6	6.2	5.7	5.2
Maximum taxable wage (thousands).....	\$16.5	\$17.7	\$19.2	\$21.0	\$22.8
[In billions of dollars]					
Total income.....	71.8	79.1	87.2	95.6	103.3
Total outgo.....	73.4	81.5	89.7	98.7	108.0
Net increase.....	-1.6	-2.4	-2.5	-3.1	-4.7
Reserve, end of year.....	35.9	33.5	31.0	27.9	23.2

¹ U.S. Congress, House, 1976 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 94th Cong., 2d sess., May 25, 1976, pp. 22-23 and 30.

TABLE IV.—TRUSTEES' PROJECTIONS (INTERMEDIATE ASSUMPTION) OF THE PROGRESS OF THE DISABILITY INSURANCE (DI) TRUST FUND FOR FISCAL YEARS 1977-81¹

	[In millions of dollars]				
	1977	1978	1979	1980	1981
Total income.....	9.5	10.7	11.8	12.8	14.6
Total outgo.....	11.3	12.8	14.5	16.4	18.3
Net increase.....	-1.8	-2.1	-2.7	-3.6	-3.7
Reserve, end of year.....	4.8	2.7	2.001	-3.6	-7.2

¹ U.S. Congress, House, 1976 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 94th Cong., 2d sess., May 25, 1976, p. 32. The economic assumptions are spelled out in table III.

² Fund has no authority to go into a negative balance. These figures are demonstrative of what would happen if the fund were to borrow money.

TABLE V.—OASDI BENEFIT SCHEDULE, 1975, 1976, AND 1977¹

	[Percentage]		
	1975	1976	1977
1st \$100 of average monthly earnings ²	119.89	129.48	137.77
Next \$290 of average monthly earnings.....	43.61	47.10	50.11
Next \$150 of average monthly earnings.....	40.75	44.01	46.83
Next \$100 ³ of average monthly earnings.....	47.90	51.73	55.04
Next \$100 of average monthly earnings.....	26.64	28.77	30.61
Next \$250 of average monthly earnings.....	22.20	23.98	25.51
Next \$175 of average monthly earnings.....	20.00	21.60	22.98
Next \$100 of average monthly earnings.....		20.00	21.28
Next \$100 of average monthly earnings.....			20.00

¹ Source: Social Security Administration, U.S. Department of Health, Education, and Welfare. See Social Security Bulletin, July 1976 p. 41.

² The average monthly earnings (AME) is a worker's taxable earnings beginning with 1951, or age 22 if later, up to the year of disability, death, or attainment of age 62 (age 63-65 for men born before 1913)—less the 5 lowest earnings years—divided by the number of months in the computation years.

³ At the beginning of 1977, the highest average monthly covered earnings possible are \$634 for a male worker at age 65 and \$650 for a woman. The monthly primary insurance amount at \$650 average monthly earnings (AME) is \$422.40.

Note: This table shows the progression of the now 9-part formula used to determine the "primary insurance amount" (PIA) which is derived from the worker's covered earnings or "average monthly earnings" (AME). Whenever a cost-of-living benefit increase becomes effective, the new PIA is calculated by increasing the old PIA by the same percentage as the cost-of-living increase. If the contribution and benefit base is raised, the benefit formula provides an additional 20-percent replacement on that part of the AME above the previous contribution and benefit base.

THE MINIMUM TAX ON TAX PREFERENCES—THE BACK-DOOR ROUTE TO FEDERAL TAX INCREASES

INTRODUCTION

Notwithstanding the passions aroused by taxation, the Internal Revenue Code (hereinafter, the "Code") has proven itself over the years to be one of the more successful systems of voluntary self-assessment yet devised by a democratic government. This record is all the more remarkable when it is considered that the Code has been relied upon to finance government; attempt to provide cyclical economic stabilization; regulate economic growth; reward, encourage, deter and/or punish various specific activities; balance international payments; and achieve a host of social objectives, including the redistribution of income. Because the tax laws are put to such a variety of uses and because they directly influence the allocation of scarce resources through greater or lesser interference with private initiative, it is not surprising that the Code is both complicated and controversial.

One fairly recent manifestation of the public concern with the complexity and fairness of the Code is a new form of tax, the minimum tax on so-called "tax preferences." As more fully described below, this tax was first enacted in the Tax Reform Act of 1969¹ and then substantially enlarged by the Tax Reform Act of 1976.² One purpose of the minimum tax was, and is, to ensure that all taxpayers pay their "fair share" of the costs of government through curtailing the benefits obtainable from "excessive" use of tax preferences, sometimes described as tax loopholes. This purpose is, to an extent, achieved by the minimum tax. However, there is a costly trade-off in that the tax undercuts certain laws (i.e., the tax preferences) earlier approved by Congress to reduce Federal income tax disincentives—or, alternatively, to provide incentives—to activities and investments believed to be in the public interest. Moreover, in imposing this new burden on capital formation and increasing the bias in our tax system against investment, the minimum tax actually complicates rather than simplifies the tax law.

Although recent federal tax legislation has significantly enlarged the minimum tax, we believe that it is an unsound device for legislating fiscal policy change and should be repealed. If tax preferences have become a legitimate cause for concern, Congress should deal directly with those items to which substantial questions have been raised.

This study reviews the events and the series of legislative proposals leading to adoption of the minimum tax and then examines in some detail the character and effects of that tax.

BACKGROUND

As already indicated, the minimum tax on "tax preferences" came into existence as a part of the Tax Reform Act of 1969. This tax revision gained momentum late in the Johnson administration when much publicity was given to the fact that, in 1966, some 154 Federal income tax returns with adjusted gross incomes of \$200,000 or more (not including those with income exclusions which did not show on the returns) were filed without any tax due at all. The alleged "problem" was that the tax law provided preferential tax treatment to certain types of income through special exemptions, exclusions, deductions, deferrals, credits, rate reductions, or similar mechanisms. As a result, these types of income were totally or partially excludable from the income tax base, and some wealthy taxpayers so inclined could structure their affairs with one or a combination of these items so as to reduce or eliminate their current tax liabilities.

This matter of certain wealthy persons paying little or no tax was a natural and limited consequence of the government having selectively reduced Federal income tax disincentives to certain economic activities. However, it was represented by certain tax revision advocates to be a gross and intolerable inequity in the system which favored the wealthy at the expense of ordinary income earners,

¹ Public Law 91-172, as described in MAPI Bulletins 4394, 4395, 4398, 4400, 4403, 4407, and 4408, and MAPI Memorandum T-40.

² Public Law 94-455, as described in MAPI Bulletin 5491.

and which, in their view, might well lead to a taxpayers' rebellion, failing remedial action. The alleged "abuses" of "tax preferences" became a rallying point both for persons perceiving a need for selective reform—including the payment of some amount of taxes from all economic income—and persons seeking radical socioeconomic change through tax law revision. "Remedial" action in the form of the minimum tax on tax preferences was the eventual result.

The Johnson Administration (1968) Proposal

The original proposal of the U.S. Treasury Department for a minimum tax was published in 1968. At that time, the minimum tax-to-be was conceived as an alternative to the tax otherwise due under the regular tax rules, and it would have been applied only to individual taxpayers. First, a taxpayer would have figured his regular tax liability without regard to special rules. Then he would have figured his liability under rules which included certain tax preferences in income but applied rates at one-half of those in the regular rate schedule. If the latter computation (i.e., the minimum tax) yielded more liability than the former (i.e., the regular tax), then the minimum tax would have been due instead of the regular tax.

This minimum tax would have been a comparative levy (i.e., the regular liability being compared with the minimum tax, and the larger of the two amounts being due) rather than an add-on tax. The rate structure for this minimum tax, being half the usual schedule, would have been progressive. Due to lack of time for consideration of "tax reform" in the 90th Congress, no action was taken on the Johnson Administration's version of the minimum tax.

The Nixon Administration (1969) Proposal

In early 1969, the Nixon Administration proposed a minimum tax which involved a somewhat different computation than the one considered in the prior Congress, although the concept was the same and the tax still would have applied only to individual taxpayers. In this case, the idea was to prevent the use of tax preferences from excluding from federal income taxation more than one-half of adjusted gross income plus certain specified preferences. Amounts of "disqualified" tax preferences (i.e., amounts in excess of one-half of adjusted gross income increased by certain stated preference income) would have been includable in the tax base subject to regular rates of tax.

This type of minimum tax was approved by the House Committee on Ways and Means during consideration of what was to become the Tax Reform Act of 1969, and it included a small but controversial group of designated tax preferences (among them, for example, interest on state and local government bonds). As in the case of the Johnson Administration's proposal, the Nixon Administration's minimum tax would have been a comparative tax involving the existing progressive rate structure.

The Senate (1969) Version of the Minimum Tax

When the Tax Reform Act of 1969 came up for consideration on the Senate side, the minimum tax was thoroughly overhauled by the Finance Committee. Among other things, it was extended to corporate as well as individual taxpayers. Further, it was turned into a supplemental, or add-on, tax applicable to preference income in excess of a \$30,000 exemption, irrespective of the amount of that income in relation to all income of the taxpayer. Also, a flat rate of tax was proposed instead of using the regular progressive scale or some configuration thereof.

