

THE 1979 ECONOMIC REPORT OF THE PRESIDENT

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

PART 3

FEBRUARY 22, 23, 28, AND MARCH 2 AND 8, 1979

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CONTENTS

WITNESSES AND STATEMENTS

THURSDAY, FEBRUARY 22, 1979

	Page
Mitchell, Hon. Parren J., member of the Joint Economic Committee, presiding: Opening statement.....	1
Byrom, Fletcher L., chairman, board of trustees, Committee for Economic Development, and chairman, Koppers Co., Inc.....	2
Jenkins, George P., chairman of the board, Metropolitan Life Insurance Co	11
Schott, Francis H., chairman, Finance and Currency Committee, New York Chamber of Commerce and Industry	14

FRIDAY, FEBRUARY 23, 1979

Bentsen, Hon. Lloyd, chairman of the Joint Economic Committee: Opening statement	39
Bosworth, Barry P., Director, Council on Wage and Price Stability	40
Keyserling, Leon H., former Chairman, Council of Economic Advisers, and president, Conference on Economic Progress	48
Mitchell, Daniel J. B., senior fellow, the Brookings Institution, and professor, Graduate School of Management, UCLA	61
Weintraub, Sidney, professor of economics, University of Pennsylvania	73

WEDNESDAY, FEBRUARY 28, 1979

Bentsen, Hon. Lloyd, chairman of the Joint Economic Committee: Opening statement	101
Thompson, Hon. James R., Governor, State of Illinois.....	121
Snelling, Hon. Richard A., Governor, State of Vermont.....	208
Hunt, Hon. James B., Jr., Governor, State of North Carolina	217

FRIDAY, MARCH 2, 1979

Bolling, Hon. Richard, vice chairman of the Joint Economic Committee: Open- ing statement	241
Oswald, Rudolph, research director, American Federation of Labor and Con- gress of Industrial Organizations, accompanied by Kenneth Young, director, legislative department	243
Young, Howard, special consultant to the president, UAW, accompanied by Jerry Tucker, legislative office	308

THURSDAY, MARCH 8, 1979

Mitchell, Hon. Parren J., member of the Joint Economic Committee, presiding: Opening statement.....	365
Brown, Hon. Clarence J., member of the Joint Economic Committee: Opening statement	366
Kreps, Hon. Juanita M., Secretary of Commerce	367
Marshall, Hon. Ray, Secretary of Labor	387
Brown, Ronald H., vice president, National Urban League, on behalf of the Full Employment Action Council	430

IV
SUBMISSIONS FOR THE RECORD

THURSDAY, FEBRUARY 22, 1979

	Page
Byrom, Fletcher L.: Prepared statement.....	3
Jenkins, George P.: Prepared statement	12
Schott, Francis H.: Prepared statement	15

FRIDAY, FEBRUARY 23, 1979

Bosworth, Barry P.:	
Prepared statement	45
Response to additional written questions posed by Representative Hamilton	
.....	97
Keyserling, Leon H.: Prepared statement.....	52
Mitchell, Daniel J. B.: Prepared statement.....	63
Weintraub, Sidney: Prepared statement, together with an appendix	77

WEDNESDAY, FEBRUARY 28, 1979

Bentsen, Hon. Lloyd:	
Charts:	
State government fiscal condition, fiscal years 1977-79	104
State government expenditures, 1977-79	105
Federal expenditures, 1977-79	105
State—Own source tax revenues, 1975-78.....	105
Memorandum from the National Governors' Association, dated November 28, 1978, to Hon. James T. McIntyre, Jr., Director, Office of Management and Budget, suggesting criteria for curbing spending in a way that minimizes the adverse effect on State and local governments	106
Hunt, Hon. James B., Jr.: Prepared statement.....	222
Snelling, Hon. Richard A.: Prepared statement	212
Thompson, Hon. James R.:	
Prepared statement	127
Analysis of the President's budget prepared by the National Governors' Association entitled "The Proposed Fiscal '80 Federal Budget: Impact on the States"	133

FRIDAY, MARCH 2, 1979

Oswald, Rudolph, et al.: Prepared statement, together with appendix material	249
Reuss, Hon. Henry S.: Table presenting fiscal 1980 budget allocation for the proposed National Development Bank	302
Young, Howard, et al.:	
Prepared statement of Douglas A. Fraser, president, UAW	315
Letter to Senator Bentsen from Howard Young, dated March 6, 1979, in response to Representative Rousselot's query regarding the cost of proposed "full employment communities" demonstration projects recommended by the UAW	360

THURSDAY, MARCH 8, 1979

Kreps, Hon. Juanita M.:	
Prepared statement	372
Paper entitled "The Productivity Decline: Its Causes and Effects"	379
Response to additional written questions posed by Representatives Mitchell and Brown	416
Marshall, Hon. Ray:	
Prepared statement	389
White paper entitled "The New Comprehensive Employment and Training Program"	392
Response to Senator Sarbanes' request to supply additional information on the joint labor-management committees	410
Response to Representative Mitchell's query regarding the use of public service employment funds for the private sector initiatives program	429
Response to additional written questions posed by Senator Javits	430

THE 1979 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 22, 1979

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

The committee met, pursuant to recess, at 10:15 a.m., in room 6226, Dirksen Senate Office Building, Hon. Parren J. Mitchell (member of the committee) presiding.

Present: Representatives Mitchell and Brown; and Senator Javits.

Also present: David W. Allen and William R. Buechner, professional staff members; Mark Borchelt, administrative assistant; and Mark R. Policinski, minority professional staff member.

OPENING STATEMENT OF REPRESENTATIVE MITCHELL, PRESIDING

Representative MITCHELL. This hearing will now come to order.

I want to apologize to everyone for being late. Traffic is just about impossible. I drove in from Baltimore for the first time since the blizzard of 1979.

We are very pleased to have as our scheduled witnesses this morning three distinguished members of the business community—Mr. Fletcher Byrom; chairman of the Koppers Co., Inc., and chairman of the board of trustees of the Committee for Economic Development; Mr. George P. Jenkins, chairman of the board of Metropolitan Life Insurance Co.; and Mr. Francis H. Schott, chairman of the Finance and Currency Committee of the New York Chamber of Commerce and Industry.

Gentlemen, I welcome all three of you. Again, I apologize for my delay and I thank you for taking the time to get here.

We have stressed throughout this year's annual hearings that inflation is a problem of major concern. In 1978, the consumer price index rose by 9 percent. There is nothing in the winds to indicate that inflation will slow down substantially in 1979, unless President Carter's anti-inflation program proves to be successful.

Much of the success of that program will depend on the ability of the Government and the business sector to work together to make it a success. We are very concerned about what the Government can do to help business move in the direction of solving some of the underlying causes of inflation.

First, we have the recent slowdown in productivity. In 1978, productivity in the nonfarm business sector rose by only 0.4 percent. This is just unacceptable, since it means that almost all of the wage increases in 1978 were passed on to consumers in the form of

higher prices. An increase in productivity will require more capital spending by business and more spending on research and development. I hope you will be able to give the committee some ideas as to how we can do this.

Second, we have the problem of increased Government regulation. While most regulation is designed to achieve very important social goals, too much regulation is excessive and unnecessary. These costs get passed on to consumers in higher prices.

If we can make some progress on regulatory reform, we can have a substantial impact on inflation. There, again, I hope all three of you gentlemen will give us some advice, counsel, and some sense of direction.

Third, we will need to talk about the wage and price guidelines, and how well they are working. Guidelines alone can't control inflation—but guidelines can be a useful part of an overall program to reduce inflation, if business and labor cooperate. So far, everyone says they want the guidelines to work. I hope they will work, and I want to get your ideas and prognosis of the workability of the guidelines.

Finally, I hope you will help us on the problem of structural unemployment. Since the bottom of the recession, the economy has created a record 12.1 million new jobs, and the unemployment rate has fallen from almost 9 percent to less than 6 percent.

However, the threat of worse inflation would make it foolhardy to use stimulative policies at this time to further reduce unemployment, especially since much unemployment today seems to be structural. We must turn our attention from cyclical unemployment to structural unemployment.

Last year, Congress enacted two new measures to alleviate structural unemployment, including a targeted jobs tax credit and a private industry program under CETA. We need to know what more we can do to create private sector jobs for the structurally unemployed.

Again, Mr. Byrom, Mr. Jenkins, Mr. Schott, I welcome you and I look forward to your testimony.

I would not dare suggest who should be the leadoff witness. Why don't you settle that among yourselves. It is a fait accompli, Mr. Byrom. Also we have copies of your prepared statement. You may submit the entire prepared statement for the record and simply excerpt from that portions that you want to read or you may submit the entire statement. It's entirely up to you.

Mr. Byrom, thank you for being our leadoff witness.

STATEMENT OF FLETCHER L. BYROM, CHAIRMAN, BOARD OF TRUSTEES, COMMITTEE FOR ECONOMIC DEVELOPMENT, AND CHAIRMAN, KOPPERS CO., INC.

Mr. BYROM. Thank you very much, Congressman Mitchell.

I certainly don't intend to read my prepared statement. I would like to submit the prepared statement for the record.

Representative MITCHELL. Without objection, it will be submitted in its entirety for the record.

Mr. BYROM. Today is a rather interesting day in that it is the 100th anniversary of the first 5-and-10-cent store of Woolworth Co. in Utica, N.Y. It seems to me, maybe, that underlines our problem

as well as anything does. It has been a long time since anyone has thought of buying anything for 5 or 10 cents.

As chairman of the Committee for Economic Development, I welcome the opportunity to meet with this committee and to give some, hopefully, constructive comments regarding the President's economic message and where we are in the economy today.

First, I would like to say we very much applauded the President's budget balancing schedule which anticipates a balanced budget by 1981, hopefully.

Restraint in fiscal policy is extremely important because it makes possible a more effective monetary policy that does not of itself have to be expansionary.

The thing that concerns me probably more than anything else going on at the present time is the rapid liquidation of the capital base of our capital-intensive industry in this country. I am not satisfied that we are dealing with this question with sufficient attention to priorities.

I am also concerned with the fact that regulatory intervention uses too much command and control and does not use the possible incentives which could be employed to bring market considerations back into judgments related to pollution control devices and to the implementation of other socially mandated goals.

I am also concerned about the effect of those who advocate intervention to achieve zero-risk standards without recognizing the importance and value of acceptable risk standards.

I certainly subscribe to your remarks about structural unemployment. I think that we must move forward rapidly with the kind of things that are contemplated by title VII in the Comprehensive Employment and Training Act. I feel we should get on with the funding of this program.

I hope that you feel that these very cursory remarks are sufficient as an introduction. What I am trying to do is to save time to answer whatever questions you may have. I would rather be responsive to your concerns than try to make a speech.

Thank you, Congressman Mitchell.

[The prepared statement of Mr. Byrom follows:]

PREPARED STATEMENT OF FLETCHER L. BYROM

Mr. Chairman, members of the Joint Economic Committee, I welcome the opportunity, on behalf of the Committee for Economic Development, to comment before this Committee on the President's Economic Report to Congress and related matters. I am especially pleased to see you in the chair, Senator Bentsen. As a former CED trustee, you are familiar with our work, and you are aware that our views have been expressed here annually since these hearings were initiated.

In my opening statement, which I am pleased to submit for the record, I should like to offer some praise, some cautions, and several specific recommendations.

First, the kind words. I applaud the basic thrust of the anti-inflation fiscal, monetary and regulatory policy changes outlined in the President's Economic Report. Further, they have earned broad support among the American public on the part of earners, producers, investors, and especially inflation-burdened consumers. This is not because wringing inflation out of the economy is going to be easy or risk-free, but because fighting inflation is increasingly recognized as essential to the general welfare and the survival of our economy as we have known it. We have all watched the building of this broad national consensus that has now made controlling inflation the nation's top economic priority.

To have continued to do too little would have insured economic disaster; to have done too much, by imposing wage-price controls, would simply have compounded and postponed the inevitable consequences until the controls were lifted. Even the

present system of so-called voluntary wage and price guidelines stirs little enthusiasm in me, though my company is complying with them. While these guidelines may have some temporary braking effect on inflationary momentum, they are basically a short-term treatment of the symptoms of inflation that breed distortions the longer they are continued. There is no quick fix to the underlying, long-term problem.

My colleagues and I fully endorse the President's admonition that "we must act forcefully and effectively to combat inflation, and we must persist until the battle is won." We particularly share the widely-held conviction of the American public that this battle cannot be won unless the Federal Government sets the first example by imposing much stricter discipline on its own performance. It is a commendable goal to hold the budget deficit to \$29 billion in the 1980 fiscal year, and to move progressively toward a budgetary balance, by 1981 if possible, but in any event no later than 1982.

That budgetary restraint needs to be accompanied by a firm monetary policy with no more than moderate growth in the monetary aggregates. I am glad to see we finally seem to have slowed monetary expansion, and trimming the budget deficit will make a continuation of that performance much easier to achieve.

Holding firmly to this budgetary goal will do more than any other word or deed of the Executive Branch and the Congress to restore public confidence that price stability can be regained in the American economy. If, however, this proclaimed budgetary restraint is cast aside by Administration or Congressional action for whatever high motives, the resulting expectations will cause more inflation.

Of course, if overall demand should show much more weakening than the Economic Report projects, some flexibility must be allowed for countermeasures. But the first line of defense against such weakening should be monetary policy—as has recently been suggested by Chairman Miller—not a sudden opening up of the floodgates to permanent additions to expenditure totals.

The needed disciplines will not be easy. In the budgetary trimming and waste-cutting process, one man's fat is another man's muscle. Moreover, it would be immoral to allow the heaviest burdens of the anti-inflationary campaign to fall on the backs of those hardest hit by inflation and least able to cope: the poor, the elderly, the handicapped and the structurally unemployed. It is also bad economics and bad social policy to treat our unemployed youth, especially minority youth, and our underskilled adults, as unusable in our economy. As CED points out in its recent study, "Jobs for the Hard-To-Employ," leaving these human resources idle is not only inhumane, it also deprives the economy of their productive output and inflates our social costs.

CED recommends meeting the problem, not by paying people not to work, nor by creating many more costly and futureless jobs outside the real job market, but by on-the-job and close-to-the-job training programs in the mainstream economy, through vigorously expanded public-private partnership efforts. This approach is in the long run both anti-inflationary and deeply humane.

A good many of the problems of Federal budget trimming require sharper distinctions between what government alone can do and what the private sector, given the incentive and the opportunity, can do better, more efficiently, and with less inflationary consequences. We have to scrutinize long-established government practices which are not only expensive, but are often also counterproductive as well as inflationary.

This is a field to which CED has addressed a whole series of policy statements over more than a decade, and their broad recommendations have never been more relevant than they are right now. Civil Service reform—a concept CED supported—is a most salutary development. Improving productivity at all levels of government is one of the important goals of the popular tax revolt that has been gathering momentum in recent months. Other goals including reversing excessive growth of government bureaucracy, and the decent burial of bureaus, programs and budgets that have ceased to perform any defensible public service.

In the public eye, reducing the burden of bloated government is not only a matter of overcoming fiscal drag; it is also a matter of improving governmental responsiveness, efficiency and effectiveness, and getting government out of those areas where its intrusion is economically destructive.

I can think of no better example than Mr. Kahn's success in deregulating commercial aviation in this country, with resulting lower air fares, increased air travel, healthier airline profits, and a scramble for new routes and services by what had been a troubled industry. Regulation is no substitute for the self-correcting processes of a market economy.

There are denser thickets to the regulatory mess, however. In recent decades, we have added to the costs of both government and industry—and have thereby fueled inflation—by proliferating regulatory regimes ostensibly aimed at broad social goals which, on their merits, are perfectly reasonable. The fault is less with the goals than with the means.

I recognize that socially mandated values require some form of government intervention in the market to do such things as the establishment of minimum standards affecting public health and safety, environmental quality, and fair employment opportunities. The trick is to define our standards realistically, and to provide the incentives and disincentives which will insure the efficient production of these goods through the competitive dynamics of the market system.

Instead, we have created a vast superstructure of autonomous regulatory bodies, and a maze of intricate and often contradictory regulations, which substitute command and control for the market process. Instead of placing a money cost on, for example, undesirable levels of pollution, and thus giving industry the incentive to solve the problem creatively and efficiently as a competitive business challenge, we have empowered a remote and expensive bureaucracy to dictate and enforce precisely how each step of the job is to be done. Time and again, this latter method of pursuing social objectives has shown itself to be both inefficient and inflationary.

Yet there are alternative ways of achieving the goals of regulation, and improving the trade-off between real income and quality of life. These ways, because they use the allocative efficiencies of the marketplace, involve less prospect of raising the costs of production, reducing employment opportunities, and adding to inflation. They include substituting incentives and disincentives for command-and-control systems, setting performance goals for industry instead of imposing detailed instructions concerning the methods to be employed in reaching such objectives, and abandoning the insistence on zero-risk goals in favor of the more realistic approach of minimum acceptable risk. In its forthcoming policy statement, CED will offer a number of recommendations on improving government regulatory intervention in the market.

I have commented on some of the more obvious ways in which we have legislated and institutionalized inflation as a new way of life. There are others. We have indexed inflation into labor contracts, social security benefits and pension plans, and may soon do the same with mortgages. We have built inflationary expectations into our purchasing and investment decisions, as individuals and as business enterprises. Worse, we are undermining our ability to expand our productive capacity—an expansion which is essential in order to counter the long-term nature of this inflation. To be blunt, we are rapidly liquidating the capital base of the core of the nation's economic system. This is happening because of the combination of high fixed costs of new physical capital; the long lead time needed to expand or modernize capacity, or to launch a new product; the unpredictability of possible added costs created by regulatory uncertainties; outmoded accounting practices and taxing policies; and antigrowth depreciation policies.

When allowable depreciation and real return on investment are inadequate, the incentive disappears—whether for a large corporation, a small entrepreneur or an individual shareholder—to invest in growth. Unless we improve the incentives for investment in new capital plant, in research and development, and in the application of technologies which reduce unit costs and lead to better products and more efficient manufacturing processes, the United States will continue to lag in productivity gains and international competitiveness, and we can continue to expect to lose market shares, abroad and at home, to our more innovative and productive foreign competitors and trading partners. Our record trade deficits of the last two years have been the result, not merely of abnormal growth in the cost of imports, but of our inability to achieve a vigorous export growth.

The economic condition we find ourselves in, domestically and internationally, is both cause and effect of inflation—and of the public as well as private choices we have made to institutionalize that inflation. Rising wages and prices are in one sense symptoms of a more basic disorder (although they are an efficient way of distributing inflationary pressures throughout the economy).

Correcting the fundamental disorder calls for more than a treatment of symptoms. Neither mandatory wage-price controls nor a Constitutional prohibition of budgetary deficits will do the job. The transformation called for is in our national attitudes and habits, our expectations of government and of each other, and our self-discipline. We cannot legislate the good life; we are going to have to make it for ourselves. Part of the solution is to relearn how to mobilize private interest for the public good.

If I may summarize my recommendations, they comprise the following disciplines, reforms and priorities:

1. Determined budgetary restraint, by both Congress and the Executive, in line with the President's budget-balancing schedule. This is the most important and most difficult discipline. Within the broad political front supporting budgetary restraint, Congress faces a multitude of competing political demands for special exemption from that restraint. Compassion for the neediest is essential, and help to those outside the system to bring them into it is a wise investment for the future. Otherwise, the pains of extricating our economy from a self-perpetuating inflation—like the costs of inflation itself—should be shared as fairly as Congress in its wisdom can decide. But the budgetary line must be held.

2. Monetary restraint. Only with continuing fiscal responsibility will it be possible to continue the present responsible monetary policies of the Federal Reserve in holding the growth in demand to moderate but sustainable levels. Should demand falter, however, presenting the prospect of a larger deficit based on a decline in revenues, the Fed should exercise a careful degree of flexibility, and I am confident it will.

3. Strengthening investment incentives in order to restore the depleted capital base of the economy. It will be necessary to encourage increased and sustained levels of investment in both physical and human resources, and in R&D, in order (a) to strengthen overall supply and capacity in the economy, (b) to reverse the precipitous decline in productivity gains and competitiveness of the economy, (c) to rationalize the enormous increase in costs of politically mandated investment in environmental, safety and other social goods, and (d) to overcome the formidable disincentives to capital formation, especially the high fixed costs of new physical capital and the extended lead time for expanding or modernizing capacity. More rapid depreciation allowances would, I believe, be a particularly constructive tax reform for these purposes. CED is also exploring the possibilities for upgrading the capabilities of the economy through public policies which promote technological innovation, and will have recommendations to make on this issue before very long.

4. Overhaul and reform of regulatory structures and reduction of their inflationary and decapitalizing impacts on the economy. I have already expressed some strong views on this subject, and shall elaborate only to say that I hope the members of the Joint Economic Committee will find CED's forthcoming recommendations in this field to be a constructive framework for improvement.

5. Major investment in human resources to provide better training and jobs for the hard-to-employ. We are pleased that the 1978 CED statement on this sensitive subject has played a useful role in the development of the President's Private Sector Training and Jobs Initiative Program. However, as Frank Schiff, CED's Chief Economist, spelled out before this committee yesterday, it is urgent that the timetable for this program be speeded up and that the business community be given real responsibility for carrying out this new initiative.

A final word. This country has a proud record of world economic leadership. We have not lost that lead, but we have hobbled ourselves unnecessarily in recent decades, and we are hurting from the consequences. We do not have to look elsewhere for blame or for solutions. We got ourselves into this bind, and we have the knowledge and the power to get ourselves out of it. What matters is whether we have the will.

Senator JAVITS. May I ask unanimous consent to ask the witness two questions and may I explain why.

I am the proponent of the principal Taiwan protective amendment before the Foreign Relations Committee. I am the ranking minority member and we are meeting at 10:30. Mr. Byrom and Mr. Jenkins are leading citizens from my home town.

Mr. Byrom, I know my colleague, Congressman Mitchell, will ask you some questions to bring out your point of view which you have already started. I have two things. I will name them both and you can address yourself to them. If Mr. Jenkins and Mr. Schott have views other than yours, I hope they will intercede.

One, it is a popular idea that indexing is good policy. For example, a resolution passed, which I violently opposed, at a major Republican meeting a week ago in Ashton, Md., endorsing the indexing of tax brackets. I gather from your prepared statement,

that you have deep worries about indexing. I refer to your comment on how it is now built into many things. So, one, the policy of indexing.

Two, we are deeply troubled now—it used to concern a few of us but now it concerns a great many—by the great lag in production by the U.S. private enterprise productivity machine.

Question. To what extent will this be helped by building up the capital base as contrasted with raising the morale of workers? In your opinion, how much of each in order of magnitude is cranked into the final equation of a grave national crisis—namely, the lag of productivity growth?

Mr. BYROM. Let me respond, Senator, and it is good to see you sir.

Senator JAVITS. Thank you.

Mr. BYROM. In the first place, as far as I personally am concerned, I am very strongly against—violent is almost the word—anything which acknowledges inflation as being an acceptable condition in an economy. To me, indexing, in effect, says that. It admits that you have quit, that you can't win the fight and you just are ready to say we are going to live with it and hope that we can contain it within reasonable bounds.

I see no reason why we have to give up the fight. I think that inflation can be eliminated over a period of time. It is not going to be easy. It took us, as far as I am concerned, by my way of reckoning, from 1966 to 1979 to get to where we are. We are not going to undo it in a matter of 6 months. But, in fact, I think inflation can be done away with, and I certainly don't think this will happen if we start to index things.

Second, on the matter of productivity—your second question—we have to separate, in effect, what we are talking about. I think, on the one hand, we have capital-intensive industries. On the other hand, we have, in the service sector, activities that are relatively labor intensive. I am satisfied that in the second of these areas, productivity is essentially the result of how an individual performs a service, of the quality of his performance, of how he reacts, how stimulated he is, how motivated he is, how hard he tries, and I am using the term "he," but I should be using "he" or "she." How much a person tries can very much affect productivity in this climate. However, the situation is different in the area I am most concerned about: the industries which provide the primary source of wealth in our society, wealth which makes it possible to have a service economy, these basic wealth producing industries are highly capital intensive.

Very frankly, I don't think that in this sector the individual motivation of the worker, unless it is negative, affects productivity very much. Productivity improvements are accomplished by significant increases in the capital base that utilizes the technology that is available to us.

I am deeply concerned, Senator, that we have all kinds of inhibitions against productivity in the capital intensive industries in our society. They involve many kinds of questions of depreciation accounting in an inflationary economy. They involve questions of antitrust policies which assume that we are essentially trying to

deal in a free-trading world when we are often actually dealing with industries that are either State-owned or State-subsidized.

Our needs in those areas, which I think are basic to the well-being of this society, have to do with capital formation and not employee motivation.

Senator JAVITS. Mr. Jenkins.

Mr. JENKINS. Thank you, Senator. I would like to echo Mr. Byrom's comments on indexing.

I, too, am opposed to indexing as a theory. Once you index something, everybody else wants an index, so you wind up indexing everything. I submit that you are far worse off by indexing everything than if we stood firm and made a good fight.

I am happy to have had a very interesting experience about 3 years ago. A group of us went down to Brazil. That was just at the height of, if I call it in quotes "relative," as they thought Brazil's indexing was a "relative" success.

Subsequent events have proved it was not nearly as successful as had been anticipated. We had a briefing. I came away from that with two thoughts: No. 1, of course, was that we are entirely different from Brazil. What went on in Brazil could never happen here. Frankly, the only reason indexing worked in Brazil for a while was because it came out of the hide of labor. It could not possibly work permanently, and I think subsequent events have shown that.

If we index, sooner or later everybody is going to demand it. I reject it totally as a concept.

On the matter of capital investment and worker morale, our problem, as we all know, is to stop the decline in productivity, turn it around, and get an increase. I think there are a number of factors that have a bearing on productivity improvement, but the principal one is capital investment.

Unfortunately, there is just not the incentive in a great many places to make this capital investment.

In my particular business, which is basically the lending of money—the investment of money—we study various propositions that are brought to us, particularly in the basic industries. When one looks at the potential return, one would be better off to invest the money in Government bonds. I think this is a sad state of affairs.

What we need to improve productivity is more capital investment. As Mr. Byrom says, I am afraid we are liquidating our capital base.

I think, obviously, worker morale is important; and as we get better facilities, that should be a help. On the other hand, I believe one of the things that does hold back capital investment is restrictive work practices. Restrictive work practices might well affect morale, but I have always been one who believes that a person should be paid well and work as hard as he possible can—8 hours a day.

I would also say that many governmental regulations, unfortunately, are restricting productive investment. I am thinking particularly of some of the expenditures that should be made and some of the things that should be done, but aren't.

We are competing against foreign businessmen which can get economies of scale. We, here, are restricted by some of our, I believe, misguided antitrust policies and are unable to get the benefit of economies of scale so our industries can compete with the world at large.

Senator JAVITS. Thank you, Mr. Jenkins.

Mr. Schott, is there anything you want to add? My time is very brief.

Mr. SCHOTT. I will be very brief, I join my fellow panelists in opposing price indexing. As long as the Government is running a deficit, there should be no further tax relief. You might conceivably have a case for an adjustment of tax brackets, but you do not have such a case while the Government is running a heavy deficit.

On the contrary, we should be seeking to have a larger growth in revenue than in spending for some time until the Government deficit is closed. That has been a heavy contribution to inflation, so therefore I am opposed to any indexing.

With respect, to productivity, I would add that the President's report has a very good discussion of the productivity problem. I believe, among the items mentioned by my associates, Government regulation should be particularly singled out. The largest productivity decline in recent years has been in mining. All of us know there were conditions in the mine that needed to be cured and one can land certain OSHA and EPA regulations as being meritorious in themselves, but our chairman has already said there is a cost attached to Government regulations.

I am afraid in the case of mining the Government regulations have contributed to the declining productivity. After a while you could say we shall get over that problem. We certainly need to have a pause and some thought about any further Government regulation of production and technology.

Then, besides that, we need capital investment and substantial capital investment so that present production methods can be brought in line with government regulations such as we have up to now and, please, no additional ones, and yet continue on that new base to improve productivity by R. & D. and capital investment.

So, we have a lot to think about as a Nation in helping to answer those questions.

Senator JAVITS. Thank you, Mr. Schott.

If I may ask one more question, Mr. Byrom. We had a meeting of top-flight economists and some business leaders late last fall. They decided that between ADR, that is, accelerated depreciation and a material reduction in the corporate tax rate, it would be a greater stimulus to capital investment if you reduced the corporate tax rate instead of reducing ADR. I don't agree with that, but that is neither here nor there. I don't own a single business except my watch. What do you think?

Mr. BYROM. As you well know, my peers are not unanimous on this view. I support your view. I think the problem is the liquidation of the capital base. What I would like to see is the kind of accelerated depreciation under which we would leave to the discretion of the firm to use as much of the available depreciation allowable within a given year provided this does not exceed what

the firm plows back in terms of plant and equipment in that particular year.

To me, more flexible depreciation allowances are the way in which we can best deal with the problem we are talking about. I feel that reduction in the corporate tax rate—obviously, any reduction in taxes—makes a positive contribution, but this type of reduction is not nearly as important as improved depreciation. The thing that bothered me was that the corporate tax reduction was coupled with an overall tax reduction which further accentuated the consumption bias which is the reason we are in the trouble we are in.

Senator JAVITS. We agree.

Do you have any differences of opinion, Mr. Jenkins?

Mr. JENKINS. I would just like to add one thing. I know there are many people on both sides of the argument. I can see many good reasons for each approach.

In my discussions with people, one thing comes through loud and clear, that is, if they could count on continuity for a while and not be subject to change, that would be as important as any factor in moving along this capital investment.

Senator JAVITS. Do you have any differences, Mr. Schott?

Mr. SCHOTT. I would just like to say we should postpone further government giveaway schemes until we have brought inflation under control.

Senator JAVITS. Thank you very much. You have been very gracious.

Mr. BYROM. I would like to indicate some degree of difference with Mr. Schott.

My only concern, Mr. Schott, is—I understand what you are saying: that it is very difficult at a time when you are trying to contain inflation to do anything to increase the size of the deficit. I agree with you on that. This is the same kind of thing which is included in the Economic Report of the President on pages 130 and 131.

On 130, they say:

If the investment needed to reach our economic goals in 1983 is to be realized, policy actions are required that will strengthen investment incentives and reduce investment costs and risks.

Then, they go on to the next page and say:

Further tax reductions designed to strengthen investment incentives may well be needed in the years ahead—

they are needed now—

to encourage a high rate of investment in new plant and equipment. Given the budgetary constraints required in the near future to reduce inflation, there is no room for additional tax cuts now.