Then, on the Senate floor, a liberalizing amendment successfully offered by proponents of a comparative rather than a supplemental minimum tax provided a deduction for regular taxes paid in computing minimum tax liability. The \$30,000 exemption, the deduction for regular taxes paid, and the relatively low flat tax rate (i.e., 10 percent), all added on the Senate side and eventually accepted by Joint Conferees, tended to blunt the impact of the minimum tax to the chagrin of certain tax revision advocates who—it will be seen—eventually managed to change all three such characteristics of the tax. Also, the list of preferences was modified to make it more nearly acceptable to broad constituencies.

Tax Reform Act of 1969 and the Minimum Tax

As finally enacted in the Tax Reform Act of 1969, the minimum tax applied to individuals and corporations. The minimum tax was equal to 10 percent of the

taxpayer's items of tax preference, reduced by a \$30,000 exemption and the regular income tax liability (in turn, reduced by any foreign tax credit, retirement income credit, or investment credit). Regular taxes not used to offset preferences in the current year were allowed to be carried over for up to seven additional years. Also, it was possible to defer some or all of the minimum tax for a year in which the taxpayer had a net operating loss which could be carried over to another year.

The tax preferences covered were (1) the excluded portion of capital gains; (2) the excess of the natural resources depletion deduction over the adjusted basis of the property; (3) the excess of accelerated over straight-line depreciation on real property; (4) the excess of the fair market value of optioned stock at the time of exercise over the option price of the stock; (5) accelerated depreciation in excess of straight-line depreciation on personal property subject to a net lease (subsequently amended to exclude the acceleration resulting from use of the Asset Depreciation Range system enacted in the Revenue Act of 1971);³ (6) the excess of rapid amortization over accelerated depreciation for certified pollution control facilities; (7) the excess of rapid amortization over accelerated depreciation for railroad rolling stock; (8) bad debt reserves of financial institutions to the extent they exceed amounts allowable based on an institution's own experience (or industry experience in the case of new institutions); and (9) the excess of investment interest expense over net investment income.

As a result of an amendment to the minimum tax in the Revenue Act of 1971, another tax preference was added representing the excess of rapid amortization taken on job training or child-care facilities over accelerated depreciation.

Tax Preferences and Tax Expenditures

As to the "tax preferences" themselves, to which the minimum tax applies, it should be noted that they are considered by the "reformers" as synonymous with "tax expenditures." These are amounts, according to the supporters of such concepts, by which government "subsidizes" various activities through concessions in the tax base, whether those concessions be special exemptions, exclusions, deductions, credits, deferrals, rate reductions, or whatever. The name "tax expenditures" was coined and popularized by foes of these modifications of the tax base who contend that they amount to government spending by indirection which might better not be done at all, or, alternatively, be performed by grant or other direct means. These persons also argue that the very existence of tax preferences leads to abuses by the well-to-do, including tax shelter syndications and related phenomena, which curb the progressivity of the tax structure and lead to assorted intolerable inequities.

Although opponents of "tax expenditures" established their most important beachhead in 1969 with enactment of the minimum tax in Public Law 91-172, they gained still another significant foothold in the Congressional Budget and Impoundment Act of 1974. That statute institutionalized in the federal budget process an annual practice of reporting on amounts of federal revenues believed foregone as a result of "tax expenditures," item by item. This listing of concessions in the federal tax base is, of course, an important document to all persons concerned with the revenues and expenditures of the federal government. More than that, though, the annual appendix to the federal budget dealing with tax expenditures has become both a basic reference piece and "shopping list" for tax revisionists who oppose some or all tax preferences.

Tax Reform Act of 1976 and the Minimum Tax

The Tax Reform Act of 1976 significantly tightens and enlarges the minimum tax for both individuals and corporations. For individuals, the minimum tax rate is increased to 15 percent from 10 percent; the dollar exemption is scaled down from \$30,000 to the greater of \$10,000 or one-half of regular income tax liability; and the seven-year carryover of unused regular taxes has been repealed. Three more tax preferences have been added for individual taxpayers, in summary as follows: (1) itemized deductions (other than medical and casualty loss deductions) in excess of 60 percent of adjusted gross income; (2) intangible drilling costs in excess of the amount deductible if capitalized and amortized over 10 years; and (3) accelerated depreciation on all personal property subject to a lease, including the acceleration resulting from use of the Asset Depreciation Range system but not bonus first-year depreciation.

³ This particular preference did not apply to corporations.

For corporations, the minimum tax rate is raised to 15 percent from 10 percent. The dollar exemption is reduced from \$30,000 to \$10,000 or the full amount of regular income tax liability, whichever is greater. Also, the carryover of unused regular taxes has been repealed. The items of tax preference have not been changed for corporations, except for timber income. There, special rules applicable to gains from the cutting of timber and long-term gains from the sale of timber have the effect of exempting timber income from the increase in the minimum tax for corporations.

The Secretary of the Treasury is instructed by the new minimum tax legislation to issue regulations under which there will be no such tax when individuals or corporations do not receive any tax benefit from a tax preference.

Generally speaking, the minimum tax changes for both individuals and corporations in the Tax Reform Act of 1976—which was signed into law on October 4, 1976—were made effective for taxable years beginning after December 31, 1975. Therefore, for most affected taxpayers, the changes adverse to them were structured so as to have a limited retroactive application as well.

A CRITIQUE OF THE MINIMUM TAX

As a review of the recent history of the minimum tax indicates, the congressional majority has a predilection toward its continuation and enlargement. With the amendments to the minimum tax accomplished by the Tax Reform Act of 1976, many more taxpayers will become liable for this levy in greater amounts on more kinds of income than ever before. Moreover, the minimum tax, which was originally conceived as a comparative tax, seems to be evolving in the direction of becoming a supplemental or add-on levy applicable to tax preferences without reference to their magnitude in relation to income otherwise taxable.

The trend line is clear. What once was offered as a means to curtail an alleged overindulgence in tax preferences by some wealthy individuals has become increasingly an instrument for curtailment by indirection of the preferences themselves. Also, the tax no longer is wholly restricted to "wealthy" individuals. It now affects many taxpayers well below the so-called wealthy class and is applied to corporations as well.

As more fully described below, the minimum tax is unsatisfactory on a number of counts, and the consequences of the tax extend far beyond those individuals and corporations subject to it. To summarize the shortcomings of the minimum tax: (1) it is an objectionable vehicle for legislating tax policy and lacks the visibility normally attached to significant tax increases; (2) it complicates, rather than simplifies, the Code; (3) it should not apply to corporations in any event; (4) it derives its impetus more nearly from popular prejudice than from objective consideration of resource allocation via the tax laws; and (5) it is a further penalty on savings and investment at a time when capital formation already is inadequate in this country.

Legislative Procedures

As a mechanism of tax revision, the minimum tax is at best an expedient. The various provisions of "tax preference" in the Code were, prior to the coming of the minimum tax, considered individually on their own merits and similarly voted into law. In enacting these provisions, Congress and the Executive Branch of government carefully determined that the federal income tax disincentive to various activities should be wholly or partially relieved. The minimum tax, to the contrary, is a tax legislative mechanism whereby this disincentive is partly reinstated without altering the Code provisions originally enacted to reduce the disincentive.

Whether or not one agrees that there should be a minimum level of federal income tax liability for every citizen, there can be little disagreement that the minimum tax is a "scattershot" device. For example, it is possible to amend the minimum tax by reducing the fixed-dollar exemption or the deduction for regular federal income tax liability, and thereby to reduce a dozen or more tax preferences without individual attention to the specific economic activities impacted by the change. Whereas the tax impacts on these activities were directly and carefully considered in the first instance, the minimum tax affords means by which tax preferences can be reduced in a composite and indirect way. Along the same lines, the accountability of a legislator to his constituents for taking a position on the minimum tax which may be adverse to one or more economic activities is diffused if not obfuscated by the mechanism.

Also the results can be haphazard and run against the grain of what otherwise is sound and settled tax policy. Consider the application of the minimum tax to the difference between the fair market value and the exercise price of a qualified stock option.⁴ In this case, the tax is levied, notwithstanding that no cash to use in payment of the liability is generated by exercise of the option, and notwithstanding that the employee cannot even liquidate optioned stock to pay the tax liability without violating the holding period requirements to which the qualified stock option benefits are tied. Also, the basis of the optioned stock is not increased by the minimum tax paid; the tax paid on the "paper" gain is not recoverable if the optioned stock is later sold at a loss; and, if the transaction ultimately results in a capital gain, the employee may incur another minimum tax partially duplicative of the one incurred on exercise. One wonders whether Congress even considered these matters in enacting its minimum tax.

To take another example, the Tax Reform Act of 1976 extends Code section 169 on rapid amortization of certified pollution control facilities. Because of the heavy burden of capital expenditures for statutorily mandated environmental protection, Congress not only extended rapid amortization, but added a 5 percent investment tax credit tax credit for qualifying facilities.⁵ This new allowance is somewhat more advantageous than the depreciation and investment tax credit otherwise available, as intended, but that result may not obtain where the taxpayer is subject to the minimum tax. Indeed, the advantage may be almost completely eliminated by related minimum tax liabilities for some companies in those industries most in need of the legislated advantage. Could Congress have intended such a capricious result as to have a taxpayer lose these new tax benefits simply because his regular tax liability in a particular year is so low—through misfortune or the normal application of other operative Code provisions—as to expose him to a minimum tax liability?

Complication, Not Simplification

The tax revision objective most often recognized in the breach is, of course, tax simplification. For evidence of this, a person need only contemplate what was wrought by Congress in terms of complication of federal income taxation by enacting the Tax Reform Acts of 1969 and 1976. As one specific example consider the minimum tax on tax preferences. It is true, as some tax revisionists vigorously contend, that the tax preferences hit by the minimum tax (e.g., the untaxed portion of capital gains) are a complicating feature of the Code. However, these preferences reflect value judgments of the body politic as to activities which should not bear the full burden of federal income taxation, and it would be both unrealistic and unwise to have a taxing system without any such concessions. Superimposed on these tax preferences is the minimum tax. The minimum tax is a complicating element because it adds to the framework of tax preferences already in the Code an entirely new set of computations to be made with respect to them.

As more and more taxpayers come within the range of potential liability for minimum tax—the number having been increased tenfold, by some estimates, by the Tax Reform Act of 1976—they will find themselves with several difficult tax computations to make instead of one. Along with the new computations associated with the minimum tax, there will be new complications, and, for government, an enlarged bureaucracy to deal with them. Also, regrettably for tax simplification, it is to be expected that the minimum tax, for so long as it is perpetuated in the Code, will be subject to periodic congressional tinkering with the rates, exemptions, deductions, and list of preferences. The very concept on which the minimum tax is predicated, that of having every taxpayer pay a "fair share" of tax on his "economic income," is one which bears the seeds of literally endless debate. If the experience to date is any indication, the outlook is for a complex addition to the Code, the minimum tax, to become even more unwieldy with the passage of time.

⁴ Except for qualified stock options granted under transitional rules, the Code provisions conferring special tax attributes in this area were repealed by section 603 of the Tax Reform Act of 1976. The discussion herein of the minimum tax in this particular context is intended only to demonstrate that application of the minimum tax can be at cross-purposes with settled tax policy.

⁵ A somewhat larger "bonus" investment tax credit than finally enacted was considered but then rejected because of budgetary pressures.

Ironically, too, the objective of some tax revisionists to "bleed" tax preferences through the minimum tax until they become easy targets of repeal seems unlikely to succeed, notwithstanding the harm that the tax will cause in curtailing the capital flow to various desirable activities. For example, experience to date shows that various preferences (e.g., the exclusion of interest income from state and local bonds), of the dozens which could be subjected to the minimum tax, command the interest of a sufficiently broad and active taxpayer base to be reasonably secure from even the most ardent of tax revisionists. Meanwhile, new legislation—e.g., the Tax Reform Act of 1969, the Revenue Act of 1971, and the Tax Reform Act of 1976—creates new preferences where Congress deems that appropriate, and the new preferences do not necessarily become part of the minimum tax base. "Tax simplification" may not be the antithesis of the minimum tax, but it seems fair to say that simplification and the minimum tax have little in common.

A Minimum Tax on Corporations

One reason advanced for having a minimum tax is that the tax preferences in the Code tend to disturb the intended progressivity of the federal income tax structure. It is contended that, given the existing rate structure, there is a special incentive for persons of high income to use tax preferences. To the extent that this is done, it is possible for these persons to reduce their taxable incomes (as compared to their "economic" incomes) to levels where the applicable tax rates are relatively low. Hence, it is reasoned, the intended progressivity of the rate structure is diminished, and that is a justification for the minimum tax. A fallacy in this line of reasoning as it applies to the corporate minimum tax is that the federal income tax for corporations is not very progressive at all. In fact, for corporations above the surtax exemption level of income, the rate is flat. Accordingly, there generally is no special incentive for a corporation of "high" income, as compared to one having low income, to use tax preferences. Also, there is very little progressivity to be distorted by the use of such preferences.

Why, then, is there a minimum tax for corporations? The Johnson Administration, which first proposed the minimum tax, intended it only for individuals. The Nixon Administration, which subsequently accepted a minimum tax as one of its reform objectives, similarly intended it only for individuals. The device was extended to corporations by the Senate Finance Committee in its consideration of the proposed Tax Reform Act of 1969. In Senate Report No. 91-552, the Finance Committee stated, as follows:

. . . [C]orporations with long-term capital gains, accelerated depreciation, intangible drilling and development expenses and percentage depletion, and financial institutions with special deductions for additions to bad debt reserves tend to pay smaller amounts of tax than other corporations.

* * * * *

. . . [T]he House provisions for a limit on tax preferences and allocation of deductions would apply only to individuals and not to corporations. In large measure, this is because these provisions [i.e., the House-passed provisions as compared to those reported by the Senate Finance Committee] do not lend themselves to the taxation of preferences enjoyed by corporations. For example, a corporation with sufficient tax preferences to be affected by these provisions could arrange to escape from their impact by merging with other corporations with relatively small amounts of tax preference income.

It would appear from these assertions of the Senate Finance Committee that the only reason for extending the minimum tax to corporations was a generalized distaste for tax preferences. For persons who might question the adequacy of this rationale, a closer look at the legislative background is instructive. In particular the Senate Finance Committee found it desirable to reject two related provisions of the Tax Reform Act of 1969 as passed by the House of Representatives. These were the "limit on tax preferences" and the provision for the allocation of deductions between taxable and nontaxable income, both of which were considered to be too complex and objectionable in certain other respects. The Finance Committee replaced the limit on tax preferences with what came to be known as the minimum tax on tax preferences, but it did not replace the item dealing with the allocation of deductions. Some observers believe that the minimum tax was extended to corporations solely to pick up the revenue loss occasioned by deleting the deductions provision from the bill.

Popular Prejudice

Like certain other public policies reflected in the statute books, the minimum tax is more nearly a reflection of "popular prejudice" than of objective economic analysis. A part of this popular prejudice is to feel that persons—especially those of means—are evading civic responsibility unless they participate through regular and sizable federal income tax payments in the cost of the U.S. government. In this particular view of "wealth" and the responsibilities which go along with it, there is no latitude for argument that taxes due were determined in full compliance with the law. One reason for this is that persons who derive all of their income from personal services—i.e., the majority of taxpayers—as compared to those who earn some or all of their income from capital do not feel that they have equal access to tax preferences. This, of course, is incorrect because many "tax preferences" are available only to persons of low and middle incomes, and these preferences are not now subject to, and probably will not ever be made subject to, the minimum tax. Also, some tax preferences now subject to the minimum tax are used by persons and entities at moderate as well as high-income levels.

Advocates of the minimum tax exploited this prejudice in 1969 when they decried the existing condition which permitted 154 taxpayers having adjusted gross income in excess of \$200,000 in 1966 to be free of federal income tax. In 1976, supporters of an enlarged minimum tax again made much of the fact that 244 persons at the same level of income (not adjusted for inflation) in 1974 reported no federal income tax. Corporate taxpayers find themselves subject to the same kind of review now by persons purporting to report annually on those entities which, allegedly, have not paid a "fair share" of taxes, irrespective of the reasons why. The idiom employed by persons exploiting this popular prejudice includes such "carefully" chosen words as "freeloader," and expressly or impliedly indicates that the real progression in the federal income tax structure is from those with the greatest ability to pay at the bottom to those with the least ability to pay at the top.

The allegations and implications which have led to the minimum tax do not hold up well under close analysis. For example, former Treasury Department Assistant Secretary (Tax Policy) Edwin S. Cohen testified on "Tax Subsidies and Tax Reform" before the Joint Economic Committee of Congress in July 1972, and he spoke directly to this point. Using preliminary 1970 data, Mr. Cohen noted that there were some 100 individuals in that year who had adjusted gross incomes of \$200,000 or more but paid no Federal income tax. However, there were 15,200 other individuals at the same level of income who paid this tax at an effective rate of 44.1 percent of adjusted gross income and 59.5 percent of taxable income. Mr. Cohen concluded as follows:

From this, it is perfectly clear that in general the rich are paying Federal income taxes in large amounts. And they are paying more than they were in 1968 while other taxpayers are paying less.

Turning to the few nontaxable persons with adjusted gross income about \$200,000, Mr. Cohen and his staff had performed further analysis. In several cases, the absence of U.S. tax liability was due to operation of the foreign tax credit in situations where the effective foreign income tax rate for the individuals had averaged 62 percent of adjusted gross income and 70 percent of taxable income. In other group of cases, the 1970 Federal income tax liability was eliminated because of deductions for State income taxes paid in 1970 pertaining to large amounts of nonrecurring 1969 income of which substantial amounts of Federal income tax had been paid in 1969. In another group, the principal element in elimination of Federal income tax liability was charitable contributions under circumstances in which Congress, in amending the law in this area in 1969, recognized that some instances of nontaxability still would result. In the remaining cases, the principal deduction was either "interest paid" or "miscellaneous deductions." Mr. Cohen felt as to some of the persons in this latter group that the existing definition of "adjusted gross income" might be giving them the appearance of having high income, whereas their large business and investment expenses suggested to the contrary.

In concluding the portion of his presentation dealing with this subject, Mr. Cohen stated, as follows:

Now I do not mean to imply from this review of the 106 cases that there is not a constant need for vigilance and improvement in the tax laws. Most assuredly there is a definite need. I mean only to indicate that there is relatively little guidance to be gained from these particular returns in relation

to major issues of tax policy, and the attention that has been devoted to them is unwarranted and unwise.