That is Mr. Schott's point. I understand the dilemma we are in. Paul Tillich said we have to learn to be comfortable with ambiguity. We are dealing here with an ambiguous situation. If we are ever to correct our problem we have to get on with the elimination of the liquidation of the capital base that is taking place. It has to happen now and we have to recognize that this is important.

Representative MITCHELL. Obviously, Senator Javits' questions have invoked questions on my part. Certain key words emerged, such as giveaway programs and problems with the President's

antitrust policy, and I would like to raise some questions in those areas.

Before so doing, I think it would be better to hear from Mr. Jenkins and Mr. Schott and then we can get into a discussion after that.

STATEMENT OF GEORGE P. JENKINS, CHAIRMAN OF THE BOARD, METROPOLITAN LIFE INSURANCE CO.

Mr. JENKINS. Congressman Mitchell, like the rest of the group, I do appreciate the opportunity to appear before this committee. I have prepared a statement here which has been submitted. Rather than read it, it had been my intention to just highlight it. In view of the discussion that has gone on, I think I will just highlight my highlights by stating that we were asked particularly for our view of the business outlook.

We see the current business cycle maturing. We have been in a 4-year expansion phase, and expect that the economy will move this year into an adjustment period which will temporarily slow output. To put some numbers on that, our company's economic forecast indicates a real growth rate of somewhere between 1¾ and 2 percent.

I noticed in this morning's paper, that the Chairman of the Federal Reserve, in his comments yesterday, indicated about the same expectations by the Federal Reserve for 1979. Unfortunately, the way we see it, growth in capital outlays in 1979 is likely to be about one-half of what was achieved in each of the last 2 years.

Now, in going around the country and discussing this with the various people with whom we do business, I find one thing: Most businessmen are reasonably confident regarding their own industry, but are concerned about the general course of the economy and such things as, No. 1, inflation, the value of the dollar, energy, Government control, economic policy decisions, and so forth.

We think that business will not get particularly good growth in real profits this year. By real profits I mean profits after consideration for inadequate depreciation and higher inventory replacement costs.

Our projections also indicate that this will be the fourth year in a row in which internal cash flow of nonfinancial corporations will fail to match outlays for fixed investment.

That means that external financing needs will be large and, by the same token, we look for long-term funds to be relatively tight.

Commercial mortgage markets are still competing for these same long-term funds. Of course, we know that the reason commercial and housing mortgage markets have been so active this year is because of the 6-month certificates tied to the Treasury bill rate.

I might say that as far as the administration's anti-inflation program, announced last October, is concerned, we support its principles and goals. But we feel as a Nation we should not lose sight of the fact that it is only a stopgap measure and success against the upward price spiral will ultimately depend on the course of fiscal and monetary policies.

We believe that more formal controls would be counterproductive and only compound other long-term problems, such as our need to raise the level of productivity.

To sum it up, we see a moderate economic adjustment occurring in 1979. We feel that fiscal and monetary policy cannot be allowed to become stimulative. Failure to at least reverse price trends at this juncture and to dampen inflation expectations have very serious implications for the long-run economic health and stability of our Nation.

Thank you.

Representative MITCHELL. Thank you very much.

[The prepared statement of Mr. Jenkins follows:]

PREPARED STATEMENT OF GEORGE P. JENKINS

Thank you for the opportunity to appear before this distinguished committee, express my opinions regarding the course of the economy, and comment on some of the problems that concern members of the business community in general and the life insurance industry in particular.

Let me turn first to the business outlook as we see it. Fourth-quarter results, as you know, were surprisingly strong virtually across the board. However, we see signs of maturing in the growth phase of this business cycle as the recovery-expansion period approaches 4 years. The U.S. economy appears to be moving into an adjustment phase which is expected to temporarily slow output. We expect the adjustment to be moderate and that real gross national product will still manage to grow by almost 2 percent for the full year.

The likelihood that consumer spending will be slowing in 1979 is supported by the significant deceleration in retail sales performance in January. In brief, we expect consumers to adjust their spending for some excesses that have occurred over the past few years. They will improve the balance between credit extensions and repayments, adjusting spending closer to current incomes, and stepping up their rate of saving from the very low levels of last year. Because consumer liquidity is relatively strong, the adjustment should be mild and of short duration.

Housing, in terms of starts, has been moving along a high plateau for about 10 months. Traditionally, housing would have been adversely affected by now through disintermediation pressures. However, the introduction of savings certificates of deposit and more recently the 6-month certificates tied to the 6-month bill rate has alleviated this problem, as has shrinkage in the gap between market rates and institutional portfolio yields. In addition, housing has been bolstered by low vacancy rates and the fact that homeownership is being increasingly regarded as an "inflation hedge" by individuals. As a result, housing prices have been bid up very rapidly, far outpacing gains in income. Home mortgage rates have moved up sharply and are now competitive with other long-term rates. Plans to buy homes have dropped significantly in the past 2 months and it is beginning to look as if cost factors will be the constraining influence on housing in the current cycle.

Growth in business capital outlays in 1979 is likely to be about half of that achieved in each of the past 2 years. I find that most businessmen are reasonably confident regarding their own industry but are very concerned about the general course of the economy and such problems as inflation, the value of the dollar in foreign exchange markets, energy, and government control of economic decisions. These concerns, coupled with poor growth in real profits—that is profits after correction for inadequate depreciation charges and higher replacement costs for inventory—are bound to affect capital spending. Moreover, growth in nominal profits will slow up considerably this year. With relatively tight labor markets, and with operating rates in the vicinity of 86 percent, the corporate business sector will be expanding output on a rising cost curve. In fact, 1978 was already characterized by a sharp slowing in productivity. Profit margins will therefore be squeezed.

This year will be the fourth in a row in which internal cash flow of nonfinancial corporations will fail to match outlays for fixed investment. Thus, their external financing needs will be large, but long-term bond funds may prove to be tight. Commercial mortgage markets are competing for these same long-term funds. The household sector, which has often acted as a pressure valve in this market during periods of peak interest rates, is unlikely to perform this role in 1979 for reasons previously mentioned—low saving and sizable commitments in various special deposits which cannot be abrogated without strong penalties.

Some slow-up in inventory accumulation for the year is expected, but fortunately there have been few excesses. This is a key reason why we expect only a moderate cyclical adjustment.

Inflation and problems in international trade and finance will prove to be persistent and will significantly influence government policies. A number of developments—some of them very recent—reinforce our expectations for a price increase in excess of 8½ percent for the full-year 1979. Among these are the price and trade impacts from the drastic shifts in both political and economic patterns in Iran, along with the four-step OPEC oil price decision and the necessary increases in domestic oil and gas prices. The high food prices registered so far this year have already added several tenths of a percent to the overall rate of inflation. In addition to these major factors, cost pressures created by the marginal use of less efficient productive capacity and labor, and other rising expenses will add to inflation. Price passalongs stemming from the large increase in Social Security taxes and the lifting of the minimum wage rate are cases in point. On the positive side, a more stable dollar in foreign exchange markets will help to slow up the rise in the cost of imported raw materials and other goods.

With such powerful and diverse inflationary pressures, it will take an extended period of monetary and fiscal caution to turn the tide. Progress will be slow but we must avoid the temptation to switch to stimulus as the economy slows. If this happens the likelihood of a more severe economic correction and financial crunch increases dramatically. In this regard, let me add that we do not feel the current stance taken by the monetary authorities is overly restrictive. Money is still available for sound investment purposes and interest rates, after allowance for inflation of recent years, are not very high.

The life insurance business has been deeply concerned over the high rates of inflation of recent years and the need for policies to bring down these rates. In fact, just a year ago our trade association, the American Council of Life Insurance, initiated a major study effort on anti-inflation policy which is reaching its final stages this week in Williamsburg, Virginia. One hundred leaders from our business, other corporate enterprise, trade union leaders, and university professors are gathered to develop a longer range approach to the solution of the inflation problem. A summary of the outcome of this inflation study will be furnished to the Joint Economic Committee in a statement to be developed next week.

As for the Administration's Anti-Inflation program announced last October, Metropolitan is supporting its principles and goals, but feels we as a nation should not lose sight of the fact that this is only a stop-gap measure and that success in halting the upward price spiral will ultimately depend upon the course of fiscal and monetary policies. More formal controls would be counterproductive and only compound other long-run problems such as the need to raise our level of productivity.

In this respect we applaud the Administration's goal of reducing the relative size of government in the economy and those measures in the Revenue Act of 1978 that were designed to bolster capital formation. A higher rate of investment in new and more efficient plant and equipment is essential if we are to improve productivity, enhance our competitiveness in international markets, and encourage energy conservation, exploration, and development.

Similarly, a reduction and streamlining of government regulatory systems would be most beneficial, especially in the case of the costly paper work and red tape involved in compliance. Moreover, a more appropriate application of antitrust legislation is necessary in a world in which U.S. industries face ever-increasing competition from many government-sheltered industries in other countries.

While job growth will continue, we expect the strong employment expansion that characterized recent years to moderate considerably and the unemployment rate to drift upward as the year progresses. By year end, it will be in the vicinity of 6½ percent, reflecting less favorable employment opportunities and also somewhat slower growth of the labor force. Efforts to mitigate unemployment must be more directly targeted than simply returning to the broad stimulative policies of the past. Job training, job placement services, employment counseling, and special incentive approaches should be used to combat structural unemployment.

While several recent changes in export financing procedure and other trade mechanisms should help us compete more effectively abroad, a more comprehensive export policy would benefit the U.S. We need to continue working to develop greater export credit harmony among countries, reduce major disincentives to exports caused by federal legislation and regulation, and help firms to take advantage of the opportunities resulting from the depreciation of the dollar by offsetting some of the difficulties to be faced in selling in other countries. Better export performance would spur domestic economic growth, create jobs and, by strengthening the dollar, help fight inflation.

In summary, we foresee a moderate economic adjustment occurring in 1979. However, fiscal and monetary policy cannot be allowed to become stimulative.

Failure to at least reverse price trends at this juncture and to dampen inflation expectations has serious implications for the long-run health of our nation and economic stability. Thank you.

Representative MITCHELL. Mr. Schott, please proceed.

STATEMENT OF FRANCIS H. SCHOTT, CHAIRMAN, FINANCE AND CURRENCY COMMITTEE, NEW YORK CHAMBER OF COMMERCE AND INDUSTRY

Mr. SCHOTT. Thank you, Congressman Mitchell. I, too, will be very brief.

In our prepared statement we are dealing with inflation, the No. 1 economic problem. We are pointing out inflation is a socially destructive force. We are pointing out that it had been stated that the inflation rate of 6 percent was sort of a base rate against which one could operate and it would not escalate regardless of demand management. We are now witnessing a major problem and before someone blames the whole thing on OPEC, again I would like to point out inflation was rapidly rising in 1977 and 1978 even before the oil problems started.

We are saying inflation is a socially destructive force in our economy; and we are convinced the reason is that each political and social interest group, in actively seeking to protect itself against inflation, engages in conduct that makes the general problem worse. I am echoing the problem of indexing. If everybody is indexed, would you not be where you were before? You are pitting one group against the other.

Real income gains, over and above the modest per capita advances the country has been making in recent years, can come only at the expense of others.

Our real income gains are limited by productivity advances which have been nonexistent, so we will have to distribute a roughly equal pie for a number of years from now on.

So we are emphasizing and reemphasizing over and over that inflation is the No. 1 problem and our policy should be conditioned by that recognition.

We are pleased that the administration is making a step toward a more nearly balanced budget. We particularly endorse the notion that spending increases have to be brought under control. We are applauding this choice that has been made and support it fully.

The President's proposed expenditure increase of less than 8 percent is a step in the right direction—the first time in decades—and we hope Congress will not add a penny to spending increases suggested by the President. In fact, we recommend to you that every spending increase and all spending be subject to the most vigorous examination.

We endorse the administration's desire to gradually bring back the proportion of GNP spent by the Federal Government from 22 percent to 20 percent and tax cuts should be conditional upon the achievement of spending restraint.

Since the Government has run not only actual deficits, but also high-employment-calibrated deficits throughout the current economic expansion, there is no doubt that massive deficits have contributed to the renewed deterioration of the inflation rate since mid-1976.

We point out that the Government would be in high-employment budget deficit in fiscal 1979 and 1980, and we say this is inappropriate. Nevertheless, the thrust of the 1980 proposal goes on in the right direction.

On monetary policy we would like to point out in particular that interest rates, although they may seem high, are not really high when you measure them against the inflation rate. Someone who pays 10 percent for a mortgage loan, in view of the escalation of house prices and the tax writeoff you get on the mortgage, and the inflation being at 9 percent, is really paying very little more for money, so we cannot agree that 10 percent is high.

Other rates are similarly high because inflation has risen. Therefore, we hope the Federal Reserve will continue to pursue an interest-rate policy that will contribute effectively toward moderation of credit demand and lower inflation in 1979, which is urgently necessary in order to bring some order into the inflation picture while the Government's budget program is still stimulative.

We are endorsing the guidelines and for the moment we are opposed to anything other than the voluntary guidelines.

I note our Finance and Currency Committee of the New York Chamber of Commerce and Industry includes members from some of the largest companies. We have expressed endorsement for the guidelines and we intend to abide by them as near as I can tell from the reactions in our committee. I want to put in a good word for them. We feel special emphasis should be placed on deregulation.

We think the example set in the airlines should be emulated.

On productivity, we feel, as Mr. Jenkins has suggested.

Finally, we have a long discussion of structural unemployment in our prepared statement. This is for the simple reason that we endorse the concept not only in theory. Several years ago the New York Chamber of Commerce and Industry recognized the seriousness of this form of unemployment and, through its educational foundation, developed a program to attack the problem.

Since 1970 we have sponsored clerical training consortia. We are a prime contractor under CETA. We are endorsing the structural CETA program which shifts funds toward the private sector. We have trained several thousand people with a retention rate of 60 percent among our members.

In New York City there is an urgent need for skilled clerical, secretarial workers. We find with proper training we can integrate structurally unemployed people into the work force and that business urgently needs them. We have made a lot of progress and we look forward to being able to use CETA funds within the President's budget request. We are looking forward to expanding on that.

Thank you.

Representative MITCHELL. Thank you.

[The prepared statement of Mr. Schott follows:]

PREPARED STATEMENT OF FRANCIS H. SCHOTT

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 1979 but in the period beyond.

INFLATION—THE NO. 1 ECONOMIC PROBLEM

Our Committee has repeatedly warned the Congress in previous submissions that inflation is a mounting and socially destructive force in our economy. We are more concerned than ever before about the problem. At recent near double-digit rates, inflation is more virulent now than at any other period except for war, early postwar periods and brief flurries following major outside events such as the OPEC price rise of 1973-74. In other words, inflation has become endemic to the economic system itself. We are out of excuses. There are no special circumstances on which to place the blame.

The self-reinforcing nature of inflation is also being revealed ever more clearly. At the recent cyclical low, in mid-1976, inflation had decelerated to about 5½ percent annual rate. The OPEC price rise and the food shortages of 1973 had spent their initiating force, and the recession of 1974-75 materially curbed wage and price demands. Inflation was proved capable of deceleration. When it began to pick up steam again, in late 1976/early 1977, the argument was advanced that the so-called "base rate" of inflation was around 6 percent, virtually regardless of aggregate economic policy. Recent events have proved this argument fallacious. The current inflation has acquired upward momentum.

While inflation is by no means the only ailment afflicting our economy—low productivity and structural unemployment among certain population groups are others—it is, as noted, by far the dominant one at the moment. Without a concerted anti-inflation program as the top policy priority, there is every reason to assume that inflation will soon mount into double-digits and continue to worsen until far sterner measures than those currently undertaken or contemplated would become a dire necessity.

The reason is that each political and social interest group, in actively seeking to protect itself against inflation, engages in conduct that makes the general problem worse. Real income gains, over and above the modest per capita advances the country has been making in recent years, can come only at the expense of others. It is the government's obligation to stop the futile race. This is so especially because the very old and very young as well as large segments of the unorganized labor force are not able to protect themselves adequately against inflation, while other groups may be able to do so. Thus, grave inequities and ever-increasing alienation of the public from government are the likely outcome of an uninhibited inflation spiral.

Aggregate demand management.—The administration has chosen to combat inflation via an array of countermeasures that will tend to reverse the rate of price increase over an extended period, rather than by abrupt measures such as a major recession or tight controls. We applaud this choice and support it fully.

In view of the recent rapid approach of virtually full utilization of men and machines, the first line of attack has to be to hold back the rate of demand growth. The administration correctly states that "to avoid creation of excess demand, economic growth needs to slow to a pace at, or somewhat below, the long-term potential rate of expansion . . . for 1979 and 1980" (Economic Report of the President, p. 79).

Fiscal policy.—The President's fiscal 1980 budget is a major step in the right direction. The proposed expenditure increase of just under 8 percent, while still permitting a large \$37 billion expenditure increase, is less than the almost 10 percent increase taking place in fiscal 1979 and well below the far higher percentage increases of the preceding five years. Furthermore, the predicted deficit of under \$30 billion is a material improvement over the fiscal years 1974-79.

We should note that the government has run not only actual deficits but also high-employment-calibrated deficits throughout the current economic expansion. There is no doubt that massive deficits have contributed to the renewed deterioration of the inflation rate since mid-1976. It is therefore essential for the Congress to refrain from adding appropriations to the administration's requests. This is not to deny that Congress may have somewhat different priorities in expenditures, but there should be a resolve to pare expenditures elsewhere if more is spent in some areas than the President has proposed. In addition, Congress should subject not only increased spending but all spending to the most stringent cost/benefit tests it is capable of devising. We support the administration's aim to reduce federal outlays from 22 percent of GNP to 20 percent two years hence.

We also support the Administration's stance against further general tax reductions until spending and the deficit are under better control. Savings and invest-

ment incentives should have the highest priority in further tax reductions when they become appropriate. The savings rate has been unusually low for the past two years, and the U.S. investment rate places this country near the bottom among industrial economies. We cannot, however, foresee any likely circumstance that would justify tax reductions of any kind in calendar 1979. Reduction of the deficit and of the inflation rate is the highest priority. If Congress agrees to this course, spending restraint will create the proper conditions for future tax reductions by 1981 and possibly even in 1980. We note and emphasize that the administration's projected budget deficit for fiscal 1980, substantial as it is, depends on favorable revenue estimates along with some spending restraint. Should the economy not perform quite as satisfactorily as assumed, the revenue shortfall will serve as an "automatic stabilizer" without any additional tax relief.

Monetary policy.—In view of the short-term inflexibility of the budget, monetary policy must act as the swing factor in the government's economic stance. Since the inflation must be dealt with even in the face of large federal deficits and strong wage/price push, the Federal Reserve is the "supplier of restraint of last resort."

The Federal Reserve has filled this role creditably in 1978. We endorse the gradual approach toward an interest rate level appropriate for curbing borrowing demand. We note that interest rates in the 9½ percent area for long-term rates and 11 percent to 12 percent for short-term rates are hardly onerous for debtors anticipating inflation just short of these figures, especially in view of the favorable tax treatment of interest payments. Therefore, we hope that the Federal Reserve will continue to pursue an interest rate policy that will contribute effectively toward moderation of credit demand and lower inflation in 1979. Such a policy cannot and should not be defined in terms of any particular interest rate level. It is results that count. If present interest rates will do the job, that would be a welcome but, to many observers, a surprising result. If they do not yet curb credit and liquidity expansion sufficiently, it is to be hoped that the Federal Reserve will not encounter political obstacles in pursuing additional restraint. As noted, the Federal Reserve carries the main burden of aggregate economic policy until the budget comes into closer balance.

One of the main obstacles to the use of monetary policy has been removed with the introduction of a variety of measures that have enhanced the competitiveness of home mortgages in the capital market. We endorse, in particular, liberal interest rate regulation of "consumer CDs" at thrift institutions. It is desirable, and now very nearly a fact, that various types of financial institutions, markets and borrowers should be about equally impacted by monetary restraint.

Supplementary anti-inflation policies.—The history of price/wage controls is discouraging, especially when they have been viewed as a shield behind which expansionary fiscal and monetary policy could be pursued in disregard of the inflation threat.

Nevertheless, on the assumption and in the hope that this mistake will not be repeated, there may be a case for voluntary guidelines such as the administration is now seeking to implement. It is unquestionably true that the dynamics of price/wage decisions would benefit from mutual and simultaneous deescalation. If the economy is poised for slower growth in 1979, as is widely believed, and if monetary policy stays on a course that assures such a result, the guidelines may help dampen the slowdown by reducing the inflation rate more quickly than might be the case without them. Therefore, we favor a good-faith effort on the part of all concerned, including business, to see whether the guidelines can be made to work during the calendar year 1979. The guidelines should not, however, be given the force of law, nor should they be prolonged beyond the initial period during which the inflation rate is "turned around."

We cannot endorse the "wage insurance" plan of the administration, which seeks to compensate workers up to specified wage and inflation rate limits if they have accepted a 7 percent wage limitation. The plan is risky with respect to its budgetary costs. It is certain to be highly inequitable as among family income units with widely varying individual situations; and it leaves out of consideration, and therefore behind, many types of income recipients other than wage earners who cannot possibly hope to get even a 7 percent increase this year (for example, savers in fixed-yield instruments such as U.S. Government savings bonds).

Regulatory and productivity policies.—We endorse wholeheartedly the broadening of the deregulation drive to industries beyond the airlines. Pro-competitive policies, including the avoidance of import barriers, are a sound component of anti-inflation and pro-free-market policies.

Although the discussion of regulatory policy in the President's Economic Report (pp. 85-91) stresses commendable progress in the government's attitude toward

relieving excessive burdens of such regulation, we do not believe that the full extent of the problem is as yet sufficiently comprehended. The fact is that regulation, including especially EPA and OSHA rules, have imposed the equivalent of heavy additional taxes on the U.S. consumer—costs that show up in the price index but not in the government budget nor in any other explicit analysis provided by the Government. Thus, it has been estimated that the cost of environmental regulations for the average U.S. automobile is in excess of \$600, or about 10 percent of the present average initial price of an automobile. In addition, car owners incur additional costs for unleaded gas that can easily add 10 percent to fuel costs throughout the lifetime of the car.

The poor productivity performance of the U.S. economy is amply discussed in the President's Report (pp. 67-72), but the explanations of the difficulties leave much to be desired. Yet, we endorse the conclusion that "The magnitude of the productivity effects does highlight two facts: regulation is very costly; and benefits should be closely compared with costs in the design of regulatory legislation and specific regulations" (p. 69).

In view of the urgent need to support anti-inflation policies in every reasonable way, there is a strong case for a moratorium on new cost-increasing regulations and a mandate for the review of existing regulations. The absorptive capacity of industry and of the public of regulatory activity has clearly been strained to the limit.

STRUCTURAL UNEMPLOYMENT

Structural unemployment persists through strong and weak periods in the labor market. Discrimination, lack of education and therefore lack of skills, poor motivation—most typically some combination of the foregoing—account for this persistent aggravation of the unemployment problem, even in periods of intense strain in skilled-labor markets. It is a national responsibility to alleviate the problem.

Several years ago, the New York Chamber of Commerce and Industry recognized the seriousness of this form of unemployment and, through its Educational Foundation, developed a program to attack the problem. Since 1970, the NYCC Educational Foundation has run eleven clerical training programs. In the "consortia" (groups of participating companies) approximately 1,500 people have been trained to fill jobs as clerks, typists, stenographers, secretaries and bookkeeper's assistants in 39 companies in New York.

Clerical consortia programs have been "hire-first" programs. After being screened for eligibility by Neighborhood Manpower centers, trainees have been assessed for academic achievement and desire for clerical training by experienced staff. They have been hired by participating companies, but immediately referred to the training agency for about three months' classroom training while on the payroll of the employing company. Participants have studied basic office procedures, business math and English, typing, and stenography or bookkeeping.

Upon successful completion of the course work and upon passage of the employer's entrance examinations, trainees have begun a 15-week on-job-training. During the classroom period, salaries for trainees have been totally subsidized by the New York City Department Of Employment; on-job-training salaries have been 50 percent subsidized. The average retention rate of trainees following training during these eleven consortia has been about 60 percent.

Now the Chamber is sponsoring a Skill Training Improvement Program under CETA Title III. This is a "train-first" program—unemployed persons without marketable skills will be prepared to take jobs as secretaries and bookkeepers. There are now 32 trainees involved in a 30-week classroom, 15-week on-job-training program, subcontracted to Con Ed. With the aid of two job marketers, they will gain employment in the private sector at salaries of \$4.25 per hour or better.

Encouraged by the success of its training program, the Chamber embarked on a new pilot program in the summer of 1978. The Chamber holds that the original Comprehensive Employment Training Act (CETA) had not directly addressed the structural unemployment problem. Although four out of five jobs are in the private sector, more than 90 percent of CETA funds have been spent on short-term public service employment positions. To deal with this pressing issue, the Chamber's Educational Foundation, in cooperation with the New York Metro Chapter of the National Alliance of Business, launched the Private Industry Council with the sole objective of offering real training and long-term employment in the private sector. The training programs will be flexible enough to train people for existing job openings in hundreds of occupations.

The Private Industry Council will give small and large employers the chance to deal directly with a business-oriented group, thus saving them from the delays connected with securing government training contracts directly through public

agencies. The Chamber found that many large firms that had embarked on training programs with the use of CETA funds had quickly become disillusioned with the red tape and delays caused by governmental agencies. In addition, many medium-sized and smaller firms have neither the financial resources nor manpower available to launch and administer government-funded training programs.

Currently the Chamber's Private Industry Council is operating under \$3.5 million in contracts with the New York City Department of Employment and the U.S. Department of Labor. It is estimated that it will cost between \$2,000 and \$3,000 in CETA funds to train one person. For this small investment the graduating trainees will earn between \$8,000 and \$9,000 during the first year on the job. Reduced structural unemployment will generate tax revenues for the City, State and Federal Governments.

Looking to the future, the Chamber's Education Foundation will expand its training program. The new Title VII of the CETA Act, passed by the 95th Session of Congress, should provide between \$10 million and \$20 million in private sector training funds for New York City. Our Chamber has been designated as the vehicle to carry out the mandate of the CETA Title VII legislation in New York City. The current momentum generated by the pilot program must be maintained. Therefore, we urge approval by the Congress of the Administration's fiscal 1979 budget request of \$400 million for the CETA Private Sector Initiative Program, which is included in the budget as it now stands.

The President's fiscal 1980 budget proposes a \$729 million reduction in total CETA outlays. The drop in total outlays is mainly the result of a phased-in reduction in public service jobs. Outlays for private sector programs can rise because Title VII is only gradually becoming operational. The Chamber supports the Administration's proposed private sector CETA program for fiscal 1980.

Representative MITCHELL. I guess we should start out with trying to wrestle with the beast, and that is where we are in terms of inflation.

Having served on the House Budget Committee and having worked with the Senate Budget Committee, I know how we arrive at a projected inflation figure. I am certain the President uses the same method. We go through a lot of econometric figures and arrive at a number.

The President says he expects the inflation rate for this year to be about 7.5 percent.

I will put this question to all three gentlemen: From your perspective is that realistic and is that the size and nature of the beast we will be dealing with this year, 7.5 percent?

Mr. BYROM. My feeling is that that is a very optimistic forecast. In all fairness it was made before the difficulties in the Mideast, but I think it fails to recognize a lot of built-in factors.

Representative MITCHELL. What is your educated guess on figures?

Mr. BYROM. I think it would be closer to 9 percent rather than 7.5 percent.

Mr. JENKINS. A minimum of 8.5 percent and likely tending toward 9 percent.

Mr. SCHOTT. I remain a little more optimistic than that.

I believe the important thing is the trend of the inflation during the year. Early in the year, clearly we are going to be running at 9 percent or more. I still hope that toward the end of the year we might be in the President's ballpark, having an inflation rate of 7 or 7.5 percent.

You see the slowdown in the economy that we are projecting and hoping for, to put it bluntly to you, will help in creating an alleviation of the shortage problems that are beginning to emerge. We think if the scenario is played out according to Mr. Jenkins—1.75 to 2 percent real growth—then the inflation rate should decline

somewhat by the end of the year. So I feel, for the year, if you take an average of 1979 over 1978, we might be in the 8 to 8.5 percent ballpark, but toward the end of the year we might be at a 7-to 7.5-percent inflation rate rather than a 9-percent inflation rate.

Representative MITCHELL. I am inclined to disagree with you and agree with Mr. Jenkins and Mr. Byrom. I think we will have a slightly higher inflation rate than the President projects.

One of the methods that has been referred to for fighting inflation this year is attempting to hold wage settlements to a given level. The President has proposed a real wage insurance effort.

Let me put two or three questions to all of you gentlemen for response.

No. 1, do you think the President's proposed real wage insurance will indeed help to hold down wage demands during this year?

No. 2, and I think one or two of you alluded to this, with reference to the companies that you own or companies with which you deal, do you think your companies' wage settlements for this year will be within the guidelines proposed by the President?

Mr. BYROM. I guess we might as well stay in the same order.

I am very much concerned about wage insurance because it has the connotation of indexing. It isn't, I know, but it implies that although the administration is asking labor to be responsible in its settlements, it implies that it is really not very sure that the efforts on anti-inflation are going to be successful and, therefore, it says to labor: "we will protect you." It very honestly is being stated as being a hoped for encouragement on the part of labor to accept what could be harmful settlements for themselves if, in fact, the inflation is not contained.

I understand and recognize the thought behind it. I guess I would like to say that I am encouraged by what has been happening so far in the way of wage settlements. I am not in favor of wage and price controls, sir, but I think the guidelines at very best, very temporarily deal with the symptoms of a disease. They don't really get at the problem.

But the thing that they are accomplishing very temporarily in a voluntary sense is making everybody think twice before they proceed to make a price increase or before they proceed to ask for a wage increase that maybe would be excessive.

I would like to believe that, in fact, as a strictly temporary kind of thing, as a cosmetic almost, the guidelines are performing a useful purpose, they may give enough time for us to cause people to believe that, in fact, the administration and the Congress intend to do something about inflation. Really, that is what is needed.

We need to perceive that somebody is really going to do something about it. My only support for wage and price guidelines is that it gives a temporary kind of thoughtful second look that may give us time for you gentlemen—and the President—and the executive branch to prove you mean what you are saying.

I would hope wage insurance is not necessary, if only because of the complications that would be involved in its administration.

This is an additional and entirely different disadvantage.

Now I have talked too long and I have forgotten your second point.

Representative MITCHELL. Do you think in this instance your company will be able to hold to the guidelines and wage settlements?

Mr. BYROM. We have told the President we intend to try. So far, we have no reason to believe we wouldn't be able to live within the guidelines.