Notwithstanding the facts presented on the public record by Mr. Cohen and his advice about the undue attention given to a few, nontaxable, high-income taxpayers, the peculiar "chemistry" of popular prejudice that propels the minimum tax and favors still more redistribution of wealth persists and grows. As already mentioned, the Tax Reform Act of 1976 substantially enlarged the minimum tax. In addition, Congress instructed the Secretary of the Treasury to publish statistics on the tax liability of people with high total income, including the number and average income of high-income people with no income tax liability (after credits); the specific deductions, exclusions, and credits used to avoid tax; the overall number of high-income individuals; and the total income and tax liability of the high-income group.

A Penalty on Savings and Investment

Whatever else the minimum tax may be, it is a penalty on savings and investment. Whereas Congress once enacted special tax provisions to reduce the disincentives of Federal income taxation to savings and investment, through the minimum tax Congress has enacted further provisions to partially reinstate the disincentives. While this may seem contradictory as a reflection of public thinking about tax incentives for capital formation, the question of capital formation does not enter significantly into the tax revision dialogue as it deals with this levy. This is because the dialogue is preempted by the rhetoric of popular prejudice to which the situation addressed by the minimum tax so conveniently lends itself. As a result, the minimum tax is popularly thought of as a deterrent to tax avoidance by the rich, not as a deterrent to capital formation. The irony of this is that the minimum tax is most certainly an impediment to capital formation in those areas otherwise favored by the taxed preferences, but it does not ensure that the rich (e.g., those few who now have high income but escape tax) will be subject to tax. As indicated earlier, this is a costly tradeoff.

In reviewing the list of tax preferences—which, as already mentioned, does not include those destined to remain inviolate due to a broad and active taxpayer base—one encounters one anomaly after another. For example, capital gains are given preferential treatment in the Code because of a general understanding that it is inappropriate to tax capital on the same basis as income from capital. Indeed, in some taxing jurisdictions abroad, capital is not taxed at all because it is realized that capital is the "seed corn" of economic activity and growth. In establishing the excluded portion of capital gains as a tax preference and later reducing the minimum tax exemption while increasing the rate, did Congress consider that it was moving in the direction of taxing capital gains as ordinary income? Would Congress have taken action to reduce the excluded portion of capital gains had the issue been considered directly and in isolation rather than in the minimum tax concept? We hope not.

Continuing, Congress has provided for rapid amortization of the cost of various types of facilities where that is believed to be in the public interest. However, Congress also has listed as a tax preference the excess of rapid amortization over accelerated depreciation for these facilities. If the objective of having "tax expenditures" for these facilities is so important, does it really matter to Congress that a small handful of taxpayers might funnel their income into these investments in such a great amount as to reduce their current tax liabilities below what what is perceived in some minds to be a "fair share"? What is a "fair share" anyway? If Congress were to consider these investment incentives individually on the public record, would it conclude that they should be reduced? Does Congress really believe, in curtailing tax preferences such as those which facilitate private savings and investment, that the Federal Government rather than taxpayers should administer the "spending" programs to which the preferences relate?

In these times of so much active concern about capital formation, not to mention the employment and economic activity which is derived from capital, it is nothing short of remarkable that the minimum tax is not only tolerated but also increased. The tax directly erodes tax concessions to investment activity and it is imposed on those persons with the greatest ability and propensity to save and invest. The effect of the tax is to increase the burden associated with savings and investment, and the increased burden can only serve to dampen that activity. As noted earlier, the small number of wealthy individuals who have avoided tax in the past can, at some modest inconvenience to themselves, continue to do so if they are so inclined. The "penalty" of the minimum tax is borne not by these celebrated few, but by a large segment of the tax structure and the economy at large.

CONCLUDING COMMENT

There is good reason to conclude that the economic and fiscal policy objectives of this country are not well served by the minimum tax on tax preferences. It is a scattershot taxing mechanism which is deficient in concept and execution. It results in tax policy inconsistencies; it complicates an already complex Code; it works in contravention of laws intended to facilitate the allocation of scarce resources to desired objectives; and it is significantly hidden by the inherent nature of the mechanism. All of this is accomplished in a purported effort to squeeze further tribute from some wealthy taxpayers who have legally reduced their federal income tax liability to low levels, notwithstanding that their situations are not typical of persons of high income generally and, in many cases, are not a result of "overindulgence" in tax preferences. Ironically, the impact of the minimum tax is much more widely felt and is borne directly by activities on which Congress otherwise has conferred favored tax status. As indicated herein, the situation is bad in this regard and it is worsening on a progressive basis. It represents federal tax policy at its worst—a classic example of bad government.

Before more harm results from the minimum tax, it should be repealed. To the extent that there continues to be public concern about "abusive" use of tax preferences, Congress should deal with the preferences individually, including the matter of any limitations to be imposed on their use.

NATIONAL ASSOCIATION OF MANUFACTURERS

Rather than offering an exhaustive analysis of all the issues of Government economic policy, we have prepared a brief commentary on three issues which seem of central importance in 1977: Fiscal policy, energy, and wage-price controls or quasi-controls.

FISCAL POLICY

In early January of this year, President Ford submitted his fiscal 1978 budget with projections of a very small deficit in 1979 and surpluses thereafter. Later President Carter submitted budget revisions with proposals for a larger deficit in 1978 and a longer wait for a balanced budget. With the hopes for balanced budgets dimming once again, the effects on business confidence and morale are not likely to be favorable. Concern may again arise over the inflationary impact of \$50 to \$70 billion deficits. One begins to wonder whether the congressional budget process, once the hope for fiscal restraint within the Congress, may have institutionalized the deficit as much as it has structured the taxing and spending process.

The administration's recent strong statements about fiscal responsibility may have a beneficial effect on business activity and consumer confidence, but legislative actions in coming months will speak louder than anyone's words.

Both President Ford and President Carter submitted tax cut proposals. The Carter package was the catalyst for the current congressional action on the H.R. 3477, although the House-passed specifics vary from those proposed.

The passage of the Tax Reform Act of 1976 was thought to be the last revenue measure for at least a couple of years. Rather significant changes were made in that measure, and there was a widespread belief that there would be a significant passage of time before another measure could be handled by the Congress and the public.

However, general economic conditions during later 1976 prompted the Carter administration to recommend the economic stimulus package, which was brought forth amidst the confused economic conditions earlier in the year. As a result, the debate over the need for, the potential size of, and the components of a stimulus package is continuing. Many in Congress may have concluded that no stimulus is needed, but it appears likely that tax reduction will be passed simply because voters expect to be receiving rebate checks in the mail.

The tax proposals are being considered in an atmosphere of much skepticism about their potential impact. The rebate proposal has been supported in a very lukewarm manner and has been criticized on many occasions. The business tax cuts proposed by the administration, including the 12-percent investment credit, have been criticized as ineffective and too small. A tax credit for incremental employment costs has been passed by the House, but its impact is uncertain at

best. The most straightforward and economically helpful measure, in our view, would be a simple reduction in corporate and individual income tax rates—which could be implemented quickly but held to within the budget limits imposed.

Apart from the stimulus package, a thorough reconsideration of the Federal income tax structure seems likely later in the year. The Ford administration's "Blueprints for Basic Tax Reform" has made a significant contribution to this effort. President Carter's campaign discussion of taxes suggests that he will be proposing substantial changes, too. The time may be appropriate for a review of such fundamental issues as the integration of personal and corporate income taxes, a broadened taxable income base with reductions in overall rates, or even a shift toward placing part of the tax burden on consumption rather than on income. Various persons and groups will benefit and suffer from any significant reforms, but general simplification is an objective which may override all specific problem areas. Certainly, a significant reduction in the tax obstacles to productive investment and capital formation would do much to improve the general economic climate. Another desirable objective would be stability in the law. Five (soon to be six) major tax bills in 9 years are just too many.

WAGE-PRICE CONTROLS OR QUASI-CONTROLS

Although the inflation rate has subsided substantially from the double-digit rates it attained in 1973 and 1974, fears of a possible renewal of inflation remain with us—and, of course, they should. One reaction has been a process of groping, both within Government and outside of it, for some form of Government intervention in the marketplace that would help to hold back price and wage increases.

At this writing, the groping process has not yet crystallized into anything very definite. Comprehensive and mandatory controls, of the type authorized by the Economic Stabilization Act of 1970, seem at present to be out of favor and have few advocates. Attention is now centered on the search for some more informal, less coercive, method of influencing what happens to wages and prices in specific instances. This search has already bumped up against reality in several instances, and hopes of what might be achieved by that approach have been somewhat deflated.

Nevertheless, the search goes on. The issue is potentially too important to be left out of this discussion of the matters which should concern the makers of Government policy in 1977. For that reason we will offer some comments on the subject. These will have to be general in nature since no specific program is as yet available for us to comment on:

1. Any program whereby Government would undertake to pronounce judgment as to the "justification" for any price increase—whether or not it had legal power to enforce compliance with its judgment—is open to the same objections as mandatory wage-price controls. If it is assumed that the Government does indeed have the wisdom to determine the "right" level for any given price or wage rate, better than the free market can make such determination, it will be generally concluded that the Government should be empowered to compel compliance. Even without such legal powers,

Government has many ways to make life unpleasant for those who disagree with its judgments, and we must assume they would be used. The distinction between voluntary and mandatory wage-price restraints is likely to become a distinction without a difference.