Representative MITCHELL. Let me put one more question to you.

Obviously you don't support price controls, but you are going to try to stay within the wage guidelines. In the real world, suppose one of your suppliers said, "I am going to up my prices" and they will exceed the guidelines suggested by the President. What could you do about that?

Mr. BYROM. Very little and if he is the sole supplier or if I don't have other materials that I can use, but normally if I find a pricing situation to be oppressive, I immediately look for another supplier or I look for another material that can be used as a substitute.

One of the things I would personally do, I would go and look at his profit and loss statement and see, in fact, what kind of money he is making. I would like to see if he is showing a return on investment that allows him to continue in business. If it is not—as is the case with many utilities—I would ask our people not to move in and argue against a rate increase because I would like to have some energy available.

I know if people are denied a return on investment that justifies their continuation in business, they will go out of business and then I wouldn't have a supplier.

Again, it is a very complex kind of thing, but when you ask me do I have alternatives, I say yes, I do, plenty of them.

The other thing is that if, in fact, somebody is producing something where I decide I wouldn't buy it at his price, that is the way the market is supposed to work. Maybe he is supposed to go out of business.

Representative MITCHELL. I am glad you said "maybe." That is the way the market is supposed to work. Obviously that has not been my experience. I am digressing a bit, but I attempted to get breakthroughs for minority businesses to supply various corporations. I get the same answer over and over again—"We have been dealing with this supplier for years. Why should we change?"

Mr. BYROM. That is not what I meant, sir.

The way the market system works is that society has a chance to vote on whether it wants a product or does not. If, in fact, there are alternative products, alternatives that can serve the same purpose, and this particular person cannot produce the product at a price that makes me want to buy it, I find no justification for holding an umbrella over that person's head to stay in business.

I don't think that is the same thing at all with minority businesses. I understand what you are talking about. That is a different question.

Representative MITCHELL. I want to come back to this because I think we are in serious philosophical differences.

Mr. BYROM. I don't think we are.

Representative MITCHELL. I think we are. I am not sure at this stage of our economic development in this country that we really

have a free-flowing, pure market demand kind of economy working.

Mr. BYROM. I agree.

Representative MITCHELL. I will make one other statement and then I will get to the other gentlemen.

There are some things which are basic to this country. We have seen a rise in the price of steel. Obviously there are reasons for that price rise, but I think any economist would be hard put to explain the rise in terms of demand in this country.

Mr. Jenkins and Mr. Schott, would you comment on the two questions?

Mr. JENKINS. As far as real wage insurance is concerned, one can say it is an ingenious idea. There is much to be said for it, much against it, but I would have to say that in theory I don't believe I would be for it. Second, although not on that same question, how it would be administered and implemented would be a monstrosity.

Our company has gone on record that we will live within the wage guidelines. As of today I see no reason why we cannot. There is nothing on the horizon that indicates we cannot.

If I might make another remark, you asked Mr. Byrom about prices. I think the industry that I represent—the life-insurance industry—can make a rather unique, if generalized, statement: take the price of an insurance policy for an individual, say aged 35, with a whole life policy for 20 years or whatever, the cost of that insurance today is no more, and may even be a little less, than it was 25 years ago, for the same person in the same circumstances.

Representative MITCHELL. That is unique.

Mr. JENKINS. In that respect, we have not raised prices.

Mr. SCHOTT. Congressman, you asked where are we actually going on real-wage insurance, and what if a supplier raises his price more than the guidelines?

The real-wage insurance is the only one directly covered in our prepared statement, therefore representing 24 large companies, our committee, New York Chamber of Commerce and Industry as a whole, in that statement we are opposed to real-wage insurance.

I share the notion that it is an ingenious idea. I guess I have two basic problems with it. No. 1 is technical difficulties. If you have one man earning \$22,000 a year, presumably he would be outside the real-wage insurance. If you have two members of the same family earning \$11,000 each, those two would be covered.

So you could have the result one family with an income of \$22,000 would be covered by the real-wage insurance and the other would not. We find it extremely difficult technically to deal with this.

On a more general point, we would like to say that any open-ended commitment by the Government to a new program, where you really don't know what the costs of it are going to be, has the potential of aggravating the budget deficit because it might substantially add to outlays. All of the estimates made for the real cost of that wage insurance program—well, fantasy is perhaps too strong a word, but "estimate" is already giving it too much credit, so they are "guesses."

We don't like any new Government spending program that amounts to a guess at a time when there is a serious Government deficit.

Where are we actually going on wage-price settlements? I think the next 6 months are going to be crucial. If you can hold wage settlements—which are the basic component of the cost-price push—within the guidelines over the next 6 months or so and thereby get inflation to decelerate, I think you have a fair fighting chance.

As far as I know, practically all big businesses have agreed to abide by the guidelines and will do so if they are not confronted with the situation you describe in your third question. What if the supplier raises prices by more than the guidelines?

I know that in most large businesses there are established procedures for taking competitive bids on anything of large size. Everything possible would be explored before one would agree to pay more than the price guideline, or for that matter, whatever the high bids are, one would look for the lowest bid. But if the lowest bid does exceed the guidelines and you need the material, then I would agree with Mr. Byrom there is not very much you can do about it.

Your own inflation forecast, Congressman Mitchell, suggests you are not going to be able to hold to the wage-price guidelines. I am not prepared to give up. I think they should be given a good, hard try for 6 months with a lot of jawboning to see if that can be made to work within the context of a more conservative fiscal and monetary policy which we and the President advocate.

Representative MITCHELL. Thank you.

All three of you gentlemen have indicated a concern for the rate of spending and the number of projects for which we spend money. Mr. Schott, I believe you referred to giveaway programs. Bear with me for just a moment and, if you will, let your nightmares come true.

Let's assume that all three of you are Members of Congress and all three of you are on the Budget Committee. You have a budget figure, a budget figure which contains uncontrollable programs; 76 percent of that budget is uncontrollable—76 percent of it. As a Member of Congress holding to the present ideas about budget cutting and exercising fiscal restraint, where would you begin to cut in those uncontrollables? Would you cut old-age and survivors insurance? That is an uncontrollable item in the budget, based on people, and you are having to pay into the trust fund. Would you begin to cut employment compensation benefits? Is that logical when we still have a 6 percent or better unemployment and the forecast is suggesting that in our efforts to fight inflation unemployment will slightly increase?

Mr. Congressman, will you give me your advice as a Member of Congress on this nightmare? Where would you start planning, just dealing with uncontrollable parts?

Don't deal with that part that says "no new programs." I will hold that separately. How do you start cutting and reducing the cost of uncontrollable items in the budget?

Mr. JENKINS. I think we are all faced with that problem in our businesses as well as in the Congress.

In direct answer to your question, I would say that if we could—if the Congress could—hold to the \$29 billion deficit figure for the coming fiscal year—sure, all of us would like to see it less—but if we could hold to that and not wind up with a deficit in the middle \$30 billions, that would be an accomplishment. We would look to further reduction in the deficit each year thereafter. We don't minimize the situation. We in business are faced with the same problems.

Representative MITCHELL. Let me make sure I am understanding you correctly. You are assuming the President's budget is different for the next year. You are assuming that was not perfectly uncontrollable and I agree with you there, but then you go on to refer to a balanced budget.

My question that still remains: Once you start moving toward that balanced budget, with 76 percent of the items in the budget uncontrollable, you come four-square with the problem of where do you cut uncontrollable programs, those mandated programs?

Mr. JENKINS. If I understand my colleague here to the right correctly, there are two ways to get this budget balanced. One is to cut expenses and the other is to increase revenues.

The thrust of what we have to say is increase the tax base. If some of these things were done, the governmental revenues would be increased to take care of that. We could get things moving, get some of these capital expenditure programs and some of these basic industries we have, moving along.

I am a great believer in the marketplace. I know the market has certain restrictions—there is no doubt about that—but I am inclined to believe the marketplace involving hundreds of thousands of people making decisions is the best regulator we could have. There are specific reasons what the market has not been allowed to work, but we have a sound economy, and if we can just unleash it, we can have a balanced budget.

Representative MITCHELL. I am glad you mentioned the area of loss of revenues.

Based on the President's budget and law, in effect there is substantial loss in revenues or tax expenditures.

What troubles me is how could all of you argue for some further tax relief for investment when I am sure you are all aware of the fact that the loss of revenues from current incentives have contributed to our current deficit.

Mr. BYROM. I think you and I are thinking very much alike, but I think we have to understand that a society which wishes to improve the quality of its lifestyle cannot do that unless there is wealth available to distribute beyond what was necessary to maintain equilibrium at the former level. I don't have to tell you that.

So, it is essential that that society organize itself in such a way as to give incentives to the wealth-creation process, not your wealth or mine, but the wealth that is available for society to distribute as it will.

As I perceive myself, you just cast me more or less as a private predator.

Representative MITCHELL. I certainly did not mean that. You are much too pleasant. I would not dare do that.

Mr. BYROM. I see my function is creating wealth that society can then distribute. In other words, I have a specific function to perform. The function of profits in my context is that necessary thing that allows me to continue to perform that function for society.

I frequently refer to profits of corporations as breathing is to life. You and I would agree we don't live to breathe, but it is very difficult to function without it. So, the profits of a corporation are its breath of life.

That is not the reason I exist. I exist to create that wealth. You and other people are trying to figure out the priorities.

The difficulty in our society is that we have lost the ability to choose between difficult alternatives. We have a pluralistic society where each advocacy group can make a very strong pitch that its particular need is paramount. You and I would not deny the idea that what they are after is important. I know of none of these so-called interest groups which are not espousing something which would be important if we could try to satisfy their goals in an orderly way.

When you ask me how do you deal with uncontrollables, it is a little bit like asking "have you stopped beating your wife?"

Representative MITCHELL. If it sounds like that, the question is obviously based upon statements that the witnesses at the table have given.

Mr. BYROM. Let's look at medicare. I suppose you could argue that it is uncontrollable, but it involves a very large amount of funds. For example, HEW published a study in 1973 which found that 21.6 percent of total medicare reimbursements in 1967 was for persons who died during that year—the study also notes that 60 percent of the persons who died in 1967 were hospital inpatients at some time during the year.

Representative MITCHELL. You had better go ahead. I drew an inference that frightens me.

Mr. BYROM. I am sure it does. You are going to think I am very callous. For example, I don't believe that we can afford renal dialysis for everybody who has kidney disease when it costs \$17,000 to \$20,000 per person, especially when it does not cure the person. We do not have the wealth to do everything you and I would agree would be the humanistic thing to do. Just to be sure you understand what I am saying, I made this remark to the deans of the medical schools at their annual convention, and six of them just said you have told me a complete contradiction of what I have been taught.

There is no price on human life. We have insisted that we had to have caps on medicines so the children couldn't get to that medicine. I have been told that the cost of that program was \$100 million and it was anticipated that the total deaths avoided would be 100.

Now, again, you are going to say you are a very callous individual. Are you saying that we the United States can't afford \$100 million to save 100 children. I am not sure the occasion of death is necessarily limited to the medicine.

What I am saying is this, and then I will be quiet: Some people say to me, "How can you claim to be a Christian and a chief executive officer?" The implication is how can I shut down a plant

which will change the well-being of a town, of a community, of families, of people? The answer is that fundamentally my responsibility is to maintain the viability of an economic institution which, if it survives, will create the wealth that allows us over a period of time to eliminate poverty.

I am not callous. We can have everything we want, but not all at the same time. We have failed as a society to understand that.

Representative MITCHELL. My question would have been believability now. I would find it difficult to say, "Pull the plug." I have never been more humanistic.

Mr. SCHOTT. I would like to deal with the questions of giving away revenue under circumstances in which the Government budget is unbalanced and then the question of uncontrollable expenditures.

I am afraid there was a misunderstanding about the revenue being given away. I would not be in favor of that. On the contrary, our prepared statement says very plainly under the present circumstances there should be no further tax cuts at this time. We are flatly against tax cuts until the Government budget is more nearly in balance.

I would not want to be thought of as voting for a giveaway program.

I would also point out if it were not for the tax cut of 1979, that is the tax cut that became effective January 1, the Government budget for fiscal 1980 would be much more nearly in balance than it is likely to be. The revenues of the Government are rising quite rapidly—for fiscal 1978, \$402 billion; for fiscal 1979, \$456 billion, an increase of about 12 percent. And revenues for fiscal 1980 rise to a projected \$503 billion, that is about a 10-percent increase even with the tax cut. So, obviously there is more money to do something with each year.

If it were not for the tax cuts, we would be in the position of being at a nearly balanced budget. I am not in favor of a balanced budget at all times, only in times of high employment.

I happen to believe, Congressman Mitchell, that there are no such things as uncontrollable expenditures provided that you give us a little time frame within which to operate. To be sure, once you have enacted a program, and have committed yourself open-ended to, say, give such-and-such to all eligible under such-and-such criteria, that is uncontrollable. You can no longer control how much you would spend.

Yet that becomes controllable. If you took a 3- or 5-year time-frame, every funding program should be subject to your review. You should start out with the old budget considerations each time around on each spending program. You would find there are very few uncontrollable expenditures.

Take the military expenditures. Are they uncontrollable? I say they are not, Congressman. The expenditures are uncontrollable only after you build yourself the box you are already in.

Representative MITCHELL. I would like to put one other question to all three of the witnesses.

We have heard testimony from Mr. Jenkins and Mr. Schott to indicate that so far as the private sector is concerned, there is a

possibility of real growth being at around a rate of 1.75 to 2 percent for 1979. I believe that is what you answered.

Again there was testimony to the effect that capital outlays in your mind over this next year will be about one-half that of the last 2 years; is that correct? If these are true projections, it seems to me they are not moving toward a moderate slowdown in the economy. It seems to me we are really moving toward some type of recessionary period based upon reductions in investment for this year and based upon your real growth rate.

Now add to those two factors, the monetary policies that Chairman Miller has suggested he is going to pursue. I suppose this year he will hold monetary growth within the guidelines of M_1 and M_2 , the guidelines he presents to the Congress. I suppose he will hold within them.

I would further assume those guidelines are a little tight, that the ceiling would be a little tighter. It seems to me there are three factors involved which operationally suggest a recessionary trend.

May I have your comment? Am I misinterpreting the facts?

Mr. JENKINS. No I don't think you are misinterpreting the facts. A recession by definition is to have two successive quarters at zero or minus growth in real GNP, as I understand it. Our projections are that there might be two quarters this year that will approach that, but with a pickup toward the end of the year, and a further pick up in 1980.

Now, it is true that this could get out of phase time-wise. I believe all of us were rather pleasantly surprised with the robustness of the figures for the fourth quarter of 1978—I would prefer to call this an adjustment. We expect in the following year, 1980, real GNP and business capital outlays should turn around and increase. But I get back to the horse that I ride all the time, which is that if we had a better investment environment we could get these capital expenditures we need.

Representative MITCHELL. Including regulations and all the other things you alluded to.

Mr. JENKINS. Yes.

Representative MITCHELL. Are there any further comments?

Mr. SCHOTT. As I stated in the prepared statement, we endorse the Federal Reserve's restraint. Growth targets are hard to define, but I would like to note it is the growth not the mechanical measurement of interest rates.

It could be that with the monetary aggregate targets that the Federal Reserve has now established, it could be that with those you will have a moderation in economic growth and in inflation. If that is not sufficient, then you have to have more emphatic restraint.

If a major recession should occur, then I believe the targets should be liberalized. I don't feel you should feel nailed to the wall, and I would hope there is flexibility in Federal Reserve policy.

I think their targets are reasonable for the presently foreseeable future. They should be permitted to do their thing until further notice. I do say this too, Congressman, if you did not have the Government deficit, then monetary policy could be more expansive.

People complaining about interest rates should look in the mirrors. One of the main credit demands that has to be financed in the

market is Treasury notes, bills, and bonds. If the Treasury itself would not be such a demander of additional funds, chances are interest rates would not be as high as they are now.

So, within that context, the Federal Reserve has been performing a creditable job.

Mr. BYROM. I agree that some of the actions we are taking are probably going to tend to move away from what I referred to earlier as a consumption bias. I would be hopeful that there would be a tendency toward savings. I would hope that that savings would end up in investment, but that is a big hope. I understand that.

I am concerned about capital spending certainly in the near term. I am satisfied that in a reasonably short period, and by near, I am talking 4 or 5 years and—in terms of the history of civilization that is not very long—this Nation has to some way or other do something about turning around the liquidation of its capital base.

It may fundamentally change the nature of the way we carry out our production in primary areas of the country. As a pessimist, about the way things are going, I feel the whole concept in private industry is under great siege, and there may be reason to believe that it is not going to survive.

In the long run we will build more plants and we will begin to introduce the technology that is available to us to increase the productivity of our society. Until we do, we are going to be in deep, deep trouble. We have less and less wealth and we continue to demand more and more from that base.

I am not worried about the Fed showing monetary restraint. I think that is helpful at the present time. If and when we do move toward recessionary tendencies, I would hope monetary policies would be the mechanism with which we try to deal with this problem, not fiscal policy.

I would rather see an easier monetary policy trying to deal with a situation than I would building, in the future, uncontrollables into our fiscal base. I think that could very well happen.

I don't think that we can anticipate that any of us are smart enough to sit down and say exactly what we will do when things start to happen that way.

At the present time, we are not in a recession and frankly I don't see any signs of moving to one. We are just worried about the fact that we probably will move toward one. We are in an inflationary spiral which I don't think we have seen the end of.

One of the reasons I am pessimistic, is that I believe the wholesale price index has yet to appear on the decline. We must find a way of answering the problem and learn to be flexible—for instance, some feel the President should have the option available whereby he could move taxes up or down for a limited period of time, subject to congressional veto. I think we need some flexibility. We don't have it with our fiscal policy.

Representative MITCHELL. I would say I see both fiscal and monetary policies involved and needing flexibility. Thank you.

Congressman Brown, please take over, I have to leave.

Representative BROWN [presiding]. I want to thank you for your discussion.

Mr. Byrom, I do want to give an appropriate reason for asking some of the questions I am going to ask. I have to make a speech to a steel group shortly.

I understand you are in a unique position to comment on the steel industry. You are a metallurgist by trade, and your firm is one of the major manufacturers for the steel industry. You are one of the leading industrialists in the country.

Would you share with me your view as to the prospects for the national economy.

Mr. BYROM. If I may first say I am not sure I am as qualified as you give me credit for but that is fine. It is true I was a metallurgist by training, but I have not been working at metallurgy since I was 2 years out of college.

Representative BROWN. I am not sure the metallurgist will save the steel industry.

Mr. BYROM. I am very, very worried about the steel industry. In fact I am so much of a pessimist, I honestly believe within 5 years we could be at the point of no return as to whether it will be necessary to inject public funding in order to keep the industry from going down the drain.

We have in the United States a series of steel plants which, for the most part, are obsolete in terms of today's technology. We have a highly fragmented industry in which no component has an incremental share of the market available to it which justifies the use of the scale economies that are possible on the basis of the available technologies.

We, in fact, have had de facto price control in the industry for 15 years or more. The return on investment in the industry is unacceptable on the basis of reported earnings and the reported earnings don't tell the true story.

Due to the shortfall in depreciation allowances, due to unfunded pension liabilities, I honestly know of no steel company today which is showing a return on its investment. It is not that capital is not available to build the plants. It is that the economics of the project do not justify investing money in it.

Interesting enough, the United Kingdom went through this same situation and came to the point where it was impossible, using private funds, to nationalize the industry. So they went ahead and proceeded to create the British Steel Co. with the intention of nationalizing the industry and using economies of scale. That was brilliant.

The only problem with it was, once they did it, then Parliament stepped in. Parliament was pushed by certain political forces, if you will, when they tried to shut down the obsolete plant, the representatives from those districts said, "You can't do that, you will put my people out of work." So they have kept the old plants operating, but it has been denied the new plant.

Could the new plant operate at capacity?

The British Steel Co. is losing a billion dollars a year—all from public funds.

If you go around the world, you can see situations where the steel industry is being used as a public-works program or for social-political purposes as viewed by that particular sovereign nation,

and almost everywhere the steel companies are owned or subsidized by public funds.

We are asking our industry to compete in a world with that kind of competition.

The problem is we are imposing on top of this competition requirements for environmental control and requirements for improvements in the occupational safety and health conditions in the plant. We are in a situation where, fundamentally, the reported revenues of the United States Steel Corp., where 78 percent of their sales came from the steel industry to less than 12 percent of their earnings—and this was without recognizing the shortfall in depreciation or the unfunded pension liability.

What I am saying to you is that the steel industry today is losing money, and we are not going to be able to do the things we need to do. A large part of the problem is antitrust policy. We are not allowing them to do the aggregations that are necessary to allow them to utilize the technology available to us.

Does that respond to your question?

Representative BROWN. It does, and I share some of your concerns and agree with some of your suggestions about actions that might be taken. I sit as a member of the board of visitors of the Harvard Business School. At our last meeting, they gave us a very interesting case to look at, the miracle of modern Japan from the mid-fifties to the year 1971. They have gotten into some troubles since then, but it bespoke the Japanese policy decision at the end of World War II to undertake world competition as a national matter, in some of the most difficult and highly technical areas which many other countries were decidedly far superior.

They decided not to go back to making toys and paper parasols, but to take on the world steel industry, to take on the world automobile industry, the electronics and computer industry, and other industries of similar nature. They have done very well, but they have done it as a national policy with the ramifications of national monopolies in these areas. Shipbuilding was another of these industries, and in most instances that decision has been directed pretty much at us.

I think the steel industry would certainly suggest it is directed at us, and the automobile industry, and they have done very well.

Now, some of the things they have done would perhaps be in the range of national subsidization that you suggested might be necessary in the steel industry.

It seems to me there are some steps we could take therefore; first, those related to our antitrust procedures, and second, those related to the writeoff or depreciation of equipment.

I have some economic statistics put together by the staff on the minority side of this committee looking at the profits of the steel industry since about 1958, the time the Japanese started their effort, as you suggested—frankly, your years are a little understated—for 20 years, or a little longer, during which we have had wage-price controls, to some extent wage controls, and certainly profit controls—you have to go back to the time that Harry Truman suggested he was going to nationalize the steel industry after World War II.

The upshot was, given the profits and depreciation of steelmill capital, profits have not been sufficient to modernize the industry. So the net result of about 20 years of operation of the industry is a negative figure.

That certainly bodes ill for us as a society.

We in Ohio are going through struggles such as the Youngstown problem. We are talking about a plant which had its last major modification in 1915 or 1916. They are almost ancient history, and I am almost ancient history myself. But the upshot is that we do have a very bad steel policy. Because of the under appreciation, there was a taxing of the industry which is another factor. This could be resolved if we had a higher replacement writeoff.

It seems to me that is a first step before we decide to subsidize the industry from other producers of wealth in this society. Would you agree with this?

Mr. BYROM. I certainly would, and, having been as pessimistic as I sounded, there are some alternatives. I was talking to Mr. Jenkins before the hearing. Several years ago my company made the proposition that we get financial institutions to underwrite a modern plant which would be operated by an operating company to produce ingots.

In other words, it would be coke, blast furnace, basic oxygen furnace, and continuous casting. It would be a continuing water port, expending between 8 to 10 million tons. It might be down in the gulf coast, you would barge the ingots upriver to various rolling facilities elsewhere.

The operating company would have a lease, a hell-or-high-water lease, with a financial institution which would be guaranteed by take or pay contracts with credit-worthy steel corporations.

Now, the thing did not fly. One of the reasons it did not fly was people were worried about antitrust policy. This would be a case of three or four companies, no one of which had need for more than 1 million or 2 million tons of steel—in effect working in an indirect way, in a way to produce an economically sized plant. That is one way of doing it.

Mr. JENKINS. Let me interrupt to say that we are inconsistent here. Business is allowed to do it with raw materials. The iron ore projects are consortiums. If we could do something like this as an institution—and we have looked at this many times—to let's say get the economy of scale of a major blast furnace through a consortium, as Mr. Byrom said, we would finance it, just as we have done with the raw materials.

Why is it against policy to do this for, say, a blast furnace? One of the things that came home to me the other day is that we have not built a new large blast furnace in this country for so long that when one of the major steel companies was considering it and went to the drawing boards, they felt they had to go to Japan for the technology. To illustrate how times have changed, Japan got the original technology from us post-World War II. Now we have to go back to them for the technology.

Representative BROWN. You have stimulated my interest.

My other interest is in the Subcommittee on Energy. Not very many new refineries have been built in this country in recent years. One of the problems we have had, is the development of

nuclear power. Now we see as a national policy the White House has turned its back on it. In recent testimony of one of the science committees on the House side, an Assistant Secretary of the Department of Energy is supposed to have said that he is not particularly worried about our delay of nuclear power in this country; other countries were developing it; namely, the French, and if they came up with anything really good, we could buy the technology later on.

That had two assumptions. One is the assumption that they would sell it to us, and the other is that we would have the money to buy it with.

I am not sure if it were the dollar which now seems to be becoming old-fashioned and not as valuable as it once was, or, if there were some other method of purchasing.

Mr. BYROM. I don't know if you know that the steel industry is importing coke from Germany at a level which is equivalent to about 20 percent of their requirements.

The difficulty is, when the Germans run out of the surplus of coke they have, we are not going to have in this country coke which is available to produce the iron that we need to make the steel.

The amount of coke—

Representative BROWN. As a matter of technological development or a matter of resources?

Mr. BYROM. About 40 percent of the coke ovens, and we build them, and this may sound self-serving, but 40 percent are over 25 years old. The normal life of a coke oven is about 30 years. These ovens are for the most part nonconforming as far as OSHA and EPA requirements. From the time you get a given order to the Koppers to build a coke plant, it takes us the better part of 36 to 40 months to build it. The amount of coke we are importing annually would require about 10 economically sized batteries to produce today. The refractories industry can only make enough brick to handle three or four of these projects at a time.

What I am saying is, right now we are short of about 20 percent of capacity to satisfy our requirements at a 90-percent operation of the steel industry. That is going to get worse before it gets better. There is no way a company can justify a new coke plant. We are going to end up in a situation where we are going to have to import a significant portion of our steel, not because we want to, but we will have no choice.

Mr. JENKINS. We could be in the same position in the steel industry 3 or 4 years out as we are in the oil industry today—dependent on foreign sources.

Mr. BYROM. The problem is it does not stop in steel. It is true in the nonferrous industries, it is true in copper smelting. You can just go down the line in capital-intensive industries in the United States where we are liquidating our productive base.

Representative BROWN. I am told it is also true in the utility field. You may talk to your friend and neighbor—

Mr. BYROM. I think we are past the point of no return in the utility field.

Mr. SCHOTT. We point out in our statement that we endorse essentially the President's Economic Report when it comes to regu-

latory and productivity policy, but we think it does not go far enough. It is just the beginning of a vague recognition of the problem. The President has made some gestures in that direction, such as the Intergovernmental Council on Regulation, which is now supposed to bring some order to the chaotic situation in which one agency after another issues contradictory orders depending on its own criteria.

We are saying, as a minimum, there should be a moratorium on additional regulatory orders preventing modernization and productivity improving measures in basic industry so that industry can adjust to existing regulations and gradually come up with technology that would take account of existing regulations, not be hit with additional regulations, but can adjust it so that on the basis you can then make productivity advances. That seems to be the rational way of getting out of that.

Mr. BYROM. Right.

Representative BROWN. Let me make a comment, which is not to disparage your company. Senator Bentsen and I have proposed joint legislation addressing the regulatory problem. You mentioned contradictory regulations. We would address that by making the Office of Management and Budget resolve those contradictions and eliminate one regulation or the other. Nonetheless, this results in OMB trying to be the traffic cop for terminating the contradictions within regulations.

We have also tried to encourage, in writing this legislation, the establishment of a productivity test of the regulations so we are not spending \$5 to get a 20-cent improvement in some areas, and similarly that we have a regulatory budget so that the budget enforcing private expenditures would be considered in the same way one would consider the budget of taxation. But when the local utility company is obliged to put on a scrubber—and that embraces almost everyone—it is almost like the tax that goes on every citizen at the requirement of the Federal Government in our interests to clean up the environment.

It seems to me one of the problems we face in trade, for instance, is that while the Japanese have been resolving to take over the steel industry of the world, the United States has been resolving to clean up the air of at least our corner of the world. Perhaps those are noble motives and should not be taken facetiously in and of themselves. If the Japanese gave thought to any environment, maybe we would be not in the position we are in, and the Japanese would not be as far ahead of us as they are in steel.

Mr. BYROM. They would have a significant advantage because their concept of the use of technology is much more intelligent than ours is as a nation. As I am sure you know, when they get to a certain level of demand below their supply capabilities, they set up what they call a recession cartel where they agree that they will eliminate the least efficient production operation for an 8-month period and will concentrate production in the most efficient, so they take their most efficient production and concentrate that production on those plants which operate at 100 percent of capacity during that period.

Our system distributes uniformly across the board.

Representative BROWN. The IRS taxing arrangement makes it more economical to use the older plant.

Mr. BYROM. There is another thing that happens and I am sure you know this. They do not use a very significant amount of equity in their capital structure. They are 80- to 85-percent debt.

Now, this would be frowned on by my friend, Mr. Jenkins. If the Koppers Co. operated with 85 percent, he would not be one of the people willing to lend me any money.

The reason it works in Japan is that the Bank of Japan guarantees the debt so the commercial bank is all taken care of and there is no concern about it.

When you can operate your company on the basis where all you have to do is service the interest on the debt but you never have to pay off the principals this changes the economics of your production significantly. That is what we are asking our private steel industry to compete with and all the rest of our industry to compete with.

We are saying to the steel industry that it should act as though the rest of the world does not exist, as though the United States is an island, that it is an isolated market and we have to maintain competition between us. Our antitrust policy refuses to recognize that aluminum is an alternative to steel and that plastics are an alternative to both of them.

It refuses to recognize that there are producers throughout the rest of the world who are prepared to invade our market at the drop of a hat. We are forcing ourselves into a protectionist stance which could be a disaster for the world. It is obvious to me why.

I am not very smart.

Representative BROWN. The antitrust laws were written shortly after the McKinley-Harris legislation and you had a different concept of what you were trying to do with the protection of developing industry in the United States than you have now.

Mr. BYROM. What can we do about it now?

Representative BROWN. One thing you might try to do about it is educate Members of Congress. I am trying to do that on the inside, but I am having even less success.

Mr. BYROM. Imagine how difficult it would be for me to do it.