2. An informal program of Government wage-price intervention could be more unjust and arbitrary than a program of mandatory controls. At least, in the case of mandatory controls the rules are laid down in advance and the penalties for violators are prescribed by law.

3. The ugly confrontations between business and Government which could result from extralegal intervention would be damaging to the morale of business and to the smooth conduct of the Nation's economic affairs. In particular, any such intervention would shake the confidence of business on which investment for future economic growth depends.

4. The existence of wage-price controls, or quasi-controls, could deceive the public into believing that they have effective protection against inflation. It might, thereby, encourage excessively expansionist monetary and fiscal policies. This is not merely a theoretical possibility—it is what actually occurred during the 1971-74 price control period and is an important part of the explanation for the inflationary explosion in 1973-74.

5. We had experience with an informal system of quasi-controls in the 1960's—the wage-price guideposts. When inflationary pressures were absent prior to mid-1966, the guideposts seemed to work, or at least they survived. When inflationary pressures became severe in the later 1960's, the guideposts collapsed and were heard of no more. In other words, guideposts seem to work when they are not needed and, when they are needed, they cease to work.

The fact is that wage-price controls, whether mandatory or voluntary, are simply irrelevant to the underlying causes of inflation, which lie chiefly in the fiscal and monetary fields. Whatever course of action may be adopted for the future, we hope that the national leadership will not deceive itself on that point.

ENERGY

The importance of energy for the economy is fundamental since the consumption of energy is an inescapable part of the process which produces the goods and services which provide for our needs, and the jobs which provide our livelihood. NAM believes that these basic relationships must be more clearly understood by all Americans.

The NAM is firmly of the belief that any solution to the Nation's energy needs must be based on reliance upon the free-market system, rather than on superseding that system. Price controls on energy are part of the problem—the largest part of it—rather than a part of any workable solution.

One of the priorities for all of us is to increase public awareness of the costs of energy development. The public must be informed that energy development requires enormous capital investment. From 1965-1974 capital investments for energy development totaled about \$350 billion. Estimates for cumulative capital needs in constant 1975 dollars between 1976 and 1985 are in the range of \$600 billion.

The Government must revise existing Federal tax policies and eliminate unrealistic price controls that act as disincentives to energy development and encourage greater energy consumption than is necessary.

Some of this consumption could be reduced by simple conservation measures and the energy thereby saved could be used in ways highly beneficial to the economy. Conservation, insofar as it dictates wise use of energy resources, can have a positive effect on the long-run economy and should, therefore, be encouraged. A national commitment to voluntary energy conservation is urgently needed not only to reduce imports and import dependence, but also to eliminate waste, improve efficiency, and reduce unnecessary personal consumption. It is clear that the best way to accomplish this is through the adoption of a national energy policy.

A balanced national energy policy will integrate the general objectives of public awareness, improved Government relations with industry, and voluntary energy conservation. A balanced national energy policy will also emphasize the effects of our actions in terms of energy consumed and the resulting effects on the economy. Priorities should be spelled out to reflect a balanced and wise set of choices from available alternatives. These priorities and choices will form the basis for specific national energy objectives.

NATIONAL FARMERS UNION

Mr. Chairman and members of the committee: We are in general sympathy with the change in direction that President Carter is proposing to try to stimulate the economy toward the goal of full employment. We would like to emphasize, however, that the agricultural sector of the economy has been largely ignored in the deliberations of the committee this week, and we believe this to be an oversight that should be given immediate attention.

The economic welfare on the farms of the Nation has a direct bearing on the general economic welfare. It is a simple fact that the agricultural economy is in an economic slump resulting from increasing stocks of a number of major commodities and the resulting effect on market prices. The average price of wheat, for example, as of February 15, 1976 was \$2.44 per bushel (49 percent of parity) as compared to \$3.66 per bushel a year ago.

Neither of these price levels are considered to be adequate to cover costs of production expected to be incurred in 1977. While farmers have been encouraged by the past administration to produce without restraints, we have been faced with meaningless levels of support. For example, the loan level under the Ford administration is only \$2.25 per bushel (46 percent of parity).

Prices of such other commodities as rice, corn, barley, and beef cattle are similarly depressed. The farmers of this Nation deserve more equitable treatment than they have received during the Nixon-Ford administration. In those recent years when prices were generally favorable, the increasing costs of production denied farmers any particular advantage. Further, the roller-coaster movement of market prices during the past 8 years has been disruptive both in terms of the ability of farmers to make a profit and to secure needed credit to continue the kind of farm operation that would lend some stability to individual farming operations.

We recognize that the new administration and the Congress cannot rectify overnight all of the adverse conditions that have been plaguing farmers over these recent years. But we believe that there is justification for the Congress to take emergency action in 1977 to give farmers, and their creditors, assurance that they will not be faced with balance sheets at the end of this year that show a loss. Every fair-minded citizen, we believe, supports the concept that no one producing food for the Nation should be forced to take a loss in such an important endeavor.

Faced already with inadequate supports and prices, the outlook in 1977 concerning the cost of farm production items is by any standards bleak and uncertain. For example, during the past year, the index of prices paid by farmers for commodities and services increased 6 percent (December 1975 to December 1976). Recently, official forecasts of the Department of Agriculture predicts further increases in

1977 in production items. Increased prices are anticipated for farm machinery, fuel, pesticides and fertilizer.

The departing Ford administration, apparently in the effort to portray the most optimistic farm cost situation for 1977, has projected that costs this year may increase 4 to 5 percent.

The Congress will be faced this year with extending farm programs which expire at the end of this year. However, in the short range for the year 1977, farmers are faced with an intolerable situation of not being counted in for services in the budget that will facilitate more realistic loan and price support levels.

We realize that members of the Joint Economic Committee work in concert with the legislative committees in the Senate and House, and also with the functional subcommittees of the Appropriations Committee of the two bodies. We, therefore, have shared with members of these committees the comments that we are presenting here today in the hope that some early action can be taken to give farmers relief this year.

In order that our general comments may be fully substantiated and supported by factual data, we have prepared a brief, simple statistical review of the current situation as it relates to (1) levels of support under current law (the Ford budget); (2) projections for 1977 production costs prepared by USDA technicians and which we believe to have great significance in the course of your deliberations; and (3) the support levels contemplated in one farm bill which has already been introduced in the Senate, S. 275.

The Agriculture and Consumer Protection Act of 1973 provides for basic farm income support through a method of target prices, deficiency payments and commodity loans. Under present law, the established or target prices and loan levels have been set unrealistically low when compared to the equitable measure of parity (table I, columns 4, 5, 9, 10). Target prices have averaged around 50 percent of parity and loans based on 70-80 percent of target prices.

Despite some criticism to the contrary, parity is an equitable measurement of the economic position of American farmers. (table I, column 6).

For some time we have heard that agricultural price supports should be tied to the actual cost of production of farm commodities. The U.S. Department of Agriculture has recently published a report, "Costs of Producing Selected Crops in the United States—1975, 1976 and Projections for 1977," prepared by the Economic Research Service, USDA, January 21, 1977, for ten major commodities (table I, column 1).

Though the Department's economists have used relatively sound methodology in calculating these costs, they still must project a cost range for the commodities based on the fact of different input costs, land values, farming practice, labor costs, and so forth, found in various parts of the country. (Table I, column 2). In order to put these costs in some perspective we have calculated the average cost of production including all inputs plus land at current value for the ten commodities (table I, column 3). For the seven major commodities included in the report—excluding barley, oats and flaxseed—cost of production figures as compared to parity prices average 63.7-68.6

percent of parity (table I, column 7). Utilizing average cost of production figures including land at current value (table I, column 3); the average cost of production ratio to parity is 66.1 percent (table I, column 8).

Table II compares the pricing provisions contained in the recently introduced Food and Agricultural Act of 1977 (S. 275) and USDA's cost of production figures for wheat, corn and cotton. Of particular significance to farm income is the fact that S. 275 target prices average 86.8 percent and loan rates 65 percent of the Department's average cost of production (table II, column 7, 8). Both the target prices and loan rate levels of S. 275 are significantly lower, in dollar terms, than the cost of production figures (table II columns 9, 10).

To put both the pricing provisions of S. 275 and target and loan rates under current law into perspective, table III compares both to current parity prices for wheat, corn and cotton.

S. 275 target prices for the three commodities average 64.4 percent of parity. Loan levels average 48.3 percent of parity (table III, columns 5, 6).

Under current law the average target price for the three commodities is 55 percent of parity (table III, column 9). The loan rate for wheat is 46 percent of parity and corn is 45.7 percent of parity (table III, column 10).

To place the entire bleak economic picture faced by farmers as they enter into a new production year in graphic terms, the members' attention is directed to table IV, parity prices, prices received and prices received as a percent of parity, as of February 15, 1976. In view of this economic situation, the Congress and the administration must give immediate and serious attention to measures designed to strengthen agriculture's economic position.

In closing, Mr. Chairman, on behalf of our national president, Tony T. Dechant, our national board of directors, and the membership of the National Farmers Union, we want to stress the fact that we are mindful of the concerns of consumers. Our organization has championed, along with consumer groups, many legislative efforts to improve the economic conditions in the cities and we are fully cognizant of the fact that attempts have been made to divide by deliberate strategy farmers and consumers to serve political aims and aspirations of the past administration.