Representative BROWN. People in the private sector have some influence over the way people vote in their own bailiwick. Even people like Mr. Jenkins live and vote in precincts someplace and perhaps might get involved in the political process. I know these multinational and large organizations are really considered floating crap games in terms of their local and parochial interests and, therefore, have no home, but I still think it would be nice if you took advantage of the locality which you do live in and got interested politically in a much more progressive way than you are, because that is where the game is and Congress has been doing this and will continue to do it, whether wisely or unwisely.

I would like to take time to lecture you about something else that I think you are all wrong on.

Considering the fact I am so outnumbered, I don't know whether I will get into it or not. That has to do with your limited view of indexing the tax system. I would like to suggest to you that the Canadian experience has been that the people who are most un-

happy with it are first, the budget-makers who must try to reduce Federal spending in Canada and the next most unhappy people are the politicians, who can't offer tax cuts every year.

Giving it now doesn't get the political benefit of cutting taxes. When those two groups are unhappy, it seems to me it is probably a pretty good system. The test is whether or not the Canadians will learn the restraint required by the budget requirements that they have automatically placed upon themselves.

We have no limits that we place upon ourselves in terms of tax revenues because we are now benefitting from inflation and, therefore, have learned no restraint whatsoever. It is a little bit like the problems created by the bill. You know, when money has become so free and easy through the inflation bonus that the Federal Government gets because of increased revenues as a result of the inflation they create, that we just simply spend money will-nilly without any concern about where it must come from, because it all comes automatically without raising taxes.

They raise automatically.

Mr. BYROM. I admit my objection to it may have a touch of idealism. The thing that bothers me about indexing is that it recognizes inflation as being something that is going to be with us. I am just unwilling to quit yet.

I don't think that has to be the truth. What you are saying is a very pragmatic response to a condition and you may very well be right. I just hate to give in at this point. I keep hoping that somehow or other people will be able to recognize that inflation does not have to be with us and that it is caused by excesses and our unwillingness to deal with the inability to choose.

Representative BROWN. When my constituents write me—and I think the same is true with my colleagues—about inflation, they don't write about the inflation of taxes. They write to me about the inflation of grocery costs or gasoline or something that they deal with every other day or two, and that is the area that they are afflicted by.

I can't think that people will get less inflation-conscious if we put the skids on one aspect which may be fairly fundamental so that some of the others may continue to be concerned about it.

Mr. SCHOTT. May I comment on that?

Representative BROWN. Certainly, Mr. Schott.

Mr. SCHOTT. I believe the basic responsibility of Congress is to restrain spending directly. You can restrain by cutting taxes and hope to make the Government deficit less, but that strikes me as being second best.

Representative BROWN. We have this Draculian effect—cut off the blood supply and maybe the monster will die.

Mr. SCHOTT. As regards Canada, it does not work. Canada has had a higher rate of government spending and higher rate of inflation and higher rate of unemployment than the United States. People are fed up with the workings of that system. Of course, tax indexing is just one small aspect of the total picture. Their spending restraints have not worked; therefore, their printing presses have been more active yet.

If you were to try to go at this directly, I suggest that you should try in conjunction with your colleagues to systematically limit the

rate of increase of Federal spending. In this way you will build a case for stabilization and eventual reduction of tax rates that is much sounder than to rely on the notion that Congress will not approve of the budget deficit that would result from taxcutting before you restrain spending.

Representative BROWN. That is like trying to catch AA members at Beatty's Bar. You don't really have a very good audience for cutting Federal spending when you start talking about the Members of Congress. We do seem to have some outside sources that are pressing at us; 24 or 25 of the States have now come up with constitutional convention calls or the approval of resolutions calling for a constitutional amendment reducing spending and suddenly they seem to have gotten the attention of Congress.

That does not indicate we have given up the bad habits. It is just that they have gotten our attention. We are trying to figure how to frustrate the restraining influences these people want to put on us and how we can avoid the constitutional convention or the constitutional amendment, but nobody seems quite ready to take the pledge of temperance in the spending game.

They talked a good game in 1978 in the campaigns, but I am not sure whether that is a Damascus Road conversion or just a conversion for the benefit of the election campaign.

Mr. SCHOTT. Mr. Congressman, just for the record, I would like to note in fiscal 1978 the increased Federal Government spending was 12.2 percent; fiscal 1979 now has an estimated 9.5 percent. The President's proposal for fiscal 1980 is an increase of 7.7 percent in outlays.

I suggest to you, Mr. Congressman, that your focus of attention should be on making these figures come true and, if at all possible, improve upon them. There is no reason why the Government outlays in 1980 have to go up the full 7.7 percent.

Representative BROWN. We have had proposals to cut back on impact aid to schools, among other things. Every President of the United States since Dwight Eisenhower has tried that, and that is when the program began. They have been trying to cut a foot or tail off that monster and nobody has been successful.

On that hinges a great deal of the deficit, to the \$30 billion level.

I suggest there has been cosmetic conservatism in that budget that is not real. We are not forced to make decisions in some of the harder areas. I have some difficulty in whether or not we are going to get those cuts. I think there has to be a great deal more aggressiveness about those things than has been evident up to now.

Mr. SCHOTT. I don't see how you would help that situation by cutting taxes.

Representative BROWN. I don't think I ever mentioned cutting taxes, but I think we would have some difficulty making progress in the basic industries if we don't in some way cut taxes or at least if we don't in some way make a realistic adjustment like the depreciation rate. This has an impact on the nature of what government takes from productive industry in the form of taxes because that depreciation rate is not realistic and therefore increases the tax take rather than reducing it.

Mr. BYROM. I ran into trouble with Congressman Mitchell, who I think has concluded that basically I am an inhuman kind of person

in that, in my presentation on that, I am saying fundamentally what we have to do is move the bias of our tax revenues away from a consumption bias and incentives toward consumption and get it to at least where there is a removal of obstructions to investments.

Representative BROWN. I know you are a businessman and politician, but I am a businessman, too. I think it should be inflation bias. We have inflation bias in our system because the tax system was devised during the great recession to get the money out of the mattress and into circulation.

Mr. BYROM. That is much better, but the problem is until we get our productive base improved to the point where it can start to create wealth to the degree that it has in the past and can again, we must limit our desires and aspirations for doing everything that will bring the quality of life up to the highest level that we perceive ourselves.

We can't afford to do it until we are creating the wealth.

Representative BROWN. I want to leave the group on a harmonious note. Let me just conclude perhaps by suggesting that all of us, Mr. Schott, Mr. Jenkins, and Mr. Byrom want to balance the budget. Speaking for myself, I would like to balance the budget at a relatively low level of tax taken out of our system so that the money could be left among those people who produce.

I think that will have the impact of making the pie larger and therefore ultimately increasing the amount of money that the Federal Government or State and local governments have to build social organizations and structures that have been so beneficial to our society.

I just want to suggest one other idea for the CED to look at. I am not sure we had a CED representative here when I suggested this. Perhaps we need a Department of Foreign Trade in this country or at least something within the Department of Commerce that elevates our interest in trade, because it has now become not 6 percent of our economy as it was just 6 years ago when I got on the Joint Economic Committee, but now 20 percent of our total GNP revolves around the whole trade issue.

If we are to be competitive and not victims in the foreign trade programs of our country, then it seems to me we have to have somebody who will have the stature, with all due respect to the President, to speak about the importance of approaching the steel industry from the standpoint of a national asset rather than as a bunch of parochial mom and pop competitors operating entirely within the structure of the geographic United States.

We may be able to rationalize our sudden move away from high tariffs to low tariffs with the Sherman Antitrust Act and a few of the other pieces of legislation that now make our regulators think in terms of busting up our competitive ability rather than enhancing it.

Nobody in our society today wants to speak in favor of monopolies because we have such a national bias against them. On the other hand, when we deal with the Japanese, the Germans, the French, the British, and all the other competitors, not to mention the Communist bloc which, of course, is a nationalized monopoly, we are dealing with people who are competing with us from the

economies of scale of a monopoly which their national private or public interest represents.

It seems to me that we have to recognize this in terms of where we head in foreign trade and maybe one way to do that is to set up a Department of Foreign Trade. I am sure in this administration, the first secretary will be Mr. Strauss and he might even be the first one under a Republican administration if he could get his act together in some other ways.

With that I think we had better close the hearing or I will be accused of taking advantage of Congressman Mitchell's geniality. We are adjourned until tomorrow.

Thank you very much.

[Whereupon, at 12:28 p.m., the committee recessed, to reconvene at 10 a.m., Friday, February 23, 1979.]

THE 1979 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 23, 1979

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

The committee met, pursuant to recess, at 10:05 a.m., in room 1202, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Present: Senators Bentsen and Javits; and Representatives Brown and Heckler.

Also present: Louis C. Krauthoff II, assistant director-director, SSEC; Lloyd C. Atkinson, William R. Buechner, Kent H. Hughes, L. Douglas Lee, and M. Catherine Miller, professional staff members; Mark Borchelt, administrative assistant; and Charles H. Bradford, minority counsel.

OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator BENTSEN. This hearing will come to order.

The U.S. economy continued its upward expansion in 1978 for the fourth year in a row.

Real GNP grew at the healthy clip of 4.3 percent. Employment rose by 3.3 million and the unemployment rate dropped by more than a full percentage point. Corporate profits rose in 1978, and this combined with the continued rise in capacity utilization helped to spur a much needed increase in real nonresidential fixed investment. Despite sharply increasing interest rates, the housing market showed continued resiliency.

These good news developments, however, were marred by an acceleration of inflation in 1978, and its apparent continued acceleration in the first month of this year as reflected in the whopping 1.3 percent January increase in the wholesale price index.

Part of the deteriorating inflation picture can be explained by the rapid increase in food prices in the early part of the year, by the extreme poor showing of productivity growth, and by the substantial depreciation of the dollar on foreign exchange markets.

However, the accelerating rate of inflation was not due to these factors alone. On the contrary, during 1978 there was a marked increase in our underlying rate of inflation of perhaps 2 percent or more.

As a result of our deteriorating inflation picture, reducing inflation has become the top priority policy for 1979 and 1980. The demand restraint program proposed by the administration and the Federal Reserve clearly reflects their concern with inflation. The

trick, of course, is to achieve overall restraint without, at the same time, triggering a recession.

In my view, the administration's anti-inflation program provides too little in the way of incentives for capital formation. A high rate of capital formation is needed if we are to reverse the disastrous course of productivity growth in the American economy which, in turn, is essential to the success of our longrun goal of significantly slowing inflation.

The need for additional capital incentives is clear. The problem is that inflation itself significantly retards investment spending if for no other reason than that the "historic cost" basis of depreciation lowers real corporate after-tax profits and therefore the real after-tax rate of return to investment.

We have before us today a very distinguished panel of economists, starting with Barry Bosworth.

Mr. Bosworth, it is very timely having you here this morning, what with the recent court decision in Nashville and some announcements this afternoon on the CPI at 2:30, as I understand it.

Mr. Bosworth is Director of the Council on Wage and Price Stability, who will discuss the progress being made with the administration's voluntary wage and price program and the overall anti-inflation program.

Mr. Bosworth, we will start with your testimony, and we will proceed without interruption to let each of the witnesses make their comments before responding to questions.

I will want you, in your statement, to respond to this court decision concerning the TVA.

STATEMENT OF BARRY P. BOSWORTH, DIRECTOR, COUNCIL ON WAGE AND PRICE STABILITY

Mr. BOSWORTH. All right.

I will submit my prepared statement for the record, and make a few introductory remarks.

I will first outline what I think the basic question is in the development of the administration's anti-inflation program and then comment about our progress and difficulties that we have encountered.

First of all, although I realize that there are a wide variety of factors responsible for inflation and that there is a wide amount of disagreement in the country on exactly what factors should be emphasized, I do think that some sense could be made out of the problem of inflation if we try to place it into two fundamental areas.

No. 1, it is a problem that has grown out of the last decade of the continuing momentum of inflation which has built up in the economy because of the price increases and expectation that those price increases are going to continue.

I think that basic underlying process of inflation is not tied that much to excess demand. It is not inflation of a historical type with demands for goods and services higher than the supply.

Instead, it is basically an inflation which most people in the economy are operating in a purely defensive fashion, trying to protect themselves. Most wage increases are justified simply on the

basis that prices have risen and people expect them to continue. Most business firms are behaving about the same way.

The first problem is that this momentum that has so deeply drained the economy and built up over the last several years, and we have to brake it.

The second problem concerns government actions. In particular, some foreign developments have tended to exacerbate that momentum of the inflation.

Also, the chairman referred to another one of them, the very sharp decline in productivity which occurred over the last decade.

In the 1950's to 1960's, we averaging productivity growth near 3 percent a year. In the last 10 years, the economy has been capable of generating a rate of productivity of less than 2 percent a year. In the last 2 years, despite a very strong economic expansion program, productivity has grown less than 1 percent a year.

I think the factors responsible for that productivity slowdown are considerably more important than capital formation.

Senator BENTSEN. I agree with that, Mr. Bosworth. You are talking about the administration's projection. It is, as I recall it, four-tenths of 1 percent of productivity growth again for next year; isn't that right?

Mr. BOSWORTH. I think that the Congressional Budget Office projection is usually slightly more than the administration's. The administration's forecast anticipates only about a six-tenths percent growth in productivity over the next year, so it is a little bit better.

I think that there is a variety of factors responsible for that productivity slowdown that we have to address.

One of the problems is that we do not completely understand why productivity has slowed down the economy to the extent it has in the last decade. We can only list some of the major factors.

In the first part of the period, I think it is difficult to argue that it was caused by capital formation, because of its historical peaks in 1974. Yet the slowdown in productivity growth can be traced well before that period.

We have had a very rapid growth in the labor force over the last decade that has tended to give us a young and inexperienced work force. We expect that to be a sort of transitory factor as we look forward to the 1980's as these workers reach their more productive years, and it should result in some improvement in productivity.

Since 1974, however, I think capital formation has been a poor factor. It has not been strong, particularly, in the area of the development of the new plants to be disposed of, or existing plants since large productivity tends to occur principally when you have a new plant being constructed.

Another major factor that we should identify has been the rapid growth in U.S. Government regulations dealing with such objectives as improving the environment and worker health and safety. These regulations have had a lot of noneconomic benefits, but their costs show up in terms of the economy as a decline in the measured rate of growth for productivity.

If I were to put numbers on it, I would think some were around three-tenths to four-tenths in our studies of the productivity growths, due to the capital formation, something on the order of

magnitude of about four-tenths, due to the shift in the composition of the work force, and some were around three-quarters of 1 percent for currently occurring conditions, because of the impacts under the Federal regulation.

The second problem that has to be addressed is to find a way to accelerate that productivity, if we are to do something about inflation.

Another area closely related to such regulatory costs lies in the responsibility of Government. All the special legislation that has been passed in recent years, such as the actions being taken to protect individual groups from both foreign and domestic competition, the attempts to guarantee minimum wages in all these actions, has been adding very considerably to the inflationary pressure in recent years, and adding to that momentum of inflation that has built up over the last decade.

The administration's program has been designed to try to deal with all of this. First, however, I want to discuss how that program can be successful in braking the momentum of the private sector.

I think there are two approaches that we can all agree would work. One is extreme fiscal and monetary restraint, which will succeed in braking this inflationary momentum. The other option would be wage and price controls. However, we have not adopted either policy because of the tremendous costs that they bring to society as a whole.

First of all, with respect to fiscal and monetary policies all you have to do is look back at the past recessions. They were extremely expensive in terms of unemployment.

Trying to break the current inflation by sole reliance on the fiscal and monetary restraints to put the economy into a severe recession would raise unemployment costs to an unacceptable level. Our own indications are that we would like to try to reduce the current rate of inflation to one-half of its current level in the next 2 or 3 years.

Another way of looking at it is on the basis of past historical experience; it would cost the country about 1 million people unemployed for about a 2-year period to bring inflation down 1 percentage point. That cost is too high.

At the same time, I think that wage and price controls could deal with inflation. But again, I think the cost of those policies are far too high. We would create distortion and other problems in the economic system that made people so mad about inflation to begin with.

I don't think the Government has the technical expertise to set prices in an economy as complicated as ours, and I think that both equity and political considerations say the Federal Government should never get involved in the business of trying to set individual wages.

The problem with wage and price controls is simply that they are too complicated. We have no mechanism to apply them in a fair and equitable fashion. Therefore, I think we are forced to something in between.

It seems to me the current policy combines two approaches to brake the momentum. First, fiscal and monetary restraints to slow the inflation, but not a fiscal and monetary restraint so severe as

to reverse the progress that has been made in reducing unemployment in current years. The intent of this fiscal and monetary policy is to relieve inflationary pressures by holding the economy at the current levels of operation. We do not want to go backwards, but at the same time we admit that we cannot continue to expand the way we have been expanding in recent years.

Second, we are adding to that some voluntary measures to see if that fiscal and monetary policy can be translated in a greater amount at less cost in terms of unemployment than would be the case in the absence of those standards.

I think the combination of those two policies can gradually, but certainly not overnight, result in substantial moderation of wage and price inflation. At the same time, though, we must begin to deal with the longer term problems of trying to accelerate productivity growth in the economy to offset wage increases and find a means to deal with special interest legislation.

The impact of that program at present, and all the economic forecasts agree, is that our economy will be slow for substantially the rest of this year. Most of the foreign economists also seem to agree, although they may quarrel about whether or not to call it a recession.

It is far too early to see success or failures in any of the price indexes of that program, but I think today's announcement of the CPI reinforces the concern that the administration has had with inflation and how serious a problem it is.

For the next several months, I think we will see very rapid increases before this program can expect to have a bite. Some of the problems in the current months are because of the very strong and unanticipated rate of growth of the economy with real GNP on annual rates.

That should moderate later in the year, but certainly in the last couple of months excess demands pressures have added to the current inflationary pressures. I think it will be noted in the very high level of corporate profits for the first quarter of 1979. There are three areas that lie somewhat outside the standards that present special problems. First of all, we have had extremely rapid, almost explosive increases in food prices. Meat prices, in particular, and even more particularly than that, beef prices, have been going up at a remarkably rapid rate. Our estimates show those prices are more than 40 percent above corresponding levels a year ago.

We are also going to continue with the serious excess demand problem in the housing area, with prices rising over 11 percent a year. In that kind of an excess demand situation, there is almost nothing the Government can do in the short run to relieve the current shortages of housing that have accumulated over the last decade.

Third, the Iranian oil situation exacerbates the tremendous problem we will face in the next year with sharp substantial increases in energy prices.

All three of these mean that even if the average American worker does cooperate with this program, he is going to be faced with large and substantial increases in the basic necessities that make up such a large proportion of his budget. That is the reason I think if we are going to ask workers to go along and take a chance

on this voluntary program to cooperate to the extent that they so far have, the administration's real wage insurance proposal is extremely important to the effectiveness of this program. We want to get some protection to those workers who are going to have to go first, and are going to have to take the hard actions to restrain their wages. There is a sharp difference between the risk that workers are exposed to in trying to moderate inflation than a business firm is. American business firms can say they will go along with this program, and if it does not work out 6 months from now, they can raise their prices. When American workers sign labor contracts and say they will go along, however, they don't have the option to negotiate in 6 months if inflation doesn't fall. If we expect them to cooperate, I think we must address that issue.

The program has come under attack in several areas; one, as the chairman mentioned earlier, is with the use of the Federal procurement policy. This is not directly the responsibility of the Council on Wage and Price Stability. The issue was raised by the AFL-CIO yesterday, and it has been raised repeatedly by various groups who say they will take it to court. I only point out that the administration has received a legal opinion from the Justice Department. The program is being done because it is good for Federal procurement, and the Federal Government should try to aim its purchases away from areas of the economy where prices are rising rapidly. That is the intent of that program.

It can have enormous benefits for the Federal procurement in future years, because one of the reasons the Federal budget is rising as rapidly as it is is the enormous inflation that has been occurring in recent years by government.

Anything that we can do in the Government to moderate that inflation of those goods will hold down future procurement costs.

I think this issue will be tested in court. Ultimately the court will have to resolve the issue. This same approach was taken with equal employment opportunity back in the 1960's, and the same challenges were made. The courts have upheld the legality of the measure, that under the Federal procurement program the Federal administration does have the authority to use it as long as it applies it in an equitable and fair fashion.

Second, the January wholesale price index indicates another problem with this program that has developed on the price side. I would evaluate our success so far in trying to get people to go along as good, despite the deep concern of a lot of labor leaders about whether or not this program will work. On the price side, I think we have received a great deal of cooperation and support for the program by the largest of American industrial firms. Our reading of the January wholesale price index shows that two factors contributed to that sharp increase: One, some notable excess demand pressure; and, second, it appears that some smaller companies and intermediate sized companies have taken advantage of the current situation, and have moved some of their price increases forward that they would normally take later in the year, either because they expect controls or because of other concerns. We have a problem in getting smaller and intermediate firms to accept this program.

I think the administration's response to that has to be to set up and implement more rapidly than previously planned the monitoring efforts by the Council on Wage and Price Stability.

We are trying to move more rapidly to implement that part of the program to identify those components of the price index that will be released today. We will show the most rapid increases, identify the companies who are producing those products, and, contact those companies to inquire whether or not their overall pricing policies are consistent with the administration's program.

It will take a couple of more months, I think, to get a reading on whether or not this monitoring effort can be successful in the smaller and intermediate companies. However, our own check on prices at present indicates that the difficulty is not due to the larger corporations. Those companies that pledged earlier this year to comply with the program have tried to go along with it.

Thank you.

Senator BENTSEN. Thank you very much, Mr. Bosworth.

[The prepared statement of Mr. Bosworth follows:]

PREPARED STATEMENT OF BARRY P. BOSWORTH

Mr. Chairman and members of the committee, I am glad to discuss with you the broad policies that the Council on Wage and Price Stability intends to pursue over the next nine months in carrying out the President's anti-inflation program, and what we have accomplished during the first 3 months. I will keep my prepared remarks brief, so I can answer any questions you may have.

We've almost finished the first stage of the program. After receiving and analyzing the numerous comments from the public on the initial standards and after many meetings with both business and labor groups, we have issued the final wage and price standards. In addition, we've issued special guidelines for retailing, food processing, professional fees, insurance, petroleum refining and for Federal, State and local governments. These standards were tailored to meet the special characteristics and problems of these sectors of the economy. We expect to issue standards shortly on utilities generally and electric utilities in particular. I will be glad to discuss with you any of these particular problems.

The regulatory review process the President promised in his message of last October 25, has been set in motion. The Regulatory Council, which is, of course, not part of our operations, has been organized to assume first-level responsibility for this effort. Its first task is the preparation of a regulatory calendar, which will, I understand, be issued this month. This will provide the Council on Wage and Price Stability with a systematic basis for planning an orderly review of pending regulations. We will be able to meet, more effectively than we have in the past, our statutory obligations to intervene in regulatory proceedings, both on our own behalf and on behalf of the Regulatory Analysis Review Group.

Regulations have been issued governing the use of Federal procurement policies to encourage compliance with the wage-price standards. While enforcement of this policy is the responsibility of the Office of Federal Procurement Policy, the Council on Wage and Price Stability will be directly involved in certifying compliance.

Although the procurement aspect of the program is not the Council's responsibility, there are a couple of observations I'd like to make for the record. First, the Department of Justice has advised us that the policy is legal. Second, the policy makes sense. To the extent that we succeed in using procurement to encourage business to hold down its prices in compliance with the standards, we advance the cause of reducing inflation, and at the same time realize savings in Federal expenditures over the long term. Twenty-two of the country's top 25 contractors have already pledged compliance with the standards; and we are now discussing with the remaining three the problems they may have.

THE STANDARDS

I'd like now to discuss the Council's main role in the anti-inflation program: the implementation and the monitoring of the voluntary wage and price standards.

The anti-inflation program was developed on the premise that monitoring efforts will concentrate heavily on those sectors of the economy dominated by large firms

and large employee groups, that have the greatest discretion in wage and price decisions.

Firms with annual net sales or revenues of more than \$500 million have been asked to file data relating to base period price changes, along with information pertaining to profit margins, in case they should later argue that they are unable to meet the price deceleration standards.

There are about 750 firms in this category

From our contacts with individual firms thus far, there is every reason to believe that the overwhelming majority of these companies will comply with the objectives of the program. Next month we will begin to publish a regular report on the extent of compliance with the price and pay standards. Since the first six months of the program year will be completed in March, we will also be able to begin to identify specific situations of noncompliance with the standards and to identify any individual firms that fall into that category.

In addition to the reporting requirements for the largest firms, companies with annual net sales or revenues of between \$250 and \$500 million are asked to file with the Council their organizational structure for compliance purposes and the revenues of major lines of business for each company treated separately. There are approximately 600 firms in this category.

The reporting requirement for companies with sales or revenues between \$250 and \$500 million serves three purposes. First, it is a signal that smaller companies are aware of the anti-inflation program. Second, it provides a basic reference for monitoring any suspected violation of the pay and price standards by smaller firms. Finally, it requires a company to make basic organizational decisions in advance of the monitoring period and discourages later organizational decisions that would serve as a subterfuge to noncompliance.

Organizations with more than 5,000 employees have been asked to indicate the method they will use for computing pay-rate changes during the program year or, in the case of government entities, to make a statement that they will comply with the program. About 850 firms, governmental units and organizations are expected to be in this category.

Beyond this, the Council will carefully follow developments in major collective bargaining agreements and provide public analyses of how those agreements square with the anti-inflation program's pay standard.

I am aware that there has been criticism that these procedures will place enormous reporting burdens on firms and that the Council staff will be swallowed up in paper work. I am confident that this will not be the case.

The data that the Council has requested is designed to satisfy several basic needs. First, if these firms do intend to comply with the program, they will need to establish an organizational structure for purposes of measuring their compliance and compute their base period rate of price increase. Since they should be doing this in any case, the Council's request should involve no extra work and only verifies that they have set up a system to measure their compliance. Also the Council must know the base period rate of price change if it is to evaluate a firm's performance. In addition, the Council has asked for information on the firms' major product lines (in a form that would correspond generally to the Standard Industrial Classification). Since CWPS' monitoring efforts are focused on market prices, it is necessary to have a list of individual companies that are active in those markets. Finally, the Council has asked for information on profit margins since some firms may resort to that exception as the year progresses. We have tried to adhere to well-known accounting definitions of the SEC to minimize the reporting burden.

The pay and price standards are explicit. In keeping with the voluntary nature of the program, however, there is a measure of flexibility to meet the differing needs of specific situations. And there are, of course, necessary exceptions.

Raw farm commodities, the first sale of imported goods, interest rates, and crude oil and natural gas, are exempt from the price deceleration standard for individual firms. We do not believe that individual farmers set farm prices, for example. This is not to say, however, that they will not be affected by the overall anti-inflation program; farm prices will be monitored on a market-wide basis. If price increases in excess of the overall inflation rate are not justified by cost increases, we will seek to find appropriate government action to expand supply and thus moderate price increases. As we succeed in reducing the rate of inflation, the price of imported goods will fall. Fiscal and monetary restraint, as it reduces aggregate demand, should reduce pressure on interest rates.

Refining and distribution of crude oil are covered by the standards. The prices at which crude petroleum and natural gas are sold are already controlled by the Department of Energy.

I am convinced that widespread adherence to the price and pay standards will have a very significant effect on the rate of inflation this year. If every company in the U.S. economy were to adhere precisely to the price deceleration standard, we estimate that the program year inflation rate would be about 5¼ percent. This figure is obtained by deducting one-half a percentage point from the 6¼ annual rate of increase of the Consumer Price Index, excluding food, during the 1976-1977 base period. Because of raw material price increases and other factors, however, not all firms will be able to achieve price deceleration. To comply, these firms will have to use the profit-margin exception, which allows cost increases to be passed through on a percentage basis up to 6½ percent on a dollar-for-dollar basis thereafter. Given full compliance with the price standard, including application of the profit margin exception, our estimate is that inflation would be about 6½ percent for the year.

This figure assumes full compliance with the pay standard and an adjustment for productivity growth.

With full compliance with the pay standard, the Council estimates actual private hourly compensation costs will rise about 7¼ percent over the year. When mandated Social Security cost increases are included, total compensation per hour will rise about 8¼ percent.

But when 1¼ percent for productivity increases is deducted, unit labor costs will rise about 6½ percent and result in a 6½ percent increase in prices. This is not meant to be an inflation forecast, but rather a statement of the program-year inflation objective assuming full compliance with the standard.

At this point in time, I am really encouraged by the response we have received. The overwhelming majority of business firms has indicated a willingness to support the program. Whether this will translate into actual price deceleration, we will have to wait and see. My judgment is that it will. There has been a lot of rhetoric, in addition, about how labor groups do not like the program and will not cooperate with it. No one likes to be asked to reduce wage demands in our present economic atmosphere. But as we monitor wage changes around the country, we find that almost everyone is cooperating with this program. One of the most visible developments in the past few weeks was the settlement with the Oil, Chemical and Atomic Workers. The two-year contract signed reflected pay increases averaging less than 7 percent per year. This settlement was reached and without a strike. I think we will find that most workers want the program to work. But, understandably, they need to be convinced that others are cooperating and that they are not going to be left holding the bag.

The difficulty of providing such assurances must be faced by any voluntary program of pay and price restraint. Workers are particularly vulnerable, since their pay rates are determined once a year, or in the case of collective bargaining agreements, once every several years. Yet firms can adjust their prices very quickly to changing economic conditions. I believe that the real wage insurance proposal is an important response to this concern and, as such, is an important element of the anti-inflation program.

Quite obviously we are not going to solve overnight a problem that has been gaining momentum for 10 years. It is equally obvious that to attempt to solve it quickly by throwing a lot of people out of work would not be the answer.

Because the reduction of inflation will require an effort that stretches over several years, there will be a need to reduce the standards in future years as the inflation abates. The selection of specific targets for future years must await an assessment of the performance of prices and pay rates during the first year. Several characteristics of those future changes should be indicated now, however, if the anticipation of such actions is not to have a perverse impact on current prices and pay actions. First, the base period will not be extended forward to include the current program year since such an action would penalize those who achieve the greatest deceleration in the current year. Second, the standard for price changes will be a cumulative one that includes the results for the first year of the program.

This is a comprehensive program that will require the contribution of everyone and will require several years to succeed. But, if the Congress will join with the Administration in providing strong leadership, I believe it can succeed.

Senator BENTSEN. Our next witness is Leon Keyserling, former Chairman of the Council of Economic Advisers. We are pleased to have you and your testimony this morning. If you will limit your oral remarks to 15 minutes, we would appreciate it. Your testimony provokes some questions that we want to get answered.

**STATEMENT OF LEON H. KEYSERLING, FORMER CHAIRMAN,
COUNCIL OF ECONOMIC ADVISERS, AND PRESIDENT, CON-
FERENCE ON ECONOMIC PROGRESS**

Mr. KEYSERLING. Mr. Chairman and members of the committee, I would like to have my prepared statement inserted in the record. Senator BENTSEN. We will take it in its entirety.