We want to see, as President Carter has recognized, the consumers and farmers of this Nation working in cooperative endeavors toward a truly national food policy that will bring to the Nation fair prices to both farmers and consumers, assuring the economic viability on farms that will produce the supplies of food that consumers of this Nation have a right to expect under a now united executive and legislative Government. We pledge our cooperation in the days ahead to work with the members of the executive branch, particularly Secretary Bergland, and a reconstituted Department of Agriculture and with other agencies of the executive branch toward this objective.

TABLE I.—COMPARISON OF VARIOUS COMMODITIES WITH USDA COST OF PRODUCTION FIGURES¹ 1977 TARGET PRICES AND LOAN RATES AND THEIR RELATIONSHIP TO PARITY PRICES

Commodity (1)	USDA cost of production		1973 Act 1977 Rates		100 percent parity price (Jan. 15, 1977) (6)	Cost of production as percent of parity		Target price as percent of parity (9)	Loan rate as percent of parity (10)
	Including all inputs plus land at current value (2)	Average cost of production including land at current value (3)	Target price (4)	Loan rate (5)		All inputs including land at current value (7)	Average cost of production including land at current value (8)		
Wheat (bushel).....	\$3.40-3.71	\$3.55	\$2.47	\$2.25	\$4.98	68.2- 74.4	71.2	49.5	45.9
Corn (bushel).....	2.44-2.60	2.52	1.70	1.50	3.42	71.3- 76.0	73.7	49.7	44.5
Sorghum (hundredweight).....	2.40-2.66	2.53	1.62	-----	5.72	41.9- 46.5	44.2	28.3	-----
Cotton (pound).....	.545- .614	.5795	.478	-----	.8284	65.7- 74.1	70.0	57.7	-----
Soybeans (bushel).....	5.76-6.07	5.91	-----	-----	7.54	76.3- 81.0	78.4	-----	-----
Rice (hundredweight).....	8.16-8.57	8.36	* 8.25	* 6.19	13.60	60.0- 63.0	61.4	61.0	46.0
Peanuts (pound).....	.140- .147	.1435	-----	-----	.283	49.5- 52.0	50.7	-----	-----
Barley (bushel).....	2.80-2.95	2.87	1.39	-----	2.96	95.0-100.0	97.0	47.0	-----
Oats (bushel).....	2.23-2.40	2.31	-----	-----	1.72	130.0-140.0	134.0	-----	-----
Flaxseed (bushel).....	7.58-8.67	8.12	-----	-----	8.49	89.0-102.1	96.0	-----	-----

¹ Cost of producing selected crops in the United States—1975, 1976, and projections for 1977.
² 1976 target price.

* 1976 loan rate.

Source: The Economic Research Service, U.S. Department of Agriculture, Jan. 21, 1977.

TABLE II.—COMPARISON BETWEEN PRICING PROVISIONS CONTAINED IN S. 275 AND USDA COST OF PRODUCTION FIGURES

Commodity	100 percent parity price (Feb. 15, 1977)		S. 275		Average cost of production including all inputs plus land at current value		S. 275 prices as percent of USDA average cost of production		Difference between S. 275 prices and cost of production
	Target price	Loan rate	Target price	Loan rate	Target price	Loan rate	Target price	Loan rate	
Wheat (bushel)-----	\$4.90	\$2.91	\$2.18	\$3.40-3.71	\$3.55	81.9	61.4	\$-0.64	\$-1.37
Corn (bushel)-----	3.42	2.28	1.71	2.44-2.60	2.52	90.4	67.8	-.24	-.81
Cotton (pound)-----	.8284	.511	.383	.545-.614	.5795	88.1	66.0	-.0685	-.1965

TABLE III.—COMPARISON OF PRICING PROVISIONS CONTAINED IN S. 275 AND 100 PERCENT PARITY PRICES AND 1977 TARGET PRICES AND LOAN RATES AND 100 PERCENT PARITY PRICES

Commodity (1)	100 percent parity price (Feb. 15, 1977) (2)	S.275		S. 275 prices as percent of parity		1973 act—1977 rates		1977 rates as percent of parity	
		Target price (3)	Loan rate (4)	Target price (5)	Loan rate (6)	Target price (7)	Loan rate (8)	Target price (9)	Loan rate (10)
Wheat (bushel).....	\$4.98	\$2.91	\$2.18	58.4	44.0	\$2.47	\$2.25	50	45.1
Corn (bushel).....	3.42	2.28	1.71	67.0	50.0	1.70	1.50	50	44.0
Cotton (pound).....	.8284	.511	.383	62.0	46.2	.478	-----	58	-----

TABLE IV.—PARITY PRICES, PRICES RECEIVED, PRICES RECEIVED AS A PERCENT OF PARITY AS OF FEB. 15, 1977

Commodity	Parity price	Feb. 15 price received	Feb. 15 price as a percent of parity
Wheat (bushels).....	\$4.98	\$2.44	49
Rice (hundredweight).....	13.30	6.74	50
Corn (bushels).....	3.42	2.31	68
Oats (bushels).....	1.72	1.62	94
Barley (bushels).....	2.96	2.21	75
Grain sorghum (hundredweight).....	5.72	3.53	62
Cotton (pounds).....	.8284	.644	78
Peanuts (pounds).....	.283	(¹)	(¹)
Soybeans (bushels).....	7.54	6.99	93
Flaxseed (bushels).....	8.49	7.16	84
Beef cattle (hundredweight).....	57.70	33.10	57
Hogs (hundredweight).....	54.90	39.30	72
All milk (hundredweight).....	12.80	9.58	72
Manufactured milk (hundredweight).....	10.84	8.43	* 77
Eggs (dozens).....	.801	.662	81
Wool (pounds).....	1.35	.730	54

¹ No price reported.

* Parity equivalent for manufacturing milk.

Source: USDA "Agricultural Prices" report.

NEW YORK CHAMBER OF COMMERCE AND INDUSTRY

STATEMENT OF THE COMMITTEE ON FINANCE AND CURRENCY

The New York Chamber of Commerce and Industry welcomes the opportunity to submit a statement concerning the President's budget message and economic report for the guidance of the Joint Economic Committee. We consider the direction of Government economic policy to be of crucial importance in shaping the behavior of the economy not only during 1977 but in the period beyond.

General Position

A higher utilization of the Nation's labor and physical resources is fundamental to sustain healthy economic growth and the use of fiscal and monetary policy in achieving this goal is endorsed so long as it avoids aggravating inflation, which is still distressingly high. It should be recognized, however, that the economy has made considerable progress in recovering from the deepest recession since the 1930s, and that the return of full economic health, which began some 2 years ago, may take a few more years to complete.

Even so, we recommend that economic policy recognize the unavoidable time lag encountered in restoring a reasonably acceptable level of employment and general price stability, and aim for steady and sustained progress. Overstimulating the economy by inappropriate Government action remains a real risk and would almost certainly be self-defeating. The primary need of Government economic policy at this juncture is to create an atmosphere conducive to fostering a broadly based revival in business investment, which is essential if the economy is to generate adequate job opportunities and avoid a resurgence of inflation.

Prior to the setback caused by the severe winter weather over much of the country, the economy appeared poised for further expansion and more rapid growth. The relatively minor inventory correction in the middle months of 1976 seemingly was behind us, business and consumer confidence were improving, and the leading economic indicators pointed to a renewed strength in the coming months. Furthermore, the unemployment rate had declined in December and fell again in January.

Most economists were forecasting growth in real GNP for 1977 in the range of 5-5½ percent—well above trend—with an accompanying decline in unemployment. Strength in consumer spending and residential construction, and a continued moderate advance in business capital outlays, were being widely projected, and the stimulative effect of the \$57 billion Federal budget deficit proposed by the outgoing administration was widely acknowledged. At the same time, concern was growing over the possibility of an acceleration in the inflation rate toward the end of 1977. In addition to the uncertain

fiscal picture, these apprehensions regarding inflation reflected impending energy cost increases, a probable reversal of the relatively favorable agricultural price situation and a fear that unit labor costs in manufacturing would turn materially upward in the third year of the economic expansion.

The impact of the severe winter has not materially changed the outlook for good real economic growth, nor has it altered the prospects for a gradual decline in the rate of unemployment. It has, however, accentuated the concern about future price increases in the sensitive areas of energy and food, and has left unanswered the question of the prospective strength of business capital spending.

Fiscal Policy

Against this background, the \$15.5 billion fiscal stimulus package proposed by the new Administration for the current fiscal year stands at the upper boundary of prudent action at this time, and it seems desirable to strive for greater balance in the program between the consumer and business sectors. Also, Congress should make no final commitment to an additional fiscal program as large as \$15.7 billion for fiscal 1978 until the direction of the economy and the extent of inflationary pressures become clearer.

Looking ahead, it needs to be realized that business may have sizable short term and long term financing needs later this year as the economy expands. Demands for consumer credit and the requirements of the mortgage market also are likely to be considerably larger this year than last. Thus, increasing the Treasury's net financing requirements in calendar year 1977—the inevitable consequence of the proposed fiscal stimulus—could put strains upon the financial markets during the course of the year. If the economic expansion continues into 1978, as is generally expected, another substantial budget deficit almost certainly would bring strong upward pressure on interest rates that might abort the economic expansion.