Mr. KEYSERLING. I will certainly try to confine myself to 15 minutes.

I must say, first, that the views I will express here today are not the majority view among economists, but I have always had confidence in the judgment of this committee to weigh what is said and not to count noses.

I must also say, not pridefully, that I have had more than a little experience in this subject. I was very active in the economic program during World War II, which accomplished miracles in the production and employment, and contained inflation.

Stabilized prices have not been mainly in consequence of price-wage controls but due to maximizing production and employment, and never fall into the trap of thinking that we can reduce inflation by striking hammer blows at the basic performance of the American economy in terms of production and use of goods and services.

During 7 years under President Truman, we faced more difficulties of all kinds than at any time since, and we brought inflation down to 0.8 percent and employment down to 2.9 percent, again, by rejecting the tradeoff and by calling forth huge increases in employment and availability of goods and services.

Since then I have watched the situation continuously, and before this committee and elsewhere I have evaluated each of the efforts to avert or reduce inflation.

Each time I have made the same criticism as I am making now, each time against the policies which are being followed now, and each time these policies failed their avowed objectives.

On the basis of this experience, I have some general conclusions and I am sorry to have to state them. The policies advanced by President Carter fill me with trepidation about our country's future—they will make inflation worse than it would otherwise be, weaken the dollar and worsen our international balances; strike hammer blows at real economic growth, production and employment, and aggravate unemployment; stifle productivity growth.

Such policies are defeatist; they sell America short, and, if perpetuated, they would reduce us to a second-rate economic power and third rate in our attention to human and social needs.

Now, I cannot discuss the problems of inflation without discussing the other damage done to the economy by the current anti-inflationary program, if for no other reason than it is my thorough proposition, supported by all the empirical evidence, that this other damage has been before and will be again the predominant cause of the inflation itself.

In the first place, the President is endeavoring to stop inflation by driving unemployment upward substantially, by cutting the real economic growth rate in half and by projecting a real economic growth rate of 3.8 percent over the next 5 years.

The first trouble with this is that the President cannot reach his goal of 4-percent unemployment by 1983 with his policies and programs, and I have much material in my prepared statement and in my charts attached to it to that effect.

In the second place, his program is unsatisfactory because the policies and programs which he presents cannot possibly attain even his own goals, and I trace the consequences of that and I estimate that his program will lead us to 6.5-percent unemployment rather than 4-percent unemployment by 1983.

The President's proposals are avowedly designed to raise the rate of unemployment to 6.2 percent during 1979 and 1980, while it needs to be reduced to 5.6 percent in 1979 and 5.1 percent in 1980, to get to 4 percent by 1980. For 1979-83 inclusive, I estimate that the President's proposals would mean 7.8 million more unemployment and 16.7 million less employment than the administration's policies and programs in accord with the mandated 4-percent unemployment by 1980 in accord with the Humphrey-Hawkins Act. The difference between the unemployment and employment estimates is that the civilian labor force grows much more rapidly when the economy is moving forward at a satisfactory pace.

The second point I want to talk specifically on is the matter which the chairman raised a question about.

I agree with the administration's goal that investment over the next 2 years has to grow much faster than other sectors. This is always true in a period of sound recovery. But the ratio between the investment goals which the President sets and practically no growth in consumption, an actual decline in real wages, a 1-percent growth in Federal purchases, a repressive tax policy and so forth and so on, and a repressive monetary policy, cannot activate nor sustain the 4-percent growth rate in investment which the President projects.

It has never happened that way; it can never happen that way.

There is no way to get a good and sustained increase in investment in the face of the cutting of the economic growth rate in half, in the face of the contrived economic stagnation, in the face of business recognition with which most economists agree that an absolute recession is probably on the way, and in the face of a demand for products being held to one-fourth the rate at which the administration expects investment to advance.

This is a death knell for investment growth.

If the economic development is as most economists expect under the President's program, there will be a sharp decline in investment because investment is the most volatile part of the economy and that is the way it always happens.

I have not heard this morning, nor have I frequently heard, any recognition of the basic reasons for the productivity decline.

Of course, we should be concerned about this, and I have repeatedly called attention to it.

The basic cause of the decline in productivity is not the availability of capital, nor is it unskilled labor. The basic cause of the decline in productivity is that productivity always declines to 2 percent or 1 percent or zero when we have a large slack in the economy in terms of high unemployment and low utilization of plant capacity.

The reason for that is very simple but I don't have to give any of the reasons because the empirical evidence is there and a pound of history is worth a pound of logic.

In an index of 100 represents plants operating at 92 percent of capacity or full utilization, and actual utilization is only 82 percent, you have an 11-percent slack in the use of capacity, but fortunately you don't fire 11 percent of the workers. You may fire 6 percent, so the index of labor utilization falls from 100 to 94.

With a 94-percent index of employment and an 82-percent index of plant utilization, the division of one into the other shows a short decline in the productivity performance.

Technologically, the productivity potential is advancing all the time. The productivity potential over the years has accelerated and this is attributed to the genius of the American economy so the reason that the actual productivity growth rate is so low is because the utilization of labor in the plant is so slack, not the quality of the labor.

The quality of the labor does not change much when the index of the use of employed labor rises, but the productivity growth rate shoots up under such conditions.

Thus, cutting the real economic growth rate in half deliberately, which reduces the utilization of employed labor, is going to reduce the productivity growth rate far below the low figures of today.

I have charts in my prepared statements on this. I cannot understand, in the face of the unanswerable evidence, that the official economists never turn to a simple explanation which every businessman I talk to recognizes as to why productivity is so low.

Now I come to the matter of the battle against inflation. We have to talk a little history.

We came into early 1953, as I have said, with 2.9 percent unemployment and 0.8 percent inflation.

When Arthur Burns then came in as my successor—I do not criticize him personally—he was worried that the inflation rate was too high and the unemployment rate was too high, and through fiscal monetary policies which he influenced on the theory of the “tradeoff” the unemployment rate rose from 2.9 in 1953 to 7.6 in 1961 and the inflation rate multiplied 2½ times.

I am not talking politics—I am now criticizing a Democratic President.

During 1961-66, under Kennedy-Johnson and Walter Heller, the inflation rate was held to 1½ percent a year, and unemployment was reduced from 7.6 to 3.8, and then another set of policies came in and we know the history since.

It has not been the Arabs, it has not been “special favors” that have made the underlying rate of inflation so very high. Economic slack has been two or three times as high as when we had reasonable price stability.

My charts trace that all the way through.

Now I want to give a few of the reasons for this, and I want to read them from my testimony because the reasons make clearer the empirical evidence.

Reason No. 1 is that we have a largely administrative price economy, and I am not saying this critically.

When sales are slack the effort to reach profit targets without an adequate volume of sales leads to faster increases in prices in basic industry than when volume is high.

I have traced this through in almost every major industry over 20 years, and it is true.

In the second place, the economic slack drops productivity growth, which correspondingly raises the per unit labor costs, so you have to have a higher price to cover those higher labor costs.

In the third place—and this is dramatically illustrated by the President's program—the philosophy of economic scarcity which leads to slack use of resources is evoked in those very areas where the biggest inflation is.

Take housing. The President's reports predict that housing starts may go as low as 1.1 million by the end of next year, and Government policy is a very important factor in that.

I wrote a book on "The Coming Crisis in Housing" just before the 1974 recession and predicted exactly what would happen and what it would do to the economy and to inflation. Just that happened.

It is going to do it again. There is nothing more inflationary under the present circumstances than the cutting in half of the rate of housing production.

The same thing is true with other areas of the economy. Energy—I represented the utilities for many years when I was a private economist.

I forecast the shortage long before we heard of the Arabs because the high interest rates—claimed to check inflation—were costing so much there was not much left over to invest in exploration and facilities.

If you run across every area of the economy, you find an intimate connection or the umbilical cord tie between the contrived shortages of the economy and the increased rate of inflation.

Now, what should we do? It is obvious. We have to alter national economic policies drastically. The current policy in its major ingredients—money policy, housing policy, tax and spending policies, guidelines policy—is an almost exact replica, with slight adjustments, of the policies used before each period of stagnation or recession. It happened five times, and we have learned nothing.

The Government needs a new "department of experience."

Reversing the course, we have got to get some congressional influence toward changes in the money policy—lower interest rates, and through the selective use of credit which we have had before, pinpointing the points where credit is needed most instead of making it most easily available where it is needed least.

We need to have a rearrangement in the spending policy, more adjustment to servicing the national priorities. We need to point Federal outlays to where the shortages are and so forth, and so on.

Well, thank you very much for your attention. I am sorry to have been so critical.

Senator BENTSEN. Well, you will be counted and there is no reason to regret it.

We are glad to hear your comments.

[The prepared statement of Mr. Keyserling follows:]

PREPARED STATEMENT OF LEON H. KEYSERLING¹*Why the President's Anti-Inflationary Policy Won't Work*

Mr. Chairman and Members of the committee, the policies advanced by President Carter in his January Economic Report and Budget Message fill me with trepidation about our country's future. They will make inflation worse than it would otherwise be; weaken the dollar and worsen our international balances; deliberately strike hammer blows at real economic growth, production, and employment and aggravate unemployment; and stifle productivity growth. Such policies are defeatist, sell America short, and if long perpetuated would reduce us to a second rate economic power and third rate in attention to human and social needs.

The President's core purpose is to reduce inflation, but the means chosen are so inimical to that purpose and so calamitous in themselves that they should be treated first. The short range goal is deliberately to reduce the rate of real economic growth from 4.3 percent in 1978 to an average of about 2.7 percent for 1979 and 1980, and to lift unemployment from 5.8 percent in December 1978 to 6.2 percent in 1979 and 1980. Thereafter, it is claimed, the growth rate will average 4.4 percent for the next three years, or 3.8 percent during 1978-1983, thus reducing unemployment to 4.0 percent by 1983.

These Administration goals are egregiously too low, because empirical evidence since World War II demonstrates that an average annual real economic growth rate of 3.8 percent cannot bring us anywhere near to 4 percent unemployment by 1983. The average would need to be about 5.5 percent, which in terms of relevant experience is moderate and practical from so high a base of unemployment and unused capacity.

The Administration's goals are also unattainable in practical terms because of deficiencies in policies and programs which I shall discuss in detail. Alice Rivlin testified before a House Subcommittee on February 13 that unemployment in both fourth quarter 1979 and fourth quarter 1980 might be as high as 7.2 percent under the Administration's policies and programs. And even if the Administration achieved its growth rate averaging about 2.7 percent from 1979 to 1981, the empirical evidence is that a 7.2 percent rather than 4.4 percent average would be needed during the next three years to reach the 4 percent 1983 unemployment goal. That 7 percent rate has never been approximated for even one year during the past quarter century, and would require policies and programs diametrically opposed to those which the Administration projects.²

My estimates are that actual growth under the Administration's policies, which will be considerably lower than its deficient goals, will lift unemployment from 6.2 percent at least in 1979 and 1980 to 6.5 percent in 1983 (barring intervening recessions). To get unemployment down to 4 percent by 1983 in orderly fashion would require reducing unemployment to 5.6 percent in 1979 and 5.1 percent in 1980. In absolutes, I estimate that the Administration's policies and programs would lift unemployment to 6.9 million in 1983, while 4.4 million would be consistent with 4 percent unemployment. The differentials in the amounts of unemployment between the two courses would rise from 500 thousand in 1979 to 2.5 million in 1983, for a five-year difference of about 7.8 million; the differentials in employment would rise from 1.4 million to 5 million, or about 16.7 million over the five years.³ The five-year difference in GNP would be almost 820 billion 1977 dollars.

These are losses neither our economy nor our people can stand, coming on top of a roller coaster performance from 1953 to 1978 which caused us to forfeit about 6 trillion 1977 dollars in GNP and more than 76 million man-woman-and teenager-years of employment opportunity.⁴

Although my estimates of needs and potentials are supported by the empirical record, while the Administration's goals seem to me and many others pie in the sky under its policies and programs recommended, sheer common sense also comes in. The proposition that the economy will be made better off in the long run by making it worse off in the short run, that business confidence will be augmented by a long period of economic stagnation with likelihood of recession, that the rescue of people struggling in deep water should begin by keeping more of them under for two years longer, violates every rule of reason and experience. Each of the five stagnations

¹ Chairman, Council of Economic Advisers under President Truman. President, Conference on Economic Progress.

² See chart 1.

³ Differences in size of differentials due to greater growth in civilian labor force under more favorable economic conditions.

⁴ See chart 2.

since 1953 has led into recession, and usually progressively severe recessions, before the upturns commenced.

Further, the Administration's entire policy is in flagrant violation of the Humphrey-Hawkins Full Employment and Balanced Growth Act of 1978, recently enacted by a majority of 105 in the House and 4 to 1 division in the Senate, and then signed by the President with the promise to implement it vigorously and forthrightly. No competent lawyer in America can, and I think no Member of the Congress whose vote indicated support for the objectives of the Humphrey-Hawkins legislation will, find anything in the legislation itself, or the legislative history in hearings, Committee Reports and floor debates, to support the proposition that efforts by the Administration to reduce unemployment should avowedly commence in the third year rather than the first year or that the best way to get from Chicago to San Francisco is to start by moving for two years from Chicago to New York. Nothing could more undermine economic and business confidence than to blare forth that comprehensive economic legislation enacted in 1978 becomes meaningless in early 1979.

The President's economists claim that a very subnormal economic growth rate can reduce unemployment to 4 percent by 1983 because of a chronic or permanent collapse in the rate of productivity growth. But the data conclusively demonstrate that the productivity growth rate has been very high when plant and labor force utilization has been moving vigorously toward, or near to full use, and vice versa. Defeatist about the real capabilities of our great economy, and apparently unaware that in a technological sense the productivity potential has been and still is advancing at an accelerating rate, the official economists are trying to deal with the productivity problem by forcing in aggravated form a recurrence of the very types of economic slowdowns which have always brought the productivity growth rate down toward zero or even made it negative. I have never witnessed anything more ridiculous than this, if it were not so tragic.⁵

The goals which the official documents set for balanced growth—a balance essential to sustained growth—have no credibility whatsoever. The goals for 1979 contemplate a real growth rate at a mid-point of about 2 percent for consumer expenditures, a mid-point of about one percent for Federal purchases, and a mid-point of about 4.25 percent for nonresidential fixed investment. There are also the official forecasts that housing starts could decline from 2.1 million in fourth quarter 1978 to as low as 1.1 million in fourth quarter 1979, and that State and local outlays could show a real growth rate declining from 3.5 percent in 1978 to as low as 1.75 percent in 1979. This crazy quilt of irreconcilable developments cannot possibly add up to even the very inadequate real growth rates in GNP projected officially for the first two years, much less for the five years as a whole. Fixed nonresidential investment growing two to four times as fast as the two other main components is hard to imagine and, if it happened, the results would be the same as when it happened before each of the four previous stagnations and then recessions since 1953.

More on the imbalances. The tax policy enacted in 1978, now relied upon by the Administration, is both regressive and repressive in its economic effects, especially when social security taxes increases get fully underway. The money policy is continuing along lines which five times helped bring on recessions, stunted economic growth, and enlarged unemployment. The wage-price guidelines, if effective, will have consequences stated so well by Business Week of February 19, 1979: "Even though weekly earnings are about 9 percent ahead of a year earlier, so are prices, balancing out any real gains for the individual worker. This pattern will worsen at least for the rest of the winter and into early spring", and "to the extent that the wage guidelines are effective, the change in real buying power will turn negative in coming months."

The President projects only a 1.4 percent average annual growth rate in the total Federal Budget in real terms from fiscal 1979 through fiscal 1983. I estimate the needed figure at about 4.7 percent, which is so much smaller than the needed GNP growth rate of 5.5 percent that it would reduce the ratio of the Federal Budget to the gross national product and would balance the Federal Budget by 1983. It is incomprehensible to me that the official economists have failed to note the glaring correlation between the size of the GNP gap and the size of the Federal deficit. Few economists now believe the President's goal of a \$29 billion deficit in fiscal 1980 can be reached under his policies. I estimate that these policies will result in an average annual Federal deficit of \$25.6 billion during fiscal 1980-1983 inclusive and \$13.6 billion in 1983 alone, while the economic growth policies which I recommend would mean an average annual deficit of \$14.3 billion during these years, a balanced budget in fiscal 1983, and a \$2.4 billion surplus in calendar 1983. Even more

⁵ See chart 3.

important, the President's policies forget that the primary purpose of the Budget is not to help stabilize the economy nor to balance itself, but rather to provide those priority goods and services which the economy and the people need but which, paraphrasing Lincoln, they cannot accomplish or accomplish so well in their separate and individual capacities. Current policies threaten to make us in due course a second rate nation in terms of economic strength, and a third rate nation in terms of exercise of basic human and social responsibilities.

Even if all the costs and tribulations set forth above purchased some gains against inflation, the price would be too high. We in the past have found means of controlling inflation by more sensible methods, under pressures far more serious than those which now exist.

But the President's program can do little against inflation, and is likely to make it worse than it would otherwise be. Alice Rivlin, in earlier referred to testimony, estimated that the Administration's policies would reduce inflation below the 7.2 percent rate in fourth quarter 1978 by only 0.1 percentage points in fourth quarter 1979 and only 0.2 percentage points in fourth quarter 1980. With meticulous regularity, experience since 1947 to date has demonstrated almost definitively that, in the main, there is an inverse correlation between the rate of inflation and the rate of unemployment.⁶ This is because the widest departures from full resource use (1) foment faster administered price increases, to compensate for low volume sales and to reach profit targets nonetheless, (2) bring higher per unit cost resulting from depressed productivity growth, (3) have induced "anti-inflationary" tight money policies which are inflationary per se, particularly in their impacts upon housing, fuel suppliers, and farm production and credit costs (these being areas where inflation is most severe), (4) have been accompanied by failure to use pinpointed public outlays to overcome other inflationary shortages, such as in medical care, (5) have a disuasive effect upon private investment, and (6) general lack of confidence flows from a roller coaster economic performance.

These are all reasons why the Humphrey-Hawkins law mandates specifically that "policies and programs for reducing the rate of inflation shall be designed so as not to impede achievement of the goals and timetables specified in clause (1) for the reduction of unemployment."⁷ The Congress realized that the so-called "trade-off", thoroughly discredited by experience, was an economic flop and a moral monstrosity. Today, the attempt of the President and his advisors to make the "trade-off" the main implement of national economic policy for five years ahead again flaunts the expressed will and intent of the Congress.

The lack of confidence in the dollar overseas, the deficits in our balance of payments and trade accounts, the competitive inroads upon our own markets, and the excessive flow of American capital abroad through multinationals and otherwise, are all based upon the fact that we are losing ground, both in economic terms and opinions of others based upon our social policies. Comparisons of our real average annual economic growth rates with those of such nations as Germany and Japan, since 1953 or since 1969, show what our international economic difficulties really stem from. And nothing could do more to decrease confidence in us overseas than cutting our own real economic growth rate in half and risking a sixth recession.⁸

The needed changes in national economic policies are really explicit in which I have said. We must fight inflation by building production and employment, not tearing them down. We must set more realistic goals; adjust policies more sensibly to their attainment; stop trying to balance the budget at the expense of the economy; improve the priority list for Federal spending; make the tax system more progressive by starting with cancelling out the social security tax increases; utilize Congressional pressures to reduce interest rates and revive selective monetary policies; stimulate more housing starts instead of allowing them to decline precipitately; and develop real budgets of needs and supplies for energy, food, and some other items. Practically all of these programs are listed in the Humphrey-Hawkins legislation, but the Administration has hardly touched them. By not doing these things, the Administration is shadow boxing against inflation, not punching away.

Most important of all, we must regain a sense of what America can and must do instead of do without, of what we need rather than what we cannot afford. Austerity and sacrifice are good things in their time and place, such as during World War II when every resource was overstrained. But what place do they really have, when almost all of our economic problems and social problems result fundamentally, not from economic overstrain, but from failing to use the available resources which are pleading to be used. The Administration's policies, in their current form, represent a shortsighted, small-minded, defeated, and deflated frame of mind and loss of nerve. This Committee and the Congress can help to change all that.

⁶ See charts 4 and 5.

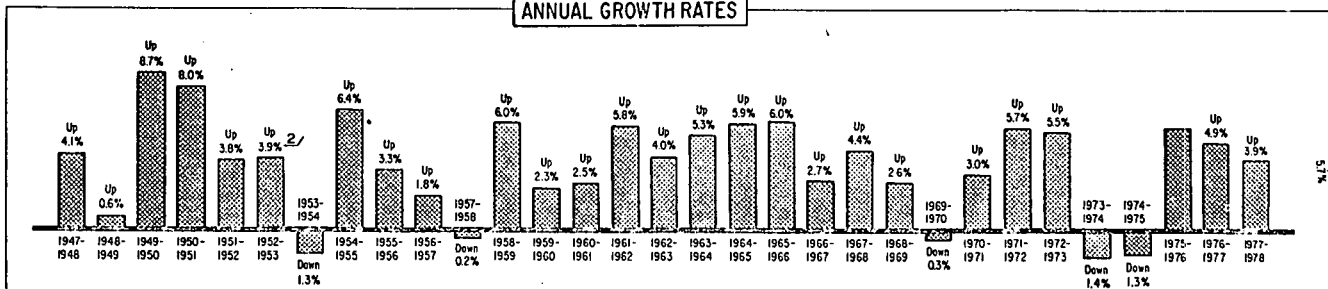
⁷ Section 4(b)(2) of the Employment Act of 1946 as amended by section 104 of the H-H Act.

⁸ See chart 6.

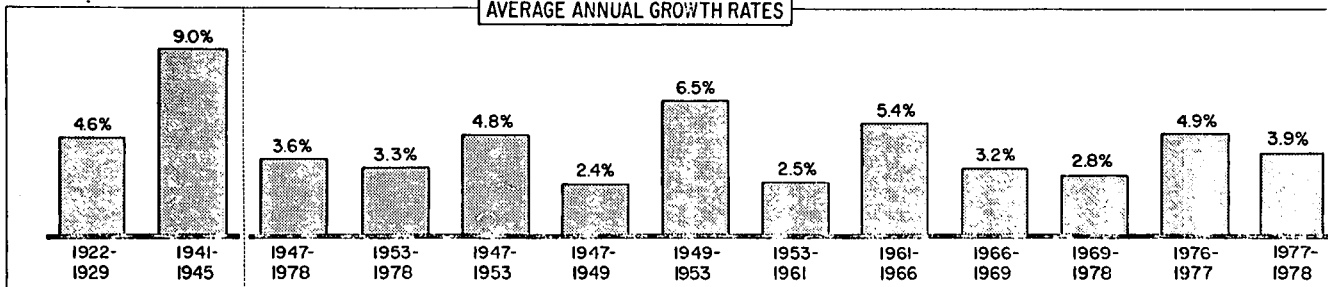
THE "ROLLER-COASTER" ECONOMIC PERFORMANCE: ECONOMIC GROWTH RATES, 1922-1929, 1941-1945, AND 1947-1978¹

(Uniform Dollars)

ANNUAL GROWTH RATES



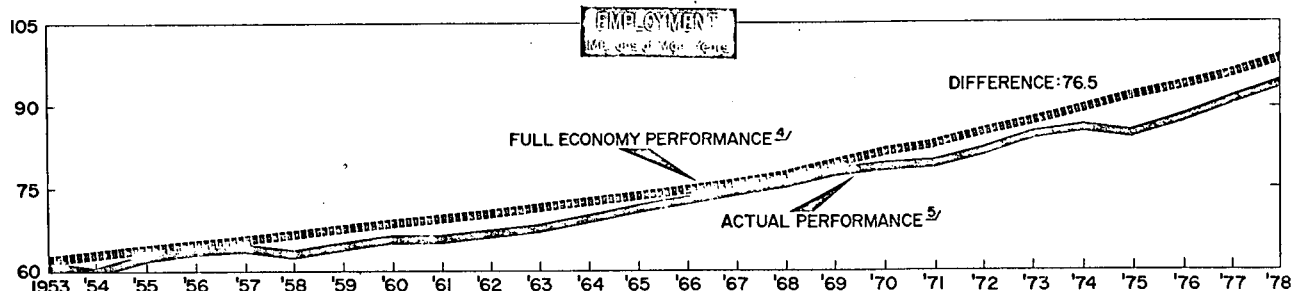
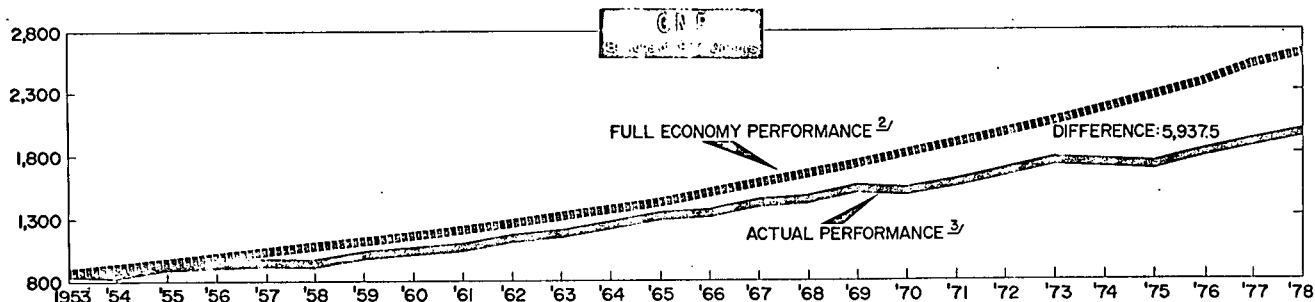
AVERAGE ANNUAL GROWTH RATES



¹1978 estimated.

²Recession during part of period. There were five recessions, 1953-1978, but some were entirely within one year, and began and ended in different years.

COST OF DEPARTURES FROM FULL ECONOMY, 1953-1978^{1/}



^{1/} 1978 estimated.

^{2/} Real average annual growth rate of 4.4 percent.

^{3/} Real average annual growth rate of 3.3 percent, the 1953-1978 average.

^{4/} Average true level of unemployment of 4.1 percent, or 2.9 percent full-time unemployment.

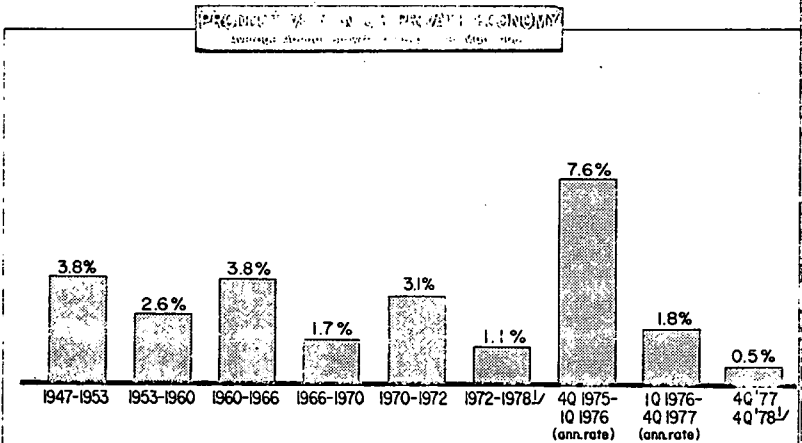
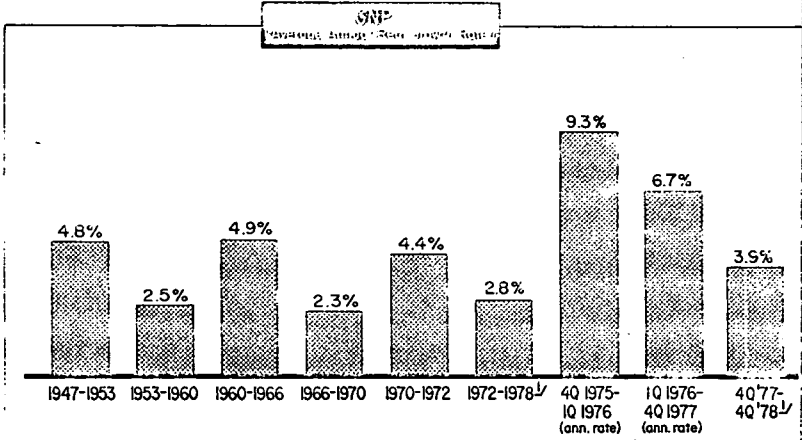
^{5/} Average true level of unemployment of 7.8 percent, or 5.2 percent full-time unemployment.

Basic Data: Dept. of Commerce; Dept. of Labor

IMPACT OF ECONOMIC GROWTH UPON PRODUCTIVITY GROWTH

Chart 3

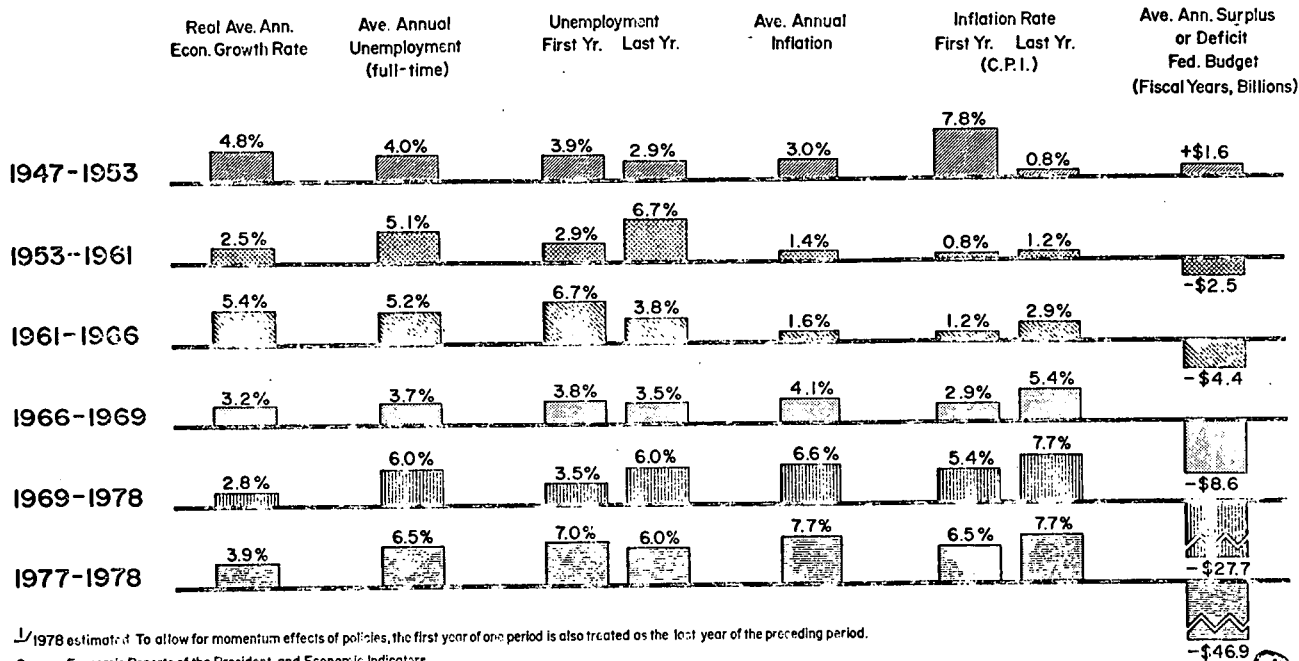
3



1/ 1978 and 4Q '78 estimated.

Source: Dept. of Labor, Dept. of Commerce

REAL ECONOMIC GROWTH RATES, EMPLOYMENT & UNEMPLOYMENT, INFLATION, AND FEDERAL BUDGET CONDITIONS, DURING VARIOUS PERIODS, 1947-1978^{1/}

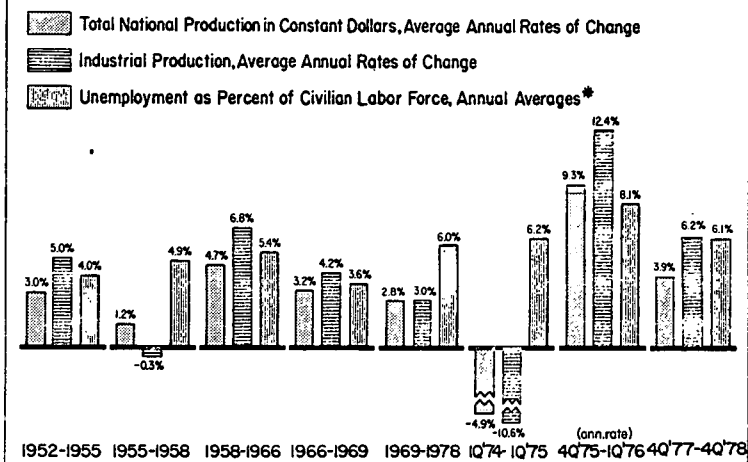


^{1/}1978 estimate. To allow for momentum effects of policies, the first year of one period is also treated as the last year of the preceding period.

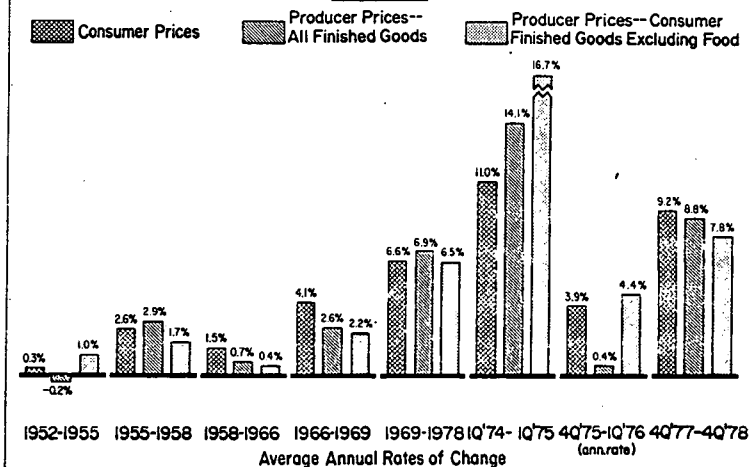
Source: Economic Reports of the President, and Economic Indicators.

RELATIVE TRENDS IN ECONOMIC GROWTH UNEMPLOYMENT, & PRICES, 1952-1978

PRODUCTION AND EMPLOYMENT



PRICES

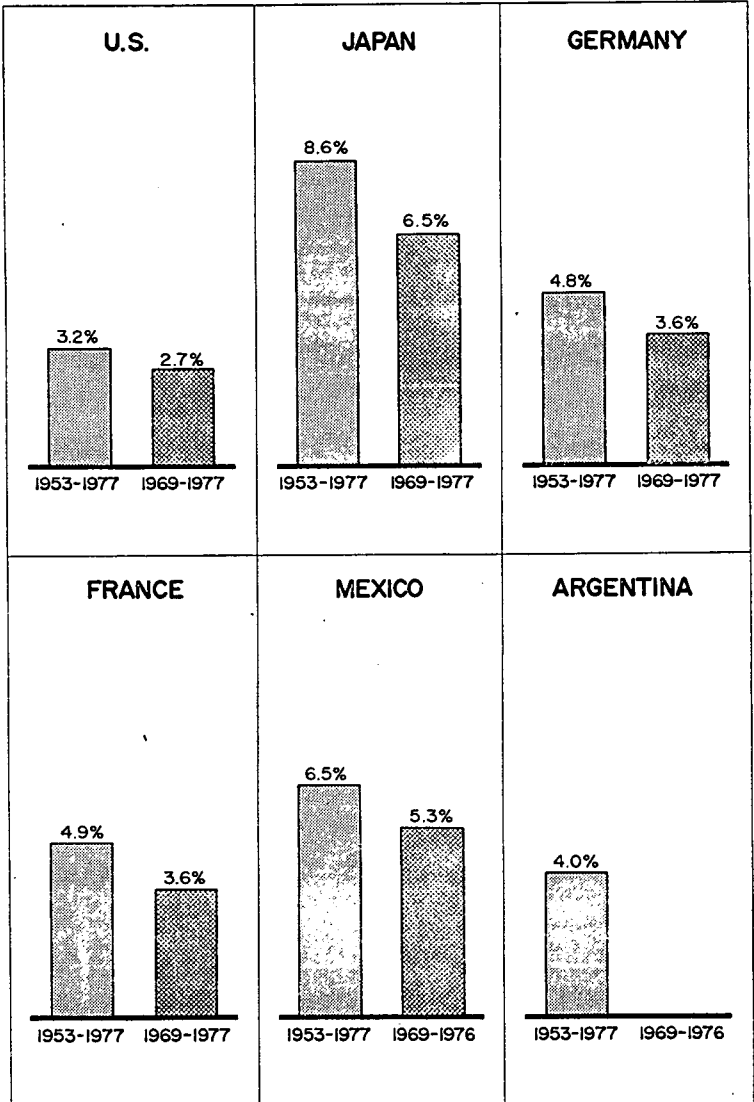


* These annual averages (as differentiated from the annual rates of change) are based on full-time officially reported unemployment measured against the officially reported Civilian Labor Force.

Source: Dept. of Labor, Dept. of Commerce, & Federal Reserve System

COMPARATIVE REAL ECONOMIC GROWTH RATES VARIOUS COUNTRIES, 1953-1977 AND 1969-1977¹

Average Annual Rates of Growth



¹G.N.P. for U.S., Japan, & Germany. Gross domestic product for all other countries.

Senator BENTSEN. Mr. Mitchell, we are pleased to have you this morning. We are pleased to have your testimony.

**STATEMENT OF DANIEL J. B. MITCHELL, SENIOR FELLOW,
THE BROOKINGS INSTITUTION, AND PROFESSOR, GRADUATE
SCHOOL OF MANAGEMENT, UCLA**

Mr. MITCHELL. Thank you, Mr. Chairman.

My name is Daniel J. B. Mitchell, I am a senior fellow at the Brookings Institution and a professor at the Graduate School of Management, UCLA. I would like to thank the committee for inviting me to express my views on current anti-inflation policies. I have provided the committee a 35-page prepared statement, detailing these views.

Senator BENTSEN. We will take that in its entirety and you can summarize it.

Mr. MITCHELL. Thank you.

My remarks today will be a brief summary of that statement.

Inflation has become the single most important economic issue facing the Federal Government. The general public is clearly distressed at the seeming inability of Government to overcome the problem. While economists can cite statistics showing that the average person has kept up with inflation, such figures miss the point. Inflation has created a climate of uncertainty. Long-term planning has become difficult. The investment outlook has become clouded. It is hard for anyone to plan for retirement or make any saving decisions.

Knowledge that inflation can induce Government to follow restrictive policies which will slow economic growth simply increases the uncertainty.

In this climate, the political leadership of this country will be tested. The public is looking for miracle remedies: proposition 13's and balanced budget amendments. Yet, there are no miracle remedies; if there were, they would surely have been implemented long ago. The most we can hope for is a gradual tapering off of inflation over a period of years. And such tapering could easily be offset or overwhelmed by such "exogenous" disturbances as the cutoff of Iranian oil and its resultant effects on energy prices.

Inflation has become rooted in the psychology of the American economy. There was a time—in the late 1940's and early 1950's—when the glimmer of recession could induce an actual fall in prices. There were many people at that time who remembered the Great Depression with its dramatic price declines. Perhaps they reasoned that it could happen again. But few people today believe that there will be much relief from inflation, whether or not there is a recession this year. Our current system of wage and price determination tends to perpetuate inflation, once it has begun. There is no way of setting the clock back to the 1940's or the 1950's. And that is why the guidelines efforts—if properly managed—can be an important element in a program designed to bring about a gradual reduction in inflation.

Both monetary and fiscal policy have moved toward a restrictive posture. The budget proposals of the Carter administration represent a cut in the ongoing rate of expenditures, a difficult-to-accomplish feat in the context of a system of outlays which is so heavily

“uncontrollable.” Despite the heavy emphasis in public discussions on the deficit, fiscal policy in the near term is primarily a matter of controlling expenditures.

In theory, the size of the Federal deficit might cause the Federal Reserve to expand the money supply in an effort to “fund the debt.” But, in fact, the Fed has been tightening monetary policy in order to defend the dollar exchange rate against other currencies and to resist inflation.

The current difficulty with monetary policy is that we don’t know how tight is tight enough, given changes in financial institutions. Because of this uncertainty, the Fed has been cautious in responding to short-term developments, and rightly so.

Monetary and fiscal policy can influence the rate of inflation. But their impact falls mainly on real economic activity. It takes a considerable rise in unemployment to produce a small reduction in price increases. That is why the administration has added wage-price guidelines to its anti-inflation program. The idea is to take advantage of the expected increase in economic slack and to promote a larger-than-expected reduction in the rate of inflation. Unlike some earlier efforts at direct-wage price intervention, the new program will not be operated in the face of strong economic expansion.

Public discussion of the guidelines has often centered on the issue of whether they would be turned into formal, mandatory controls. I find this issue rather empty: For larger firms and Government contractors, there is little distinction between so-called voluntary guidelines and controls. The new program is imposing obligations on the private sector.

It must be operated with those obligations in mind. In practice, this means that it must be adequately staffed so that questions can be answered and appeals can be heard. In practice, this means resolving the contradiction between a desire to deal only with large firms and unions and a program which nominally covers firms and bargaining units of all sizes. In practice, this means operating the program in a flexible manner so that economic reality penetrates the rules.

The last point is especially important. It is generally conceded that the key to the program is labor cooperation, whether tacit or explicit. If it turns out that inflation in sectors beyond the reach of guidelines—food prices, oil prices, and imports—is accelerating, consideration must be given to adjusting the wage standard.

The Kennedy-Johnson wage guideline passed into oblivion when it failed to recognize an acceleration of inflation. And the 5.5-percent standard of the Nixon administration controls went the same way, although perhaps with a little more grace.

We should learn from the past about the perils of a rigid stance in the face of altered circumstance.

Originally, the administration appeared to believe that its proposal for “real wage insurance” would permit a rigid guideline administered by tiny staff to weather any changes in economic circumstance. In testimony before the Senate Banking Committee last November, I warned that real wage insurance was not capable of such a role and that it was a complicated and ill-conceived plan.

On February 5, in testimony before the House Ways and Means Committee, I backed that warning with a detailed analysis of the real wage insurance plan. The plan is complex and filled with anomalies. Its rules differ from the guidelines so that it is possible to qualify for one program but not the other. It involves the IRS in assessing productivity bargaining and tandem relationships. It diverts resources to the small employer sector where wage pressures are not expected to be a major problem. And it draws Congress into ongoing collective bargaining negotiations.

Already, Congress has become an unwilling participant in the sensitive trucking and automobile negotiations. The budgetary costs of real wage insurance are uncertain and its incentive effects for bargainers are marginal at best. Over 4 months of the program year to which the proposal applies have already passed. Even the strongest proponents of the concept have never claimed that it would have retroactive effects.

A quick death for the real wage insurance proposal would be the optimum outcome. But, paradoxically, the second best outcome would be a quick birth with the plan put into effect essentially as proposed. The worst outcomes would be a slow death or a prolonged labor. We need to get on with the business of managing the guidelines.

Congress could be more profitably discussing the adequacy of the size of the staff of the guidelines program, the extremely comprehensive nature of the program, and the bridges to organized labor.

Thank you, Mr. Chairman.

Senator BENTSEN. Thank you very much, Mr. Mitchell.

[The prepared statement of Mr. Mitchell follows:]

PREPARED STATEMENT OF DANIEL J. B. MITCHELL ¹

Current Anti-Inflation Policies

I. INTRODUCTION AND SUMMARY

The current inflation problem has persisted for over a decade.¹ If there were an easy miracle cure for inflation, common sense suggests that it would already have been implemented. Thus, the theme of this paper is that while policy is generally moving in the right direction to fight inflation, the most that can be expected is gradual relief. Furthermore, it is quite possible that even with the right trend in policy, short-term problems—such as the Iranian oil shutdown—can overwhelm the effort at deceleration.

In Sections II and III, it will be argued that much of the research and discussion on inflation has been misplaced. The emphasis has often been on finding the initial cause of inflation, i.e., the spark that started the current era of inflation back in the 1960's. But the spark is a matter of historical interest. The current dilemma is the perpetuation of inflation and the need to break into the wage/price spiral. How much effort should be expended on decelerating the inflation process is really a political question. As discussed in Section IV, some economists in the 1960's were relatively sanguine about the impact of inflation because the costs of inflation are hard to measure or even define. But political pressures to resist inflation have mounted. That rising pressure is the best available measure of the costs, and it is clear that the costs are severe.

Sections V-IX deal with specific anti-inflationary policies. These are monetary and fiscal policies, the new wage/price guidelines, controlling the costs of regulation,

¹ Daniel J. B. Mitchell is a senior fellow at the Brookings Institution and a professor at the Graduate School of Management, University of California, Los Angeles. He was Chief Economist of the U.S. Pay Board during Phase II of the Controls Program begun in 1971. The views expressed in this statement do not necessarily reflect those of other Brookings staff members or the officers and trustees of the Brookings Institution.

² Parts of this paper are based on an upcoming Brookings study on anti-inflation policy in which several Brookings colleagues are involved. The opinions expressed, however, are my own.

and real wage insurance. Fiscal policy in the near term is primarily expenditure policy. And there are heavy constraints on what may be accomplished. However, fiscal policy has moved toward a more restrictive stance. Monetary policy is less constrained, but is beset with new institutional structures that make policy actions difficult to interpret. The possibility of monetary overreaction, based on imperfect information, suggests a need for caution. Each bit of bad news on inflation should not call forth an automatic tightening of monetary policy. Finally, it is important to note that both monetary and fiscal policy will have their primary effects on real growth, not on inflation. Especially in the short run, restrictive demand policy will produce only a mild slowdown of inflation.

The new wage/price guidelines can make a contribution to deceleration. Virtually all economic forecasts suggest a growth slowdown and a rise in unemployment during 1979. Thus, the guidelines will be operating in a different climate than that which accompanied the Kennedy/Johnson guideposts of the 1960s or the Nixon controls program. Unlike those earlier programs, the new guidelines will not have to face rising demand pressures. On the other hand, the new guidelines may have to cope with food-fuel price pressures similar to those of 1973. Such pressures will require flexible administration of the guidelines. In particular, it may be necessary to loosen the wage guideline if price inflation picks up substantially.

Real wage insurance will not remove the need for flexible guidelines administration. Indeed, real wage insurance may never become law. And while it is debated in Congress, the proposal could have a disruptive effect on ongoing labor-management negotiations. Real wage insurance is excessively complex and can have only a marginal effect at best. It deserves a quick burial. But if that is not possible, a quick birth would be the second-best option. The worst outcome would be a prolonged debate and an attempt to tinker with the plan.

Regulatory reform is surely one of the most important long-term issues before the Congress. It could produce some significant cost savings which can only help in the anti-inflation effort. But the issues raised by proposals for deregulation and regulatory restraint are complicated and are not amenable to quick solutions. In the interim, Congress ought to be cautious and conservative about any new proposals which raise the price level.

II. THE CAUSES OF INFLATION

In the 1960's, economic textbooks debated the causes of inflation in terms of two polar models. The "demand-pull" theory suggested that inflation had its cause in an overheating of the economy provoked by excessively-expansionary monetary and fiscal policy. Alternatively, the "cost-push" model attributed inflation to upward pressure on wage and prices from groups seeking to maintain or enlarge their share of available income. Inflation was seen as a competitive struggle for income which vented itself in rising prices because the claims on income exceeded its availability in real terms.

Neither model is entirely satisfactory as a complete explanation for current inflationary pressures. Most economists would agree that the inflation which built up in the late 1960s was caused by classic demand-pull pressures. Indeed, it would be difficult to point to any substantial cost-push pressures in the early 1960's that could have sparked the inflation, especially if "cost" is a code word for "wages." If one is searching for an "initiating cause" of the inflation of the late 1960's, monetary and fiscal policies are good candidates. A limited form of cost-push explanation could be added to account for the 1973-74 episode of dollar devaluation, world farm price increases, and OPEC oil price increases. However, that episode was not the product of a domestic struggle for income; much of the impetus was international. In any case, the search for the initial cause is misleading. The key issue today is not what started inflation but what is perpetuating it.

III. THE PERPETUATION OF INFLATION

Once inflation has occurred for a long period, it tends to continue. The mechanism is primarily a wage/price spiral. Prices reflect the cost of labor; wages reflect the cost of living. Inflation that has occurred in the past comes to be expected and is pushed into present. In some cases where long-term contracts are utilized, it is pushed into the future.

The wage/price spiral is not completely self contained; if it were the inflation rate would never vary. It can be influenced somewhat by monetary and fiscal restraint, for example. An increase in the unemployment rate tends to produce a small decrease in the rate of wage change. In turn, this will tend to affect price changes which will affect later wage changes. Thus, the cumulative effect of a "softened"

economy is greater than the initial effect. But the speed of the adjustment appears to be slow.

Part of the difficulty in using traditional demand restraint policies is that a slowdown in the economy is less effective as an anti-inflationary device than it once was. In the late 1940's and the mid 1950's, there were two episodes in which recessions induced actual drops in the price level. Perhaps in those periods, many people still remembered the Great Depression of the 1930s when prices fell by almost 25 percent. Possibly they thought that the recessions might herald a return to depression levels of output and a fall in prices. Recessions may have acted as a "signal" at that time which produced a self-fulfilling reaction of prices.

It has been argued that if the government were now to announce a tough, inflexible, and long-term policy of demand restraint, the announcement itself would have a dramatic effect on inflationary expectations. Effectively, according to this view, such an announcement would restore the signaling effect of recession. Inflation would cease to be self-perpetuating; people would again act as they did in the 1940s and 1950s. But it is not clear how a representative government can make such a commitment credibly, since it amounts to stating that government will ignore whatever pressures arise to restimulate the economy. And there is no way of knowing whether such a commitment—if it were made—would have a substantial anti-inflation effect.

IV. THE COSTS OF INFLATION

Economists have had a hard time trying to measure the costs of inflation or even define the costs. Some economists in the 1960s were tempted to believe that the gains to some people and the losses to others induced by inflation would cancel out, leaving no net public discontent. This view is not widely held any more. Inflation is a generator of uncertainty. It makes long-term planning difficult. It means that even if nominal wages are not cut, real wages can fall appreciably. And it "politicizes" the income distribution by forcing reopening of the redistributive features of the tax system and by inducing direct government involvement in wage/price decisions.

Such costs cannot be totaled into a dollar aggregate. They are strains in the social fabric for which the index is the political channel. That index is currently registering considerable public unhappiness over the lack of progress in slowing inflation.

V. AGGREGATE-DEMAND POLICY IN THE SHORT TERM

By the end of 1978, virtually all economic forecasters were expecting a slowdown in economic growth, despite the fact that no such slowdown was yet evident. A sample of such forecasts—all made at about the time the Carter Administration was preparing its forecast—is shown on Table 1. It is clear from this table that the Carter Administration is relatively "bullish" on economic growth compared to private forecasters. But even the Administration forecast suggests some increase in unemployment. In part because the Administration was optimistic on growth, its inflation forecast was at the pessimistic end of the range.

Evaluation of current and proposed aggregate-demand policies must be made within the context of considerable uncertainty about the economic outlook. However, it is clear that monetary policy has definitely moved toward a tighter stance than was anticipated, even 6 months ago. And the Carter Administration's new budgetary proposals also represent a tightening. These shifts in direction are the consequence of fears of accelerating inflation and the related concern over the value of the dollar in international exchange markets.

TABLE 1.—SELECTED ECONOMIC FORECASTS, LATE 1979 AND EARLY 1979

[In percent]

Source and date	GNP deflator inflation rate 1978-IV to 1979-IV	Growth of real GNP 1978-IV to 1979-IV	Peak unemployment rate, 1979*
Data Resources, Inc., Jan. 1979.....	7.4	0.5	7.1
Manufacturers Hanover Trust, winter 1978-79.....	7.2	.2	7.2
UCLA business forecast, Dec. 1978.....	6.2	.9	7.1
Wharton, Dec. 1978.....	6.9	1.4	6.1

See footnote at end of table.

TABLE 1.—SELECTED ECONOMIC FORECASTS, LATE 1979 AND EARLY 1979—Continued

[In percent]			
Source and date	GNP deflator inflation rate 1978-IV to 1979-IV	Growth of real GNP 1978-IV to 1979-IV	Peak unemployment rate, 1979 ^a
George Perry, Brookings, Jan. 1979.....	6.8	.8	6.4
Carter administration, Jan. 1979.....	7.4	2.2	6.2

^a 1979-IV.

(i) *Fiscal policy.*—Fiscal policy could affect the rate of inflation in three ways. First, there is the standard analysis which suggests that a decrease in spending or an increase in tax rates is contractionary. The problem in the past has been that much of the contractionary effects associated with a tightening of fiscal policy have fallen on real output rather than inflation. In the short term, say over a period of a year, a 1 percentage point increase in unemployment might slow the inflation rate by 0.5 percent. (Some would say that is an optimistic estimate.) To obtain that increase in unemployment, real GNP would have to drop by perhaps 3 percent relative to its trend. Thus, for a 1 percentage point reduction in the inflation rate, the economy must sacrifice 6 percent of real GNP, if not more. At current levels of production, this is equivalent to a cost in real output of about \$130 billion.² And, obviously, the burden of that cost is not going to fall on the population in an equitable manner.

A second type of fiscal policy relates to taxes that have a direct influence on prices. The most obvious examples of such taxes are state and local sales taxes. A substitution of income taxes for such sales and excise taxes would directly lower the price level as it is conventionally measured. Unfortunately, the importance of excise taxes to federal receipts is small, leaving little room for such adjustments by the federal government. Unless the federal government is prepared to compensate state and local governments for lost sales or property tax revenue, the only major tax cut available for direct price effects would be a cut in Social Security payroll taxes. However, such cuts would raise significant questions about Social Security financing, questions that Congress is unlikely to wish to face during the coming year. Thus, the chance for any direct fiscal exercise on the price level in the near term is remote.

A third possible influence of fiscal policy on inflation could operate through an induced effect on monetary policy. It is sometimes argued that large budget deficits "force" the Federal Reserve to finance the debt through monetary expansion. Were the Fed to feel obligated to buy a substantial fraction of the net issues of Treasury obligations, large deficits would indeed have substantial monetary implications. However, there are no legal or institutional obligations of the Fed to finance the debt. And, as Table 2 illustrates, the statistical evidence does not show any close linkage between Fed purchases of Treasury obligations and Treasury issuances of such obligations. Deficits do not automatically call the shots for an independent Federal Reserve, nor should they.

The alleged monetary effect of fiscal policy is really the only channel by which the budget deficit itself—as opposed to spending and tax decisions—could play an important role in aggregate demand policy. Thus, the recent concentration by the public on the deficit as the source of inflation is misplaced. The deficit does have significance over the long term for the rate of national saving and investment. But even from that perspective, it is necessary to have an expanding economy with good prospects for investors as a precondition for a high rate of investment.

² The cost estimates are highly sensitive to the assumed impact of economic slack on inflation. Arthur M. Okun, using a lower estimate of the response (0.3 percentage points off the inflation rate per point of additional unemployment), set the real output cost at \$200 billion per point of inflation. See his "Efficient Disinflationary Policies," *American Economic Review*, Vol. 68 (May 1979), p. 348.

TABLE 2.—CHANGES IN FEDERAL DEBT HELD BY PUBLIC AND BY FEDERAL RESERVE

[Dollars in billions]

Fiscal year	Net change in Federal debt held by public (1)	Net change in Federal debt held by Federal Reserve (2)	Ratio (2)(1) (percent) (3)
1955	\$2.1	—\$1.4	—66.2
1956	—4.3	.2	—4.6
1957	—2.8	— .8	28.5
1958	6.9	2.4	34.6
1959	8.6	.6	6.9
1960	2.2	.5	23.0
1961	1.4	.8	56.1
1962	9.8	2.4	24.6
1963	6.1	.2	38.2
1964	3.1	2.8	89.5
1965	4.1	4.3	106.0
1966	3.1	3.1	99.8
1967	2.8	4.6	160.3
1968	23.1	5.5	23.9
1969	—11.1	1.9	—16.7
1970	5.4	3.6	67.1
1971	19.4	7.8	40.1
1972	19.4	5.9	30.4
1973	19.3	3.8	19.5
1974	3.0	5.5	181.7
1975	50.9	4.3	8.5
1976	83.4	9.7	11.7
1977	57.2	18.2	14.4

¹ Figures for fiscal year 1977 reflect an extra "transitional" quarter. Data have been adjusted by multiplying them by four-fifths.

For the present, therefore, federal fiscal policy is largely a matter of spending decisions. Tax policy has already been laid out, and there is little sentiment for major tax changes at this time. A substantial portion of federal spending is considered to be "uncontrollable" because it follows previously-established formulas. The Administration estimates that a simple continuation of existing federal government services would have cost \$12.5 billion more than the proposed level of outlays in fiscal 1980.³ But the budget reduction by itself can have only a small effect on inflation in the short term, perhaps a reduction of one or two tenths from the inflation rate.

(ii) *Monetary policy.*—Monetary policy is currently in a paradoxical position. On one hand, it is the more flexible of the two aggregate demand policies because it can be changed quickly in response to economic developments. But on the other, changes in the institutions surrounding the financial sector have made the response of the economy to monetary policy uncertain. In particular, a major element in the responsiveness of the economy to monetary contractions was through disintermediation in the savings institutions, a shortage of funds to the housing industry, and a resultant construction crunch. The disintermediation occurred as market interest rates surpassed legal ceilings on interest rates paid on deposits in savings institutions, thus enticing savers to move into such assets as Treasury bills. However, the introduction last June of new certificates geared to Treasury bill interest rates appears to have sheltered the housing industry from the impact of disintermediation. Savings institutions have retained their deposits—although at considerable cost—and borrowers have been able to obtain mortgage loans, except in states with restrictive usury ceilings. This development is somewhat ironic, since housing prices have been a clear area of overheated speculation. A cooling off of such speculation would have been especially desirable.

Whether one prefers interest rates or monetary aggregates as measures of monetary policy, it is clear that in the last quarter of 1978, a dramatic shift occurred.

³ Office of Management and Budget, "Special Analyses, Budget of the United States Government, Fiscal Year 1980" (Government Printing Office, 1979), p. 13.

During the first half of 1978, the Fed appeared to be in a reactive posture. Growth in the monetary aggregates tended to exceed the targets established by the Fed for the year, a process which continued into the third quarter. As Table 3 shows, M-2 was rising at an annual rate of over 10 percent during that quarter. But by that time, the Fed had moved toward a more activist position, pushing up interest rates, partly in response to depreciation of the dollar.

International considerations produced a dramatic policy reaction in the fourth quarter, when it became apparent that foreign-exchange traders were not satisfied with the prospects of the newly-outlined anti-inflation program. Growth in the monetary aggregates slowed substantially, and interest rates reached new peaks. This tighter stance has continued into 1979.

TABLE 3.—INDEXES OF MONETARY POLICY

(In percent)

Period	Annualized rate of growth of money supply			End-of-period Federal funds rate	Discount rate (New York)
	M-1	M-2	M-3		
Dec. 1976 to Dec. 1977.....	8.0	9.3	11.3	6.56	6.0
Dec. 1977 to June 1978.....	8.6	7.8	8.0	7.60	7.0
June 1978 to Sept. 1978.....	9.5	10.8	12.4	8.45	8.0
Sept. 1978 to Dec. 1979.....	.2	4.5	7.4	10.03	9.5

M-1 = circulating currency plus demand deposits (excluding domestic interbank and U.S. Government deposits).

M-2 = M-1 plus bank time and savings deposits other than large negotiable certificates of deposit.

M-3 = M-2 plus deposits at mutual savings banks, savings and loan associations, and credit unions.

Source: U.S. President, "Economic Report of the President, 1979," (Government Printing Office, 1979), pp. 251, 259.

Given the uncertainties over monetary policy, it would be most unwise for the Fed to react to each month's inflation news with a further tightening of monetary policy. The short-term response through the housing industry and disintermediation has been substantially attenuated, so that the monetary mechanism can be expected to work only gradually through the effect of interest rates on investment decisions. Because of the lags involved in this mechanism, the Fed could easily overshoot, pushing the economy into a deeper recession or slowdown than intended. A cautious approach is warranted until a clearer trend in economic activity emerges over the next 2-3 months.

Finally, it is important to note that the channels through which monetary policy affects inflation are much the same as those of fiscal policy. That is, monetary policy restrictions will primarily slow the growth of real output, producing only a small anti-inflation dividend, especially in the short run. The current boom in agricultural prices and the effects of the OPEC oil price increase and the Iranian production shortfall are not likely to respond to monetary policy. And, perversely, the impact of increased mortgage interest rates has a dramatic worsening effect on inflation as measured by the consumer price index.