It is misleading to contend that these consequences can be avoided by having the Federal Reserve speed the growth of the money supply beyond the existing targets, which we believe are sufficient to accommodate foreseeable rates of real economic growth. Exceeding the current targets for the monetary aggregates surely will impart an overall inflationary bias to monetary policy, and, as we have seen dramatically demonstrated in recent years, the financial markets are highly sensitive to inflationary expectations. If the Federal Reserve were to raise its monetary targets, inflationary psychology would quickly be intensified and interest rates would soon rise.

Form of the Fiscal Stimulus

We endorse the emphasis in the President's fiscal stimulus program that is placed on job training and on extra revenue sharing grants for those areas of the country with high unemployment. We question at this point, however, the efficacy of the one-shot tax rebates and believe that more can be gained from a permanent reduction in personal income tax rates. But our greatest concern is over the lack of balance in the present economic stimulus program.

As it now stands, the fiscal stimulus is heavily weighted toward the consumer, at a time when the major need is to spur business investment.

As has been well publicized, the one major sector of the economy that has lagged in the recovery from the 1974-75 recession is business spending on new plant and equipment, particularly the expansion of manufacturing capacity. The significance of lagging business investment for the future growth and stability of the economy must not be underestimated. An increase in capital outlays is necessary to provide for satisfactory growth in the number of jobs over the near term, and it will be essential for productive capacity to expand, as well as to continue to modernize and cut costs, if inflation is to be kept under control further down the road.

Consequently, we support the efforts of Treasury Secretary Blumenthal to restore the proposal for increasing the investment tax credit contained in the administration's package. Increasing the investment tax credit not only will provide a meaningful incentive for business investment, but it will serve as a signal to the business community that the Government is currently aware of the importance of capital spending in promoting sustained economic expansion. Still the investment tax credit will do little to foster the expansion of plant capacity, which is where the need lies. Although increasing the investment tax credit will be a positive first step toward encouraging business investment, other actions are also necessary, the most important of which is the creation of an overall environment that will be conducive to risk taking.

Summing Up

In conclusion, we urge Congress, as we have in prior years, to aim for steady and sustainable economic growth. The fiscal stimulus should be moderate and large-scale Government deficits must not become a way of life. The private economy, which has already provided more than 4 million jobs during the past 2 years, is poised for still further job creation in 1977 and 1978. Congress should realize, however, that new plant and equipment must be in place if sustained economic growth and additional productive jobs are to be created, and that there is a long leadtime on basic expansion programs. The country will face serious shortages of energy and of many basic materials if this warning is disregarded in favor of make-work schemes.

Finally, we would emphasize that private and productive job creation functions best in an atmosphere of business confidence in the future. Further rapid growth of the public sector and additions to the existing myriad of regulations and controls is not helpful to business confidence; nor, it should be noted, is the threat of resurgent inflation. The business community is hopeful that Congress will recognize these essential needs in taking action on the administration's fiscal proposals.

MEMBERS OF THE COMMITTEE ON FINANCE AND CURRENCY

Francis H. Schott (chairman), vice president and economist, the Equitable Life Assurance Society of the United States.
Robert F. Bennett, controller, the Port Authority of New York and New Jersey.

George T. Conklin, Jr., president, the Guardian Life Insurance Co. of America.
Frederick W. Deming, vice president and senior economist, Chemical Bank.
Orson H. Hart, vice president and director of economic studies (vice chairman),
New York Life Insurance Co.
George Hitchings, vice president and executive director, MacKay Shields Financial
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Yves-Andre Istel, managing director, Kuhn, Loeb & Co., Inc.
Edward J. Kirwin, vice president, secretary and treasurer, Martin Simpson &
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George Keyt, economist, General Motors Corp.
Charles E. Lilien, vice president, the First Boston Corp.
George W. McKinney, Jr., senior vice president, Irving Trust Co.
Charles Moeller, Jr., senior vice president and economist, Metropolitan Life
Insurance Co.
Austin S. Murphy, chairman and president, East River Savings Bank.
George J. Nelson, president, the Nelson Fund, Inc.
James O'Leary, vice chairman of the board, United States Trust Co. of New York.
Robert Ortner, senior vice president and economist, the Bank of New York.
Gary L. Pote, vice president, Bache Halsey Stuart.
C. H. Reing, economist, Mobil Oil Corp.
Charles E. Saltzman, partner, Goldman Sachs & Co.
John C. Van Eck, president, International Investors, Inc.
Walter R. Williams, Jr., chairman, Union Dime Savings Bank.
John D. Wilson, senior vice president, the Chase Manhattan Bank.
Donald E. Woolley, vice president and chief economist, Bankers Trust Co.
Andries D. Woudhuysen, executive vice president and director, Drexel Burn-
ham & Co., Inc.
Frank A. Brady, Jr., staff coordinator.

UNITED STATES SAVINGS AND LOAN LEAGUE

(By Norman Strunk, Executive Vice President)

Our interest in the Economic Report of the President relates primarily to the thrift and housing industries. We are appreciative of the recognition you gave to our comments on the economic report of a year ago.

We are pleased with the progress reported relative to the continued recovery of the American economy despite the slower rate of advance during the fall months. In the light of the very cold winter, which had a devastating impact on homebuilding, we do not expect major improvement in the economy until late in the spring or early summer.

We share the concern expressed in regard to the energy problems which we face. These problems have been accentuated by the skyrocketing oil, gas and electric bills which many families are now facing. We would urge that special efforts be made in the tax and credit laws to encourage energy conservation improvements (such as insulation, storm doors and windows, heat pumps, et cetera) for existing as well as new housing units, and we would encourage accelerated experimentation with new sources of energy (solar and wind power devices.)

We agree that "The creation of permanent, meaningful and productive jobs for our growing labor force requires a higher level of investment" (p. 4 of the economic report). In order to assure an adequate supply of capital for private investment, higher savings levels on the part of business, government and consumers will be necessary. Accordingly we continue to favor special tax incentives to encourage saving and capital formation, including tax incentives for individual savers as well as investment credits and other capital stimulus for business firms.

We were pleased with the performance of the savings and loan industry during our Bicentennial Year. Both the inflow of savings and the volume of home mortgage financing achieved record levels. For most of 1976 savings and loan associations were originating four out of five of the home mortgages made. High rates of savings reflected the improving economy as well as reduced levels of inflation. We are concerned, however, that rates of inflation may increase and would urge your committee to make special efforts to restrain inflationary forces. Recent proposals on the fiscal front, especially, have created greater concern about accelerating rates of inflation. We are of the opinion that high levels of saving help to reduce inflationary pressures by assuring adequate supplies of capital and thus help to keep interest rates within reasonable bounds. High rates of saving also reduce pressures on the markets of current goods and services.

Concern over the possibility of future inflation emphasizes the need for greater flexibility in arrangements for mortgage financing. Experiments in several States, notably California, indicate that the variable

rate mortgage is practical and acceptable to the public. We would urge the extension of its use to Federal as well as to various State chartered savings associations. More generally, we favor experimentation with a wide range of mortgage instruments, including the renegotiated note (as in Canada), the flexible payment mortgage (which relates the borrower's mortgage payment to income), the so-called "reverse annuity" mortgage which enables families to unlock the "savings" created by builtup equity in their homes, as well as other arrangements for increased mortgage flexibility.

Higher levels of inflation have created special problems for the younger people who aspire to homeownership. We have been especially interested in proposals, such as those recently put forth by Senator Brooke, which would enable potential home buyers to accumulate up to \$2,500 a year on a tax deductible basis for as long as 4 years in order to accumulate funds for downpayments on homes. Adequate downpayments obviously stretch available funds for lending further, and provide an important commitment for buyers to their homes and communities. We would urge special support for such proposals since they both stimulate thrift and encourage homeownership.

We appreciate that relatively stable long-term interest rates over the past year have created a favorable economic climate for the thrift and home financing industries at this writing. An accelerating economy, however, may put upward pressures on interest rates in the year ahead, and while it is not now anticipated, rates could reach levels later in the year which would lead to disintermediation and thus create special problems for the thrift institutions and reduce the availability of funds for home buyers and builders. We are especially concerned that recovery be continued on a gradual basis so that a doom does not break out and we are faced with a difficult readjustment period again.

We appreciate the work that your committee carries forward in its efforts to develop sound economic conditions. We are especially appreciative of your concern for our problems in the thrift and home financing industries.

JERRY VOORHIS, FORMER MEMBER OF CONGRESS

If ours is to be a generation of conscience, its basic, long-term objective must be the preservation of planet Earth as a good habitable home for future generations.

This objective should determine governmental policy respecting energy conservation and development. For *how* the energy problem is solved will be the most important single factor in deciding the Earth's future habitability.

If, again, we are to be a generation of conscience our first immediate objective must be to bring an end to the human indignity of unemployment and to restore job opportunity to all who can work, support their families and contribute to the wellbeing of the society to which they belong. Denial of that opportunity is economic injustice at its worst. It is also bad economics for it deprives the Nation of needed production and the Government of desperately needed revenue.

These two objectives are not as disparate as may at first glance seem. Indeed they can, with wise, prudent and compassionate policy complement one another.

But certain quite drastic changes in our concepts and programs will be necessary if this is to be the case.

The starting point with respect to both objectives should be at determination of what the Nation does *not* need and what it *does* need.

To begin with we do not need more military frightfulness, more overkill weapons systems whose cost will be nothing less than astronomical. For long enough the practice has been to try to negotiate with the Russians from a position of strength regardless of the cost or drain on our exhaustible resources. This practice has, to say the least, been considerably less than fruitful. Is it not time to try a new approach—that is to stop further new weapons development and challenge other nations to do likewise as a base for fruitful negotiation?

Second we certainly do not need further proliferation of nuclear weaponry around the world. Neither do we need to pockmark our Nation with nuclear powerplants with all their unsolved problems and dangers including the unavailability of their production of vast amounts of radioactive poisons—the very stuff from which nuclear bombs and weapons can readily be made.

Third we do not need further pollution of the Earth. Which means that we do not need energy expensive means of production or transportation. We need energy conservation instead.

To mention but two examples of this we need fewer and smaller, not more and larger automobiles. And we need to put a stop to monopolization of our best agricultural lands by Soviet-type collective industrialized farms which use more energy in most cases than they produce in food and fiber value.

All of these points are very much in line with what President Carter has been saying since he first began his successful campaign for the Presidency.

It should be added that in a time of immediate and impending scarcities we do not need to devote man power, capital, or natural resources to the production of harmful or frivolous articles of sheer luxury.

What then do we need?

We need vastly more homes, built at costs the average family can afford.

We need more and above all more rationally delivered health care again at costs the American people can afford.

We need a healthy unpolluted environment and to that end, among other things we need a rational national and local system of mass transportation that will be less energy expensive and less polluting than the no-system we have now.

We need to do our duty by the oncoming generation to which, even, under the best of circumstances we will probably leave a world afflicted by unsolved problems and dangers which our generation has largely created and probably failed to solve. Hence we need to provide better educational opportunity for that next generation as the least we can do to prepare them for what they must face.

We need to rehabilitate our core cities and to develop a way to make the affluent suburbs bear a proportionate responsibility for that accomplishment.

We need maximum production of food, not only to improve the inadequate diets of much of our own population but also to ward off the threat of widespread hunger in other parts of the world such as could—perhaps even should—lead to violent upheavals of desperate people.

But such all-out food production must not be accomplished at the sacrifice of the fertility of the precious and irreplaceable topsoil of our country. Thus an effective soil conservation program—so criminally neglected during the regime of Secretary Butz—must be reinstated. Neither can we afford to seek maximum food production by farm practices so energy intensive that the cost from a resource point of view is greater than the gain. What this means is that measures are called for to halt in its tracks and indeed to reverse the trend toward mammoth industrialized agriculture with the concomitant destruction of the owner-operated farm. We need food production by the most efficient productive unit known to man—the American scientifically managed optimum sized owner-operated farm with its diversification, its soil preservation, and its use of more labor-intensive rather than energy-intensive methods of production.

Finally we need—perhaps more than anything else unless it be abundant food supplies—the development of clean nonpolluting, renewable, and inexhaustible sources of energy—hydroelectric, solar, wind, tidal, geothermal, and the like. And we need to see that this is done in such manner as to break, not enhance, the energy monopoly on the part, principally, of major oil companies. Processes developed with the aid of taxpayers' money should be patented in the name of those taxpayers' Government. And it must be recognized that those giant corporations which now control most of our present energy sources have a natural, built-in motivation to resist the development of new sources, and to try as they always have, to withhold from the market more of their own products than can be marketed at their monopolistic prices.

The energy problem can only be solved and the new sources developed by agencies that want to do that job. These are public agencies, agencies of Government but hopefully allied with those many small business enterprises which have been working at the development of solar, wind, tidal, geothermal, and other clean sources for many years but have been denied the resources or the governmental help needed to make their processes widely usable and practical.

President Carter spoke of the employment of thousands of workers in the development of solar energy if he was elected. Much of that employment would have to be by public agencies if it is to be free of exploitation and indeed subtle sabotage. This would be an excellent place to start a reemployment program of major dimensions.

In general it will be evident from the above history of what we need as a nation and what we do not need that most of what we do not need—large automobiles, luxury items and gadgets, military weaponry, and nuclear powerplants—are at present in the private sector and that many of the services and things we do need such as hydroelectric and solar energy, mass transit, better health care, education, slum clearance and urban rehabilitation, and environmental cleanup—fall mainly in the private sector.

Furthermore, the march of automation has sharply reduced employment opportunity in the private sector. And if we are in earnest about conservation of resources and their use for essential purposes we simply cannot any longer afford to attempt to reemploy our jobless people in the manufacture of more gadgetry. Probably it can't be done anyway.

Nonetheless, as the President has stated, it is desirable to keep as much employment as we can in the private sector. But if this is to be done we need to reassess some of the presently available incentives. At a time when we do not want more energy-intensive productive processes and when we need desperately to get our people back to work it seems senseless to offer industry investment tax credits which encourage the purchase of job-destroying machinery. So we not need to substitute an employment tax credit program to encourage employers to hire more people? If energy is to be conserved do we not have to veer in the direction of more, not less, labor-intensive productive processes? And if it is desired to retain an investment tax credit in some form it should be made selective. That is the credit should be allowed, for example, for investment in housing or in clean energy development, but not for construction of nuclear powerplants or for automated machinery for the manufacture of automobiles.

However much governmental policy is geared to encourage private employment however, if we are to focus our national effort on the meeting of the real needs of the Nation, a considerable and probably growing amount of work and employment will have to be in the public sector. And from the outline of needs given above it is evident that if those needs are even reasonably met there is ample job opportunity for millions of people now unemployed.

The problem of course is how to mount these public service programs without further burdening the already overburdened middle-income taxpayer?

One way of course is by constructive tax reform—by taxing unearned income as earned income is taxed, for example, and by closing

some of the other still-gaping loopholes. Enough is known by congressional committees about this to make it unnecessary to detail the matter further here. Suffice it to say that billions of added revenue could be realized without increasing the taxes on middle- and lower-income families.

Second, several billion dollars could be lopped off the swollen military budget if a rational defense policy coupled with genuine disarmament negotiations and tight contracting practices were in effect. And the Nation would be more not less secure than it is now with the constant escalation of the arms race. And this would become politically practical if the vast job opportunities in development of clean energy, in home construction and in mass transit development were under way. For the real—and from a personal viewpoint almost justified—resistance to cuts in military appropriations comes from the people whose jobs and livelihood depend on those appropriations. They have to have some place else to go for work. They could have.

But there is one other source of revenue that has, rather strangely, been hardly discussed but which in present circumstances certainly seems to recommend itself. This is the use of a selective and graduated sales or excise tax imposed selectively for the purpose of channeling capital, labor, and above all scarce resources into those areas of the economy which should be expanded and away from those which must in the interest of conservation be curtailed.

The example that comes most quickly to mind is that of a very heavy tax on large and even moderate sized automobiles, graduated upward as gasoline consumption increases. Private airplanes and pleasure boats would belong in the same category of big "energy eaters," even though less guilty of pollution than the automobile. Another example would be a heavy tax on the sale of luxury goods of all kinds, including certainly increased taxation of alcoholic beverages and cigarettes, but also applied to furs, jewelry, and—reluctantly—to energy-expensive forms of recreation and pleasure. And if we mean business about reemployment and about conservation of resources the excise tax on energy-intensive and job-eliminating machinery, should be a high one. So should the tax on energy-consuming household appliances.

On the other hand the sales or excise taxes on anything affecting clean energy development, such as solar heating appliances should be very low if any. Food and prescribed medicines of course should not be taxed at all except for food consumed in expensive restaurants. And there might, for a time at least, be no tax at all or a very small one on the sale of insulating material and devices calculated to conserve energy. Books, educational materials, and items important to health care should of course be lightly taxed, if at all.

The difficulty arises in the area of consumption of energy where such consumption is for many people an absolute necessity. The prime example is gasoline. It is the means of the main cause of air pollution, namely, from the plethora of our automobiles. But until we have a full system of mass transit—which is surely a good many years away—people must use gasoline to get to work, for example.

From the standpoint of energy conservation there should be a heavy excise or sales tax on all forms of energy consumption. But this would burden middle and lower income families beyond the point

of elemental justice. Hence the only solution would seem to be a system of rationing whereby a certain amount of gasoline or other energy source would be allowed on the basis of need to individuals and would, in the shape of the ration card be taxed no more than at present, but where any excess consumption beyond the rational amount would be subjected to a very steep tax indeed.

In conclusion let this be added with greatest emphasis. Under our present monetary system practically all the money of our country comes into existence because someone—the Federal Government, a business, or an individual contracts a debt. This someday has got to be changed and the sovereign Government of the United States enabled to bring such additions to the monetary supply as conditions demand into circulation without having to go into debt to private creators of our money—namely the commercial banks.

And furthermore our chances of reemploying our people or of cleansing our environment are markedly handicapped by the exorbitant interest rates now in effect. Until those interest rates come down, drastically, the Nation's tribute to the moneylenders will hang like a millstone about our collective necks.

The writer of this commentary having once been a Member of the House of Representative himself, is not so naive as to believe that the measures herein proposed can be easily or even quickly realized. But he does believe that the time has come when our Nation must begin to move in the directions indicated if we are to have hope for a better tomorrow or perhaps for any tomorrow at all.