VI. INTERNATIONAL CONSIDERATIONS

A variety of special measures designed to support the dollar were announced last November 1. These measures, which were the outcome of earlier policy conclusions, signaled the end to the position that such interventions in the exchange market could be avoided through the use of floating exchange rates. The dollar exchange rate affects the domestic inflation rate; it is estimated that a 10 percent devaluation of the dollar produces an eventual 1.5 percent increase in the consumer price index. Devaluation raises the prices of imports, exports, and other substitute goods. And inflation affects the dollar exchange rate; a perception of a faster pace of inflation in the U.S. relative to inflation abroad puts downward pressure on the dollar. The timing by which this process occurs is not precise. And it is quite possible for "runs" on the dollar to occur due to the intangible loss of "confidence" in the currency.

The decision to defend the dollar carries risks, however. Unless intervention is accompanied by a slowdown in inflation, downward pressures on the dollar will resume and the government will suffer capital losses on the liabilities it has incurred. With hindsight, it appears that the deterioration in the net export balance in recent years was indicating an increasingly overvalued dollar. It could be argued,

therefore, that the United States should have acted to slow its domestic expansion well before mid 1978. This step would have reduced the rate at which imports were sucked into the domestic economy and might also have increased exports. The lack of a policy response in the past has required a more abrupt change in policy now.

Even with floating exchange rates, individual nations must coordinate policies and must consider international developments in formulating policies. One area in which international cooperation will be needed is the so-called dollar "overhang," recently estimated at \$60 billion.⁴ These dollars represent the holdings of official foreigners which exceed what they would normally wish to have in their portfolios for investment and reserve purposes. The overhang was acquired during a period in which foreigners acted to support the dollar. A quick release of these dollars in the exchange markets could depress the dollar. Moreover, knowledge that official foreigners have a pool of dollars which they wish to unload is itself destabilizing.

VII. THE WAGE/PRICE GUIDELINES

Because of the limited response of inflation to demand-restraining policies, governments in all industrialized countries have sought other means to influence wage and price decisions directly. The diagnosis of a wage/price spiral suggests that inflation will perpetuate itself unless some outside force changes inflationary psychology and puts downward pressure on a large number of wage and price setters simultaneously. This type of diagnosis ultimately led to the guidelines program announced last October.

The new guidelines program is nominally voluntary; it is not backed by the force of law. Pains are taken to distinguish the program from mandatory controls. Yet the distinction is one of degree. Under the program larger government contractors are required to certify that they have complied with the standards. The legality of this aspect of the program has been challenged. But even without it, large firms and contractors would probably feel compelled to comply. Although the program is nominally voluntary, the Council on Wage and Price Stability has filled the Federal Register with rules that are hard to distinguish from regulations. Larger companies are also being "requested" to send in reports to the Council, just as they would be required to do under controls.⁵

It is important to avoid dogmatism in assessing the new program. A common response to the effort has been the assertion that "controls don't work." Yet the evidence is mixed. During the Korean War, wage/price controls were accompanied by relatively stable prices and there was no "bubble" of repressed inflation when the controls were lifted. During the period since the mid 1960s, there have been episodes of controls, other forms of direct wage/price intervention, monetary restraint, and fiscal restraint. It is hard to say which policy "didn't work" in recent years. No policy was highly effective. This time, however, the odds for success are improved by the prospect for decreased demand pressure.

(i) *The specifics of the rules.*—The new guidelines have been altered since their original announcement. But the basic outlines are as follows. Firms must decelerate their rate of price increase by 0.5 percent relative to the increase experienced in the base period 1976-77. Under the deceleration rule—which is a carryover from the now-defunct deceleration program announced a year ago—a maximum increase of 9.5 percent is allowed. In addition, a minimum increase of 1.5 percent is permitted without question. Firms which cannot comply with the deceleration standard due to uncontrollable cost increases are allowed cost-justified price increases. Under cost justification, firms are required to limit their profit markups to the margin experienced during the best two of the last three fiscal years prior to October 2, 1978. However, their profits per unit of output are not to rise more than 6.5 percent. Special rules apply to certain industries and to state and local agencies.

On the wage side, pay adjustments are limited to 7 percent unless they were set forth in contracts or pay practices prior to the guidelines announcement. Union contracts can include 8 percent wage increases in the first year of multi-year contracts averaging 7 percent per annum. Maintenance of benefits due to factors such as rising insurance premiums is chargeable only up to 7 percent. Certain costs of maintaining pension benefits are not charged at all. And union escalator clauses are charged as if the inflation rate were 6 percent, regardless of the actual experience.

Both the pay and price standards provide for exceptions due to "gross inequity." But the pay standard also provides exceptions for pre-guidelines tandem relations,

⁴ Lawrence B. Krause, "The 1979 International Business Outlook," Economic Research (February 1979), p. 6. (A publication of Goldman Sachs.)

⁵ COWPS regulations appear in the Federal Registers of Dec. 28, 1978, Jan. 4, 1979, and Jan. 25, 1979.

post-guidelines tandem relationships, productivity bargaining, and labor shortages. In addition, low-wage workers (those earning \$4 per hour or less) are exempt from the 7 percent standard. Special rules are provided for certain types of executive compensation such as stock options. Professional fees are limited to an average increase of 6.5 percent.

(ii) *Administration of the rules.*—The new guidelines program is a very ambitious one. It is apparent that the program's administrators really wish to concentrate on larger firms and wage-determining units. But the rules nominally apply to firms and units of all sizes, including governments. The Council on Wage and Price Stability is requesting funding for an additional 90 staff members, which would bring the total up to 233. By comparison, the wage/price controls of Phase II (late 1971 to early 1973) involved a staff of about 4,000 persons.⁶ And the Phase II controls exempted small businesses of 60 or fewer workers in most industries.

COWPS faces a dilemma under the current arrangements. Even with 233 staff members, the Council will be swamped with business. And even if there were a desire to increase the staff further, there are limits to the speed at which an agency can expand. The new program is imposing obligations on wage and price setters, despite its voluntary label. Thus, COWPS must be prepared to answer questions, hear appeals, and generally regularize procedures. If regularization does not prove to be possible, given the staff size and workload, then a reduction in coverage of the program must be seriously considered.

Obvious areas for program coverage reduction are small businesses, public utility prices, and rents. A small business exemption would have been carefully worded to avoid exempting small firms covered by major union contracts involving many employers. But in general, small businesses are not likely to be sources of strong wage or price pressures. (And if they do become sources of such pressures, there is little COWPS can do about it.) Public utility rates are already regulated by governmental agencies on a cost-markup basis. Additional regulation is superfluous. And rent coverage is meaningless. There are simply too many rental housing units for COWPS to undertake meaningful rent controls. And such controls would probably have undesirable consequences, even if they were possible. Rent complaints took up an inordinate amount of time and resources during Phase II.

Prior to the announcement of the guidelines, COWPS had an ongoing program of review of regulatory decisions and general research into cost problems of certain industries. This aspect of the COWPS operation ought not to be lost in the crush of work related to the guidelines. Moreover, there is a certain tension between the guidelines operation and the regulatory activities. COWPS may find itself asking for guidelines cooperation from firms and unions with which it has a disagreement concerning regulatory policy. It would be useful to insulate the regulatory and guidelines components of COWPS activities from each other.

(iii) *Monitoring of inflation and monitoring of the program.*—COWPS plans to use conventional data sources—such as the wholesale price indices—for compliance monitoring, along with reports received from larger firms and units. However, these same data sources will be used by the public to monitor COWPS program. It is important, therefore, that a public information program be undertaken to interpret available price and wage data. If price indexes are rising due to sectors exempt from the program (such as imports), this fact should be put forward.

Wage data are already becoming available which require some explanation. As shown on Table 4, surveys by the Bureau of National Affairs, Inc. have reported that median first-year wage gains since the guidelines went into effect have averaged about 8 percent. The standard for multi-year contracts (probably more than 90 percent of the sample) is 8 percent, but the data suggest that about half of the contracts surveyed have been running above the standard. It is possible that these contracts all qualify for the tandem or other exceptions, but if that is the case, it ought to be publicized. As time goes on, COWPS will have to deal with reports on wage changes and union settlements from other sources, especially the Bureau of Labor Statistics. These reports may also require interpretation, or they may suggest sectors in which the guidelines are being ignored.

Finally, COWPS will be receiving a variety of reports from larger firms and units. It is possible that useful public reports—aggregated to avoid disclosing confidential information—could be made available so that the public could be kept aware of the progress being made by the program. Information should also be made available concerning the appeals activities. How many exception requests are being received?

⁶ Statement of Dr. John T. Dunlop, Director, Cost of Living Council, before the Subcommittee on Production and Stabilization of the Senate Committee on Banking, Housing, and Urban Affairs, Feb. 6, 1974 (GPO, 1974), p. A-107.

What types of exceptions are being requested? What is the disposition of these appeals?

TABLE 4.—MEDIAN FIRST-YEAR UNION WAGE SETTLEMENTS

[In percent]

Period	All industries ¹	Manufacturing	Nonmanufacturing except construction
Third quarter 1978.....	7.8	8.4	7.7
Oct. 31 to Nov. 13, 1978.....	7.5	8.9	8.4
Nov. 14 to Nov. 27, 1978.....	8.7	10.0	8.0
Nov. 28 to Dec. 11, 1978.....	8.0	8.6	6.9
Dec. 16 to Dec. 25, 1978.....	8.4	9.0	7.5
Dec. 26, 1978 to Jan. 8, 1979.....	8.3	8.9	7.0
Jan. 9 to Jan. 22, 1978.....	8.0	8.7	(²)
Jan. 23 to Feb. 9, 1979.....	8.7	8.7	(²)
1979 through Feb. 9.....	8.3	8.7	7.2

¹ Contains a few construction settlements not shown separately.

² Sample too small for meaningful calculation.

Source: Bureau of National Affairs, Inc., Daily Labor Report, various issues.

(iv) *Can guidelines help?*—By itself, the guidelines program is obviously not a cure-all for inflation. But—as noted earlier—movements in demand are expected to be in an anti-inflation direction. They will reinforce the guidelines effort. Unless virtually all economic forecasters are seriously mistaken, 1979 will not be a repetition of 1966 and 1973 when demand forces worked against efforts at direct intervention in wage and price setting.

With good luck, the guidelines might knock a half a point or even a point off the inflation rate. With not-so-good luck, the guidelines might at least prevent short-run inflationary impulses from food and fuel from becoming permanently embodied in the wage/price spiral. With bad luck, the guidelines could be blown apart by a food-fuel price explosion, leading to a rejection of the guidelines in a major union situation or simply a loss of confidence in the programs by the public.

In short, whatever success occurs is likely to be measured in inches, not yards. The public must be told not to expect miracles. The guidelines authorities should avoid the temptation to grasp at food-fuel problems which are beyond their reach. In 1973, attempts to control meat prices quickly emptied supermarket meat counters. Attempts to prevent world oil prices from being reflected at American service stations led to gasoline lines and informal rationing. These mistakes should not be repeated.

The guidelines must be operated flexibly. In particular, if a new plateau of price inflation is reached, the authorities ought to seriously consider raising the wage standard or providing a more explicit cost-of-living exception.⁷ The 7 percent standard was very tight when it was first announced last October. At that time, compensation per hour was increasing at about 9 percent per annum and consumer prices were rising at about an 8 percent rate. The recent worsening of inflation makes the wage standard still tighter.

Basically, the key rule for the guidelines administrators is that it is better to “roll with the punch” than “lead with the chin.” A defiant stand against inflation may be good public relations in the short run. But the longer-term prospects of the program will suffer if the guidelines are administered in a rigid fashion. The Administration should not count on real wage insurance to reconcile a price explosion with wage restraint. At best, real wage insurance will have only a marginal influence. And, it may never be passed.

⁷ In principle, unionized units can install escalator clauses providing 100 percent protection against inflation. However, 100 percent escalator clauses are quite rare because of the need of employers to have advance knowledge of their wage rates. In recent years, average escalator protection has been 57 percent in the major union sector. Escalators are extremely rare for nonunion workers. And nonunion units cannot install escalators if wages are raised by more than 7 percent as a result under COWPS rules. For data on major union escalators, see Victor J. Sheifer, “Collective Bargaining and the CPI: Inflation vs. Catch-Up,” Proceedings of the Industrial Relations Research Association, August 1978, forthcoming.

VIII. REAL WAGE INSURANCE

The most novel feature of the guidelines program announced last October was the proposal for "real wage insurance." Under this plan, workers in employee units accepting wage increases of 7 percent or less would be rewarded with a potential tax rebate. The plan would provide protection against inflation above 7 percent and up to 10 percent, subject to certain limitations.

As part of recent testimony before the House Ways and Means Committee, I submitted a 45-page report on real wage insurance, a report which expressed strong doubts about the plan.⁸ That report makes clear why the initially-appealing idea of real wage insurance has provoked considerable skepticism in the press and in Congress. Ironically, the reasons for the skepticism can be found in last year's Annual Report of the Council of Economic Advisors. That report contained a discussion of "tax-based incomes policies"—of which real wage insurance is a variant. The CEA concluded that such plans are inherently highly complicated, might not have sufficient wage-restraining effects, and could turn the Internal Revenue Service into a controls agency. Curiously, the judgments reached in January 1978 did not extend until last October.

Originally, the real wage insurance proposal threatened to have a very detrimental effect on the guidelines program. Its designers apparently thought that real wage insurance would have such widespread appeal, that a rigid 7 percent wage guideline could be enforced with virtually no staff. Real wage insurance threatened to make the program rigid so that the wage standard rules could be written into the tax code. Fortunately, the widespread doubts which the plan evoked pushed the Administration toward a more flexible guidelines system and a larger staff. But if the prospects for Congressional passage of real wage insurance pick up, the Administration could fall back into the rigid rules/tiny staff model. That is one of the chief dangers of real wage insurance.

Real wage insurance poses another danger. As long as Congress debates the issue, there is a potentially destabilizing effect on ongoing collective bargaining negotiations. Already, the Congress has become a party to the sensitive automobile and trucking negotiations. Moreover, as the anomalies and peculiarities inherent in real wage insurance become apparent, the entire anti-inflation effort could come to be viewed as the latest version of a "WIN" button; a multi-billion dollar version.

There are many odd consequences of the real wage insurance plan. These cannot all be enumerated in a brief summary, but the following six are especially worth mentioning:

(1) The rules of the wage guidelines are not the same as the rules for real wage insurance. Some of the exceptions to the 7 percent rule permitted by COWPS are not reflected in real wage insurance. And there are differences regarding fringe benefits and other aspects of computation. It is possible to qualify for one plan but not the other. This is a strange outcome for a plan which is supposed to reward compliance with the guidelines.

(2) Workers with cost-of-living escalators will be double compensated for inflation; once from the escalator and once from the tax rebate.

(3) There will be individual workers who receive larger than 7 percent wage increases who will be eligible for a rebate because others in their units got less. And there will be workers who receive less than 7 percent and receive no rebate because others in their unit received more. The problem of workers versus units becomes especially apparent for job changers and moonlighters.

(4) The union and nonunion sectors are treated differently. They are covered by different computation rules and timing rules. The differences involve the treatment of fringe benefits, promotions, and employee mix. Thus, workers in units receiving identical pay raises could be treated in a disparate fashion.

(5) The proposal appears to contain a control-year problem which could permit wage increases of up to 15 percent in a unit to qualify for a rebate. This can occur if workers under a union contract negotiated before the guidelines receive 7 percent under their old contract and then negotiate a new agreement for 8 percent in the first year.

(6) The proposal would have the IRS evaluate the savings realized from a productivity agreement in case of an audit. But evaluation of such agreements is a complex matter over which labor and management sometimes disagree.

Despite assertions by the Administration to the contrary, the plan is complex. The Administration assumes that the proposal by itself provides a strong incentive for wage restraint. This is purely an assumption. According to recent testimony of the Chairman of the Council of Economic Advisors before the House Ways and Means

⁸ The statement entitled "Real Wage Insurance and the Wage Guidelines" will appear in the hearings record for Feb. 5, 1979. In the interim it is available from the author.

Committee, real wages have almost always increased on an annual basis. But this plan proposes instead a zero increase, hardly a strong incentive, especially for the big union situations which have experienced the greatest real gains in recent years.

Moreover, over 4 months of the control year to which this plan applies have already passed. Can real wage insurance have a retroactive effect? It clearly did not influence the recent oil workers' settlement. That settlement—in fact—illustrates an important point. It is the guidelines themselves which will produce whatever wage restraint there will be from this program, not real wage insurance. And it is the guidelines program which should be getting the resources, resources which will be diverted to the small employer sector where wage pressures have not been a major problem by real wage insurance.

Paradoxically, the Administration's real wage insurance proposal is as well drafted as such a plan could be. Tinkering with that plan may correct some anomalies, but will create new ones. Hence, Congressional leaders should look at the plan as it is and make a quick decision. Prolonged debate would be disruptive. But it is important that Congress look at the specifics of the proposal, the technical issues, and the anomalies. Congress cannot pass a nice idea; it can only pass a detailed bill.

IX. REGULATORY REFORM

One of the areas singled out by the President in his guidelines announcement was the need to reduce the costs of government regulation. The biggest success story in deregulation has been the administrative and Congressional moves in the airline industry. There are prospects for further cost reductions in the deregulation of ground transportation. However, there are obvious complications as well. Regulation of railroads and trucking is interrelated, since the two industries compete with each other. Reforms in one sector might be difficult to accomplish without reforms in the other. Thus, further deregulation may be a prolonged process. The anti-inflation consequences—especially in the near term—are also likely to be small.

Regulatory reform in some of the newer agencies, such as OSHA and EPA, will also be complex. There have been suggestions for regulatory "budgets" which would limit the costs an agency could impose on the private sector. However, the measurement of the costs of regulation is almost as complicated as the measurement of the benefits. Thus, while regulatory reform is a vital issue Congress must address, its results will be slow in coming.

X. CONCLUSIONS

With the exception of real wage insurance, the current anti-inflation efforts of the federal government seem reasonable and desirable. Monetary and fiscal policies have moved toward greater tightness. But both these policies have their impact primarily on real output; their anti-inflation effects are small. The guidelines can help in making wage and price setters more responsive to monetary/fiscal restraint. But the guidelines must be administered flexibly and must be reviewed in the light of changing economic conditions. In particular, if price inflation makes the wage guideline unrealistic, the wage standard may require upward revision.

Real wage insurance will not eliminate the need for flexibility and realism. In fact, the real wage insurance plan could impose costs on the guidelines efforts rather than the benefits its drafters expect. The plan is filled with anomalies that could prolong debate in Congress, and thereby disrupt ongoing collective bargaining negotiations. A quick death would be the best outcome for the proposal. But, paradoxically, the second best outcome would be a quick birth with the plan put into effect essentially as proposed. The worst outcomes would be a slow death or a prolonged labor.

Senator BENTSEN. Our next witness will be Sidney Weintraub, professor of economics at the University of Pennsylvania.

STATEMENT OF SIDNEY WEINTRAUB, PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA

Mr. WEINTRAUB. Thank you.

President Lincoln, until Grant emerged, lamented the "slows" of his generals. They deferred battle despite superior numbers and equipment.

Our stagflation bog is now 11 years old. Our policies betray a case of the "slows."

The testimony just this week of the chairman of the Federal Reserve Board, speaking of 6, 7, 8 years for fighting the inflation trauma, I think confirms this. I have heard other remarks suggesting that we must unwind it slowly.

We do have the "slows". The double-trouble promises to linger, sometimes more dismal on the inflation front, sometimes more alarming in respect of the unemployment plight.

It is the inflation surge that accounts for the decline of the dollar in foreign markets. It gives us the stock market jitters, it accounts for the historic high interest rates.

Wherever we turn, with respect to housing, with respect to rebuilding the cities, or our transportation network, or in trying to exploit new energy resources, in health care, in everything, we are told, "Now, go slow," we cannot do it for fear of inflation. I think that controlling inflation is our first priority.

Monetary maneuvers, fiscal plans and some income policy feint comprise the present strategy. Once again, we are relying on monetary policy. Apparently, the thought is that there is a new precience not matched by immediate Federal Reserve predecessors. I am skeptical of this. Words abound on recession prospects. Surely, unless monetary policy creates a recession, or slows growth, it stands little chance of curbing inflation.

We talk about soft landings. Metaphors about "soft landings" make vivid reading but spurious analysis.

It seems to me that monetary policy acts out a kind of "destroy-to-revive" fantasy. We try to get the patient sick and then we seek ways to restore health. This has been our story over the last 11 years.

We have, however, in the current inflation drama, a new growth industry. Students of our colonial history know of early opposition to Government expenditure and taxation; this is not exactly a new phenomenon. Its novel status now is that it has become a vocal, organized "industry." Insofar as popular ire contends that government budgets are the inflationmaker, the fusillades are largely misdirected. In general, on this, government, the Federal Government particularly, has been getting a bum rap from many States, especially in the light of the Federal Government making available about \$80 billion in grants-in-aid.

State and local budgets would be in a more dismal plight if these moneys were not forthcoming.

With respect to Government expenditures, I would argue substantially that Government expenditures are more the consequence of inflation than the cause. In 1963 prices, the current fiscal year outlays of about \$500 billion would be about \$240 billion. Whenever defense hardwares goes up, whenever office supplies raise in price, when civil servant pay scales rise, then outlays rise. Pricewise, given what is happening in the private sector, Government outlays for exactly the same programs will be heavier. You cannot avoid this result.

Now, this is not to condone wasteful Government expenditures. Obviously, I, too, am opposed to waste, but if you cut all costs down to the bone, if it were possible to eliminate every dollar of waste, you would still find Government expenditures going up to match the general rise in prices so long as you try to maintain roughly

the same programs. As I look at the Federal expenditure total, I get a figure of about \$358 billion out of this \$500 billion on which it is very hard to do any trimming. I wish you well in cutting. Of course, I want you to trim insofar as you can. I would like to see my own tax bill lower, but I don't think too much can be done.

I might add, I favor a tax cut.

Deficits are often condemned as the inflationmaker. However, in the 51 budget years since 1929, we have had only 9 years of surplus and yet, over this period, until the last 10 years in any event, the general price level behaved rather well.

In fact, in the year of the largest deficit, in 1933, with a 55-percent deficit—\$4.5 billion of expenditures, about \$2 billion of revenues—the price level actually fell. Thus deficits are surely not an automatic force for inflation. The better analysts, in using the argument, largely tie deficits to borrowing from the banks and increasing the money supplies. The theory is really a sister of a monetarist position.

Inflation, in my own view, a position which I have held for many years, is largely a result of money incomes outpacing output levels. You can't avoid a rise in the price level if incomes, on average, go up by 10, 15, 20 percent per annum, and productivity goes up 1, 2, 3, or 4 percent—or whatever small numbers you want to put in there.

The void, the vacuum, between the series will be filled with higher prices. When we talk of money incomes advancing, inevitably we must emphasize money wages and salaries, which comprise 75 percent or so of the total income. Employee compensation is rising currently at the rate of about \$140 billion per annum. In 3 or 3½ years, just the rise in employee compensation will exceed the existing totals of Federal Government expenditure.

Now, how much of Government outlays can you cut in Washington? \$10 billion; \$20 billion; \$30 billion? I don't think you can get to those numbers, but suppose you could. Contrast this to what I am talking about: for the same output, for the same amount of work effort for the same amount of services, total income payments will go up in the \$140 billion range. It seems to me that when we concentrate on Government outlays—in the light of the current sentiment on deficits, on expenditures, on taxes—we are looking at the smaller sized stem rather than the major factor.

I have often said we have been guilty of an assault on the laws of arithmetic. We are trying to raise money incomes by extremely large numbers. In England, they have been trying to raise wages, as in 1974, by 25 percent; Australia, by the same number, and then in both countries they are astonished that the price level rises by approximately the same amount.

The belief that we can raise money incomes in compliance with these numbers, and without any price consequences seems to be a result of an urge to invent a modern Aladdin's lamp. Now, I don't want anyone to think that I want to depress labor income. I would like to make everyone a millionaire and I don't think we should wait too many days to do it—today, next week, 2 weeks from now.

If we can raise money incomes, regardless of the movement of productivity, there is every reason to raise incomes by enormous sums. Once you say we cannot raise all incomes by 8 percent each

hour or 18 percent each hour, or 800 percent each hour—or even bigger numbers—you are suggesting there is roughly a right rate, a right pace of increase. I think we have got to focus on the right rate.

I have a chart in my prepared statement indicating that money wages far, far outstrip the price movement—whatever date you wish to start with—in our history. Starting with 1929, it goes well above productivity. If the chart included a price line, this would fall in between the wage and productivity curves. With respect to profit margins, those who say it is excess profits which are responsible for the price trend, if we go back to 1950, on the score of the average price markup the average profit margin prices would be about 12 percent lower rather than being 150 to 160 percent higher.

This is not to suggest the unimportance of money. I have always argued on the importance of the money supply but it seems to me the big impact, the hammer blows of monetary policy, is on output and employment. Whenever we have tight money we do have some downturns in jobs.

To ignore the prewar period, in 1949, 1953, 1957, 1960, and most of the years since 1968, whenever tighter monetary policy has been invoked, we have had a clout or direct blow on the housing industry, and then the multiplier ramifications run through the economy.

There have been comments here on labor productivity, on the abysmal slow pace of productivity increases. I am one of those who thinks this is a more durable problem.

Let me offer a small illustration. I think that the terms of trade have been going against us, and that this will persist. Let's assume the price of a barrel of oil is \$2 and the price of an automobile \$4,000, as in the recent past. With the car selling now at \$6,000, and the barrel of oil selling at \$15, it requires 5 cars for 2,000 barrels of oil. Previously, for just one automobile we could get 2,000 barrels of oil.

When we look around at the prices of sugar, coffee, cocoa, copper, and so on, all the materials on which we are dependent on our imports, we see substantially the same kind of phenomena. I don't think there are any immediate remedies here, and—

Senator BENTSEN. Mr. Weintraub, I must ask you to summarize.

Mr. WEINTRAUB. Thank you. I will.

On the matter of the Carter anti-inflation program, it seems to me that this was belated by about 18 months. I applaud the fact that he has taken the steps that he has, and that something is in motion. I also think the Council is veering down the road to limited, though old-fashioned controls.

Further, I have some reservations on the suggestion of publishing a bad boy, or a non-complying list of firms. This sounds like a new kind of WIN button being devised.

In brief, it seems to me that the program is designed mainly to put a cap on inflation in the range of about 7 percent. I think this is too high. I favor a program to stop inflation, not to slow inflation.

A policy to slow inflation generally argues, let's not stop it quickly, let's not hurt anyone else other than those who have been ravished already by the 100-percent rise in the last 10 years.

In conclusion, I agree with the view of a right to a job, a right to income—a right particularly of available work opportunities. I regret that Thomas Jefferson did not include this in the Declaration of Independence, the unalienable right to jobs. But there is also, as John Stuart Mill said in his essay, "On Liberty," denying the right of anybody to act overtly to injure others. This, I think, covers the inflation ordeal.

Thank you, Mr. Chairman. I have attached to my prepared statement an appendix on my views on an anti-inflation package.

Thank you.

Senator BENTSEN. Thank you very much, Mr. Weintraub.

[The prepared statement of Mr. Weintraub, together with an appendix, follows:]

PREPARED STATEMENT OF SIDNEY WEINTRAUB

President Lincoln, until Grant emerged, lamented the "slows" of his generals. They deferred battle despite superior numbers and equipment.

Our stagflation bog is now 11 years old. Our policies betray a case of the "slows". The double-trouble promises to linger, sometimes more dismal on the inflation front, sometimes more alarming in the unemployment plight.

MONETARY AND FISCAL ANTIDOTES

Monetary maneuvers, fiscal plans, and an incomes policy feint comprise the present strategy.

Monetary policy: A destroy-to-revive fantasy

Again, we are embarked on a monetary misadventure to control inflation: the reigning faith seems to be that what has failed before will now somehow succeed. Players in the current drama intimate that there is new percipience not matched by immediate Federal Reserve predecessors. I wish it were so.

Words abound on recession prospects. Surely, unless monetary policy creates a recession or slows growth, it stands little chance of curbing inflation; only by an employment debacle, thereby possibly blocking the wage climb, can it hope to arrest the price splurge. Metaphors about "soft landing" make vivid reading but spurious analysis.

In perspective monetary policy acts out a sort of "destroy-to-revive" fantasy. Fed policies set roadblocks to economic expansion; after the slowdown, when we think the economy has suffered enough, steps are taken to revive it. There is an inner irrationality in this marching up the interest rate hill preparatory to a slide down.

Tax and expenditure protests: A new growth industry?

To students of our colonial history, opposition to government expenditure and taxation is not exactly a new phenomenon. Its novel status now is that it has become a vocal, organized growth 'industry'. Insofar as popular ire contends that government budgets are the inflation-maker, the fusillades are largely misdirected.

In inflation season and out, wasteful outlays by government can hardly be condoned. Nonetheless, government expenditures for any fixed programs of government activity are more the result of inflation than the cause. The Federal 1979 budget of about \$500 billions would be about \$240 billions in 1963 prices. Whenever prices of defense hardware or office supplies surge, or when civil servant pay escalates, government expenditures will inevitably mount.

Federal nondefense GNP outlays are not very much higher, relatively, than in Herbert Hoover's time. (Vast transfer outlays, however, complicate the comparison.) State and local governments far outspend Washington in GNP. Cutting expenditures will mean fewer orders in the private sector, fewer civil servants, thus fewer jobs. Scalewise, the anti-inflation impact is likely to be small, operative indirectly through unemployment restraints on wages and salaries.

Beset by inflation the cry for lower taxes comes on strong. Lower taxes, by and large, should raise market expenditures and thus enhance private sector employment. For advocates of higher unemployment as the proper inflation medicine, a tax

cut is hardly an ideal remedy. It tends to negate any assistance from tight money or curtailed federal outlays.

I favor a tax cut, I might add. But this is because unemployment is edging up and because of doubts on the efficacy of unemployment to stop inflation.

Deficits and inflation

Many hold government deficits culpable for inflation. Factually, over the past 51 budget years surpluses have popped up in only nine years, sometimes in piddling amounts. Despite the deficit-ridden path, the price level behaved fairly well, judged by standards of the last decade. In our 55 percent expenditure deficit in 1933, the price level tumbled. Deficits are not an irresistible inflation-maker.

For better analysts, the deficit theory of inflation is a disguised form of monetarism. Deficits usually compel bank borrowing; money supplies increasing, the Quantity Theory then takes hold.

To eliminate deficits we will have to reduce outlays or raise taxes. I detect no ground swell for the latter. Similarly, I doubt any great prospect for sharp pruning of government outlays during our stagflation trauma. Our best chance to close the deficit hole will be through budget restraints during a job and output ascent—not under a planned recession.

THE WAGE-COST MARKUP (WCM) INFLATION THEORY

Inflation, in my view, in an economy where money wages and salaries comprise the bulk of business costs, and the lion's share of consumer demand, is attributable to an excessive rise in money incomes compared to labor productivity.

Employee Compensation is now rising at about \$140 billions per annum. In under four years merely the sum of cumulative additions to the total will outweigh current Federal government expenditures.

The assault on the laws of arithmetic

Recent years have witnessed a precipitate assault on the laws of arithmetic. Productivity inches up, say by 1 plus percent per annum, and we rush pell-mell to raise money incomes—meaning wages and salaries mainly—by 8, 10, 12 percent or more (as in England) per annum. Then we profess astonishment that prices lunge to fill the productivity and money income gap.

The myth that money incomes can lurch steeply without generating inflation reflects an urge to invent a modern Aladdin's lamp: make everyone a millionaire. When labor announces for a general 8 percent advance we should protest the modesty and insist on 80, 800 percent more. After all, the Fed—in the recital of its eternal vigilance—can ward off inflation.

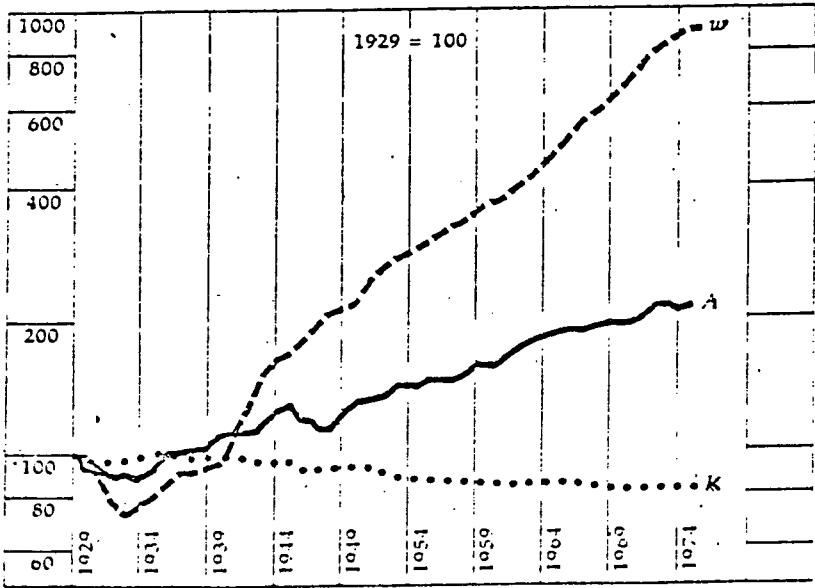
With outsized pay grants through the economy, my conviction is that the Fed's monetary gestures will resemble the seven maids with seven brooms flailing at the seven seas.

The WCM theory

The price level equation for the private sector can be written as: Price level equals average price markup times average money wage divided by average Labor Productivity.

Eschewing deeper analysis here, the accompanying chart depicts the slight down drift in the markup (k) since 1950: the price level should have scored about 12 percent lower rather than steaming by about 160 percent. Average money wages (w) have far outstripped productivity gains (A). A price level plotted on the same chart field would sit about midway between w and A.

The price level emerges as literally a tug-of-war between w and A developments. The consumer price level formulation is more complex; nonetheless, after conceding that other factors can explain mild price bumps and wiggles, the practical doubling of the price level since 1967 would stress the heavy wage-salary and productivity imbalance.



Index numbers of $K, W, A, 1920-1975$

Money in the WCM theory

The importance of the money supply is not belittled in the WCM theory. Operative effects, however, are almost entirely confined to production and employment directly, and the price level indirectly. If tight money knocks people out of jobs, or deters growth so that unemployment swells, thereby containing average pay hikes, the price level will be reined.

The price level pressure thus comes on the roundabout as by some recession. Parenthetically, the adoption of a steady 3-4-5 percent "rule" for annual money growth would not work too badly if the price level was once stabilized by first aligning average pay to average productivity.

Note the major reservations: "if" the price level was stabilized by an effective incomes policy, the rule could then prevail, almost mechanistically. Monetarists too often assume the price level would be stabilized regardless of the average pay-productivity trend.

The productivity creep

Dismay is widespread at the miniscule productivity creep.

A typical prescription is to urge a tax cut to favor investment, even by some who opt for tight money and budget slashes, and thus some recession which would negate any investment splurge.

I, too, favor judicious tax cuts—once we have an Incomes Policy in place, thus allowing the easing of monetary policy without inflation alarms.

Still, the productivity problem is likely to be more obdurate without new technological triumphs because of rising raw material costs. For example, not many years ago we were able to exchange about one automobile for 2,000 barrels of oil. That is, assume the auto price was \$4,000 and a barrel of oil \$2. With an auto selling at \$6,000 and a barrel of oil at \$15, it requires five cars for the same quantity of oil. Through OPEC, the higher cost of extracting minerals, higher prices of coffee, sugar, cocoa, copper, etc., we realize smaller domestic quantities of these items for the same amount of work-hours.

Instant remedies are precluded. Productivity jumps from 1 to 2 percent, or 2 to 3 percent, are enormous when compounded over time. If spectacular productivity surges could be captured there would be no poor or underdeveloped countries.

A better inflation record would strengthen the dollar, lower import costs, and facilitate faster growth through segmented investment. Conversely, until productivity returns to historic norms, a tighter incomes policy will be indispensable to a sidewise price path.

THE CARTER ANTI-INFLATION PROGRAM

The President, in his October 24 and November 1, 1978 pronouncements, finally set an anti-inflation course after the more casual approach of last spring. Regrettably, the action was about 18 months belated. It is still too tentative and there is a long road to travel.

The announcement-effects of Fed policy, and the international stabilization measures, have imparted some buoyancy to the dollar. Fed policy, however, will require, as remarked, some economic slowdown to be effective against prices. Monetary policy is capable of aggravating our unemployment ordeal without yielding much inflation surcease. The stagflation double-trouble promises to persist.

The President's budget aims to reduce, slightly, the scale of government in GNP. On inflation it is unlikely to dent the sorry price trend.

Incomes policy measures consist of a plea to hold average pay hikes to about a 7 percent norm, accompanied by price standards just short of the pay guides. Sanctions for violators involve a denial of government procurement, a trial balloon call for boycotts—quickly disavowed by the President—and intimation of the publication of a "bad boy" roll—a new kind of public enemy listing as against the earlier WIN button merit badge. The news media reports staff recruitment and the issuance of directives attesting to the functioning of the Council on Wage and Price Stability. Too, there is the "real-income insurance" now before Congress. (A comment on a related approach appears as point 3 in the Appendix.)

A brief critique

The Council seems to be veering down the road to limited old-fashioned controls, poking its way into pricing and wage decisions, forging exceptions to fit special cases. It is still too early to judge the agency, whether it will be a mouse or a lion, despite the four months that have elapsed.

The pay and price norms, I think, have been set too high: the 7 percent pay norm, and the roughly 6½ percent price move originally promulgated, hardly ends infla-

tion; it caps it at a jagged height. Prices at this peak will double in a decade; some supporters are skeptical that even this tier will hold.

In promoting the numbers the pervading philosophy concurred that inflation must be unwound gently, otherwise many who counted on inflation will be hurt; the judgment then has been to bleed those who have been ravaged already.

This is distressing. A strategy to stop inflation should target to stop it. The President will reap as much flak for this tentative inflation-oriented anti-inflation step as from a more precipitous price and wage-salary drop. Better to face the acrimony and to promote public education now, rather than to drain our energies into 1980 and beyond. The October inflation message assures us that there is a stagflation dialogue in our future. Our inflation-unemployment affliction is not over.

Beyond the high numbers, and the bureaucratic overtones of controls tempered by new types of sanctions, the current environment begs to minimize government intervention in the economy. Government should not exacerbate conflicts in the economy. Firms that want to pay more than the noninflation pay rate should be free to do so—it was childish bureaucratic bungling to utter even a one-day reproof on Pete Rose's baseball contract. Cost deterrents, not a procurement scramble nor a social offender (or public enemy) list should be evoked on those who puncture the pay norms; for monopoly-type price markup excesses we do have an Anti-Trust Division.

In all this I maintain, therefore, my predilection for the Wallich-Weintraub TIP, modified in some details. (See Appendix.)

CONCLUSION

The inflation "slows" still beset us; the problem is finally being attacked—slowly. Assessment of its critical severity is belated and inadequate; its blot on our economic performance and national well-being is still dimly apprehended.

Simultaneously, we are backward in creating an environment for maximum employment. There is an "unalienable" right to jobs, to income and human dignity, at roughly current real wages. A pity that Thomas Jefferson, with what John Adams called a "peculiar felicity of expression," did not inject a right-to-work clause in the Declaration of Independence. Too, John Stuart Mill's observation, in his celebrated essay *On Liberty*, denying the right of anybody to act overtly to injure others—which covers the inflation ordeal—remains apt for a democratic society.

Socialist economies, obviously, control money incomes. Some with market economy features, such as Hungary, have an enviable price level record. We will have to learn to gear money incomes, on average, to productivity norms while, at the same time, avoid jeopardizing the basic freedoms of the market economy.

I remain an optimist despite our long frustration.

Appendix

[Excerpted from *Challenge*, September-October 1978]

PROPOSAL FOR AN ANTI-INFLATION PACKAGE

On the premise that the "carrot" and the "stick" will both influence conduct, the following package reflects my own concept of the proper legislative design for TIP.

1. *Amend the Davis-Bacon Act.* According to law, prevailing wages must be paid on current government or government-assisted construction. The government is thus already operating an incomes policy. Labor and business now lobby for contracts which create jobs, and shortly thereafter there are strikes for higher pay, involving raids on the public purse. A new clause, however, can require that, over the life of the contract, average pay increases for all personnel are not to exceed 5 percent per annum.

A construction authorization incomes policy (CAIP), should help hold the line on construction excesses. Penalties can include disallowing overpayments on the corporate income tax form, and remanding sums equal to the excess above 5 percent to the government.

2. *Amend government procurement contracts.* CAIP can be applied to government procurement generally, especially to defense contracts, where pay increases are paid for by the public.

3. *Reduce personal income taxes.* Reduce the personal income tax by a credit of 2 percent on employee compensation, with a minimum tax reduction of 2 percent on employee compensation, with a minimum tax reduction of \$200 and a maximum of \$300 on all incomes rising by 5 percent or less per annum. This borrows from the original Okun proposal. Largest percentage benefits would redound to wage earners' advantage and help induce wage restraint.

4. *The (modified) Wallich-Weintraub TIP.* All business firms employing 500 or more employees or having an annual wage and salary bill of five million or more, are subject to the following tax provisos:

a. For average employee wages that increase by not less than 3 percent nor more than 5 percent per annum, the firm's tax rate will be lowered by (at least) 2 percent below the standard corporate tax rate.

b. If the average annual pay increase exceeds 5 percent, the firm will be subject to progressive penalty tax rates.

Essentially, (b) is the original Wallich-Weintraub TIP. Proviso (a) is inserted (from Dr. Seidman) with the 3 percent floor intended to preclude greater rewards to firms that beat down pay levels; it dispels any possible allegation that TIP is a plan to "create slave labor." It should also encourage pay moderation to foster price stability. Restriction to large firms should render the proposal administratively feasible. Others may prefer to include only firms that are even larger in size.

5. *TIP-CAP: A productivity bonus.* Firms reporting average value-added per employee surpassing the economywide 2-3 percent trend of the past might be granted a pay prerogative above the 5 percent norm. Calculations would have to be made for average product corrected for price level inflation (CAP, or Corrected Average Product). This would be a bit more complicated than TIP calculations, but would involve only simple subtractions (of cost of materials from sales receipts) and applying standard price level indexes as a deflator.

This would be a productivity bonus. Perhaps one-third of the superior productivity increase above 6 percent might be added to the 5 percent standard increase. Not all of the productivity gain should be commanded by employees, however, for the firms should be motivated to reduce prices.

6. *TIP supplements.* Various supplements can be attached to TIP-CAP to assure compliance. For example, certain firms might be in cash-flow financial straits if their 5 percent settlement offer were rejected by labor, resulting in a strike. Such firms might be cleared for a government-guaranteed loan to meet fixed charges. Clearly, loan availability would have to be monitored to prevent collusion.

Labor, in rejecting a settlement at 5 percent (or a trifle more) might be subject to penalties ranging from mild to stringent, depending on strike duration and the (vague) national interest. Labor specialists should promote this discussion.

7. *Amending the anti-trust laws.* To allay objections that prices are absolved from sanctions, the Federal Trade Commission (FTC) might be mandated to report quarterly on trends and profit margins, especially among the 2,000 largest firms, measured in terms of sales or employment.

Firms reporting extra productivity improvement should be expected to lower prices. Where there is evidence that they are not doing so, the FTC might be empowered to report and to seek remedial policies.

Profit margins have been declining. Until contrary evidence emerges, further action can be deferred.

8. *Government employees.* Average pay increases for federal employees would be limited to 5 percent per annum, with corrections every two or three years if the private sector trend exceeds this norm. State and local employees would be brought under the same 5 percent tent through the leverage of federal grants or other federal aid programs.

CONCLUSIONS

These appear to be the essential legislative provisos to accomplish a firmer match-up of money, wage and salary trends to the productivity norms. None of them does violence to the market economy; mostly, they invoke the tax laws and, confining them to the largest firms, they spell only minor complications. They are modest by way of intervention in the market system. If successful, they ought to capture the big prize of full employment without inflation. Over the past decade a workable policy of price level stabilization would have enhanced GNP by \$50 to \$150 billion per annum. Inflation drift will inflict equal or greater annual losses in the future.

Senator BENTSEN. I will limit the members to 10 minutes per round on the questions. I will exercise the prerogative of the chairman by starting.

Mr. Bosworth, the CPI index for January will not be released, I understand, until 2:30 this afternoon, so I don't have it to discuss at the present time. Perhaps you can give us some idea of where it is headed. We are looking at some awfully rapid price increases

over the next several months. We have had no testimony on that one.

With that in mind, how can you possibly achieve the President's 7½-percent inflation goal? Are you still holding to that?

Mr. BOSWORTH. First, I am not going to try a couple of hours ahead of time to predict what the CPI increase is, because I could easily be proved wrong. There are two things that I am reasonably sure will show problems.

Senator BENTSEN. Let me interrupt, for a moment, to talk about the productivity number because we were talking from memory, both of us, on what the productivity increase would be for 1979.

The staff has researched it for me. I had correctly said 0.4 percent, and you quoted something higher than that.

Mr. BOSWORTH. I stand corrected on the 0.4 percent.

I think that the CPI will show a very high rate of increase this afternoon. We know that there will be very substantial increases in food prices in January.

Also, there will be dramatic increases in the dairy area, which have been up very sharply over the last year. I would emphasize that we believe that the rise in beef prices is almost exclusively due to the rise in farm prices. The margin, the difference between the retail value and the farm value, has been less than 6 percent.

January will show again that the margins have been held down fairly well, but there will be very big increases at the farm level in food prices. In other words, I would guess that the rate of increase in food prices will be well over a 1 percentage point increase.

In the housing area, there is no reason to think that the rapid escalation of housing prices will not continue for the next couple months. That is what I would label as our second major problem.

In housing, I really think that it is a classic excess-demand situation, in part, having to do with demographics, the fact that the postwar baby boom is at the house-buying age.

Senator BENTSEN. Mr. Bosworth, I just have 10 minutes. The question I have is: Do you still believe that with all of those factors that you continue to go along with a projected 7½-percent inflation?

Mr. BOSWORTH. I think we can get down very close to 7½-percent inflation. After the first quarter is over and we get into the spring months with better weather, we believe there will be a substantial amount of moderation in food price increases.

I think my uncertainty in answering your question explicitly depends almost exclusively on energy. If the Iranian oil supply is restored soon and the world prices don't rise rapidly, I think you are talking around 7½ percent.

Senator BENTSEN. I hope you are right on that.

Now, this morning, I read that a U.S. district judge in Nashville has not approved the TVA settlement on pollution abatement and that was partially because of your intervention. What is your comment concerning that? What do you think will be the result of that?

Mr. BOSWORTH. I saw the same article in the paper. We had regarded the issue as pretty much settled. TVA had attempted to get an out-of-court settlement under the environmental protection laws with respect to local coal, way back last summer. The Council

made an effort to discuss the issue with TVA because we are concerned about trying to find the least costly way to cut down on the pollution that comes from powerplants.

The problem basically is that western coal is low sulfur coal. The use of western coal will mean lower pollution, but it will also mean there will be a drop in the local regional use of coal; thus some requirements to use local coal could be passed. That is more costly because that will then require more equipment to cut pollution.

We wanted those issues investigated. TVA declined to do so last fall. A company wrote and asked us about the issue. I wrote them that the issue was settled as far as we were concerned; the Council's involvement was some months ago. Now, we find that this letter that we wrote to the company has been put before the court.

But the Council has not been involved since last summer.

Senator BENTSEN. Is it true that prices have been raised in anticipation of the possible mandatory wage and price controls? Is that part of what we are seeing? You have spoken principally of food, but are there parts of the industry where decisions have been made suggesting a pattern that might have been instigated by management feeling that wage and price controls are not in the offing?

Mr. BOSWORTH. Yes. Our concern is not only in the food area, it is also in the nonfood area. What is startling in the January producer price index is the wide range of price increases that have occurred.

It seems not to have been a problem with the larger companies. The automobile industry is not one of those, the steel industry is not one of those, the aluminum industry is not one of those, et cetera.

It seems to be much more broadly spread in those categories of the economy dominated by smaller producers. We are still trying to contact some of these companies and see what the reasons were for the price increases, so I cannot give you a complete answer to that question yet.

Senator BENTSEN. Mr. Keyserling, I recognize the fact that productivity goes downhill every time there is a lessened use of capacity, since businessmen keep on supervisory personnel; you cited that. But has this been happening in our economy? Have we actually had such a reduction in the utilization of capacity in this country that it would lead to such a substantial lowering of productivity?

Mr. KEYSERLING. We certainly have. Of course, it depends on what period you start your comparisons with. My whole objection to much of what is looked at is that it assumes systematically that we have a very short-range problem. What has been happening since 1953, with some undulations, is a chronic and increasing secular or long-term increase in unused capacity, increased unemployment, and increased inflation all at the same time, and unless we take a long enough view, we are flying blind.

Now, I do have a chart here which shows what I am talking about. It is chart No. 3 in my prepared statement. Chart No. 3 traces over various substantial periods of time, beginning with 1947 and running through 1978, the relationship between productivity

growth and real economic growth, which correlates closely with unused plant capacity.

It shows a very strong and positive correlation between the rate of real economic growth—which correlates very closely with the degree of utilization of plant and human power, and other productive resources—and the rate of productivity growth, so I think it is all there.

Senator BENTSEN. Well, let me ask you about these numbers. We have also heard, and it seems to me, as compared to the rest of the world, we have an aging manufacturing capacity. I often wonder about the percentages of capacity utilization that are recorded. When they talk about 85 percent utilization of capacity, the part that is not utilized normally consists of the older plants or the older parts of the plants or those parts that are not as productive.

Are those not usually brought onstream when you get to even higher percentages of utilization? Isn't that perhaps distorting the numbers some?

Mr. KEYSERLING. It is not distorting my numbers. I think it is refuting the official reasoning because the official reasoning is just as defective in its examination of our overseas problems as in its examination of our domestic problem.

Let me get, just for a minute, into your question about the overseas situation. The weakening of the dollar, increasingly unfavorable trends in our trade and balance of payments, our failure to be competitive which is bringing too many goods from overseas into the United States, and the excessive flow of American capital overseas through multilaterals and otherwise—developments that are all due primarily to the relatively weaker performance of the American economy.

I have a chart 6 here which shows that, during the last 10 years, the Japanese and German economies have been growing two to three times as fast as ours in real terms.

Also, on previous occasions, I presented to this and other committees, charts showing that those countries also tried to reduce inflation by cutting economic growth and higher unemployment and every time they did that, the inflation went up, and when they abandoned that approach, the inflation went down. I have drawn up a chart within the last couple days, showing that this is true even until now, but I have not yet had time to reproduce it.

Why are we not getting enough business investment, nor getting rid of old plants rapidly enough to be more competitive? It is just because demand for and sales of what industry produces are not expanding enough.

So, the high inflation in the United States, the lower productivity growth rate, the lower real economic growth rate, and the selective and inflationary shortages—deliberately contrived staginations and recessions—are all one ball of wax. And these all contribute to the increasing competitive advantage of these other countries who have, for these very same reasons—relatively more investment, a higher ratio of investment to GNP, relatively more new plant and so forth—is all part of one picture.

Let me read my last paragraph, because it bears so directly on this. I am not going to try to answer what some of my friends have developed in the laboratories of their own minds. I would like to

look at the great laboratory of the American economy in action. What worries me more than any single thing is this. There is no planning—and Senator Javits will be interested in this as a sponsor of the Humphrey-Hawkins legislation related to this. There is almost no planning in what the administration is doing; its own programs are in conflict. It is listening to the advice of six contending top economists and I can never tell who is “top,” and the President does not decide who is “top”.

What worries me most of all, as I state in my prepared statement:

We must regain a sense of what America can and must do instead of do without, of what we need rather than what we “cannot afford.” Austerity and sacrifice are good things in their time and place, such as during World War II when every resource was overstrained. But what place do they really have, when almost all of our economic problems and social problems result fundamentally, not from economic overstrain, but from failing to use the available resources which are pleading to be used. The administration’s policies, in their current form, represent a shortsighted, smallminded, defeated, and deflated frame of mind and loss of nerve. This committee and the Congress can help to change all that.

As to productivity, it almost makes me cry to see an administration, with the kind of technological potential that we have, with the enormous growth rate in it, which is going to cause more and more unemployment if allowances are not made for employment action, yielding and bowing to the idea that we have really suffered an irretrievable loss in our ability to increase productivity growth. The administration is not doing anything much about the causes of the decline, and until they start doing that by a reversal of policies, it is never going to get productivity up.

Senator BENTSEN. Mr. Keyserling, I agree that there are things we can do, and have to do, but my time has expired and I want to yield to my distinguished colleague, Senator Javits.

Senator JAVITS. Thank you, Senator Bentsen.

First, I would like to join our colleague from Texas and thank him for being with us. It is all very helpful and very helpful to the country.

Mr. Bosworth, one thing that you have said puzzles me. As I gather from your statement—and please correct me; I am just trying to summarize what I have gathered from the testimony—you feel the administration should go right on doing what it is doing and that it will result in an inflation rate of 7 to 8 percent, notwithstanding current evidence that invalidates that proposition; is that correct?

Mr. BOSWORTH. I don’t think the program is locked in concrete. I think that there will have to be some changes made.

Housing, for example, has continued to rise and we have to find something to do about it.

The standards have been in place basically in the last couple of months. We can’t say on the basis of the WPI report a month prior to that, “Now we will switch course and go to something else.”

I think the administration has been careful to emphasize that you cannot get overnight success out of this program; it will take some time to have some impact.

There are, however, two thoughts that have been going on in recent months—the problem of food and the problem of housing.

Standards of wage and price limitations do not directly address these issues, when there are farm price increases or when aggregate demand exceeds supply.

Just because the inflation rate has continued high for the first month of 1979 I don't think that the forecast of 7 to 8 percent inflation has to be invalidated.

Senator JAVITS. Well, in other words, what I said is correct. I am not disagreeing with you. I just wanted to get it clear.

You say what the captains of ships say, "Steady as we go"; right?

Mr. BOSWORTH. Basically, I think you are correct.

Senator JAVITS. Well, I mean, we have our choice as to whether we agree or not, but I think it is very important to get it clear.

The other thing that you said that interested me greatly was that you don't have so much trouble in the "voluntary" guideline situation with big business as you have—I suppose it is implied—with small business; is that correct?

Mr. BOSWORTH. I think we have much more visibility and awareness of the program, and efforts to comply with it on the part of the large firms.

Right now some of the smaller firms seem to feel that the program does not apply to them; we will have to overcome this attitude.

Senator JAVITS. Now; do you have any plans for overcoming it and if so what are they?

Mr. BOSWORTH. I think basically the task of the Council on Wage and Price Stability is to get the monitoring up and running and to begin to contact some of these firms where we see sharp price increases.

I think the most effective means of driving home to these intermediate companies—those with less than \$500 million in sales—is to bring some of them in and ask them about their price actions. This program applies to them just as much as it applies to General Motors.

Senator JAVITS. Well, to me, that is very big news. This is one of the first times I have ever heard a Government official, Republican or Democrat, say that you could get compliance out of big business, but you are having some with small business.

I think that is a very important point because it is so popular in our country to make big business the whipping boy. Often it deserves to be bitterly criticized; but just to take for granted that it is big business that is at fault is not good for the country.

I think it is a very fair statement and I am glad you made it.

Now, turning to one other aspect—our time is rather limited, so it is hard to ask too much.

Turning now to the issue of productivity which has concerned very deeply Professor Weintraub and also by implication Mr. Keyserling, who happens to be a very old and dear friend of mine—this has been not only a matter of great concern, but of great activity as far as I am concerned and a few others here, including our chairman.

The thing that puzzles me is this: I would like to reconcile the two points of view again as I understand.

As I understood Professor Weintraub's point, he really said that unless you can improve the rate of productivity from its present

catastrophically lower state, you have to reduce the American standard of living.

Again, these are very hard words for politicians, just like what Mr. Bosworth said about big and small business, but it is a fact because what he says is the wage bill is going to eat you up alive.

Now, what Mr. Keyserling says is this, don't worry about raising the productivity by tightening your belt; just increase the output of goods and services and that will raise productivity.

Now the question that bothers me is this, Mr. Keyserling: It is a fact that the theory behind your theory is that business then makes enough to modernize, but it may also be true that statutory policies of depreciation give us a completely distorted view of business's ability to do that because it does not deal with replacement cost nor does it deal with modernization, it takes the standpat, old American plant and depreciates it at "normal" rates.

Is that the hole in your theory?

In other words, is your theory invalidated because unless we are realistic so that more production in volume does produce truly greater ability to modernize and thus replace the theory in balance?

Let's ask Professor Weintraub and see if he agrees with me.

Mr. WEINTRAUB. Senator Javits, might I state, as you know, that a long time ago we had Kenneth Galbraith as a price controller. He always insisted that it was much easier to control the large firms than the small ones. I think that the reported recent facts bears this out.

On the productivity issue, in general, you can write down a set of statistics. But these apply to the yesterdays. Where are we getting the new technological breakthroughs currently?

Largely, when they evolve, they represent a help; if they come along, we will be in pretty good shape in the inflation struggle. We probably could get productivity up a little bit—maybe by one-half percent; 1 percent; or even 1½ percent—by fuller employment. But you are not going to get fuller employment unless you first resolve the inflation issue.

You cannot get businessmen to go ahead with modernization investment as readily at 10 and 12 percent, and even higher rates of interest, as you can get them to act at interest rates about half those numbers.

Further, the general contraction in economic activity by fighting inflation through monetary policy does lead to unemployment and militates against putting new capacity in place. So I tend to think that we just won't get ahead on the production front unless we first cope with inflation.

There I come back to: How to do it? Monetary policy has the great drawback of trying to move—unsuccessfully—against the one illness, inflation, by putting us in unemployment jeopardy.

One further point you mentioned—

Senator JAVITS. Professor Weintraub, I must interrupt. My time has expired.

Mr. WEINTRAUB. I want to agree with you, Senator.

Senator BENTSEN. Let Mr. Weintraub finish the answer to your question.

Mr. WEINTRAUB. I agree with almost everything Senator Javits said and I am not in conflict with much of it, and none of this surprises me on the basis of past experience.

Let me try to reconcile this.

Point 1. Let's, for the moment, say that productivity is the big problem.

The question is: How do you get it up? I admit it is a problem. You say that inflation is the big problem. I admit that. The question is: How do you get it down?

Productivity is increased by two things: Full utilization and more investment. You need both.

Full utilization depends on more markets. Business is not going to invest more when the growth rate is cut in half or when recession is on the way, even if business has the capital.

Therefore, I think the first step is to supply the essential basic ingredient to the encouragement of business to invest more. This is more markets, more ultimate demand, with more consumer buying and more public outlays in proper proportions.

If you find, as you start, the business still needs more capital to invest, on which a lot could be said, then we should have pinpointed improvements in the tax cuts to bring that about.

We should not have the kind of broadcast tax reductions that we have had over the last years which have gone willy-nilly to almost everybody whether they have needed it or not.

I led the way to pinpoint the tax reductions during the Korean war, and this was very effective. So you have to do both of those things; you cannot leave out either of the important ingredients.

Now a word and what was said about labor and wages. I will merely quote from what Business Week said a week or two ago.

It said a week or two ago that, during the past year there has been a 9-percent increase in prices and a 9-percent average increase in wages. I don't know where the "800 percent" comes from. So, labor made no gains in buying power per worker. And then, Business Week said that, if the guidelines are effective, labor's buying power would absolutely decrease.

Now, wage-earner buying power is two-thirds of all consumer demand and consumer demand is two-thirds of the whole economy. You cannot get an increase, you get, rather, a decrease in output and employment of the whole economy if these kinds of policies on guidelines, spending, taxation, and monetary policy are followed—with more, not less inflation. This has happened five times since 1953. Why is the administration trying the same things again?

Senator JAVITS. Thank you very much.

Senator BENTSEN. Congresswoman Heckler.

Representative HECKLER. Thank you very much, Mr. Chairman.

I would like to say to Mr. Bosworth that you recommend a stable course as Senator Javits described it.

Let me say that I think the ball is in your court as Director of the Council on Wage and Price Stability.

If you succeed, we will have a stable course. If you fail, then the public pressure against the increase in prices will cause and force the Congress to take another course and that will back us into wage and price controls which I do not favor.

So, I feel that those are the options.

You will succeed or, based on your achievements, there will be few options available to the Congress which cannot be avoided. I would like to ask at the outset, Mr. Bosworth, do you speak to the President?

Mr. BOSWORTH. Occasionally.

Representative HECKLER. I think it is disappointing that it is only occasionally.

Did you have an opportunity to speak to him about his announcing his support of an increase in the price of sugar from 15 to 15.8 percent?

Have you spoken to the President about that?

Mr. BOSWORTH. I, personally? No. That would normally go through Mr. Schultze, Chairman of the Council of Economic Advisers, or Alfred Kahn, the Chairman of the Council on Wage and Price Stability.

Usually, I don't give advice directly to the President.

Representative HECKLER. In other words, you monitor the price increases in the private sector, but if the President initiates the price increase, you have no voice in that?

Mr. BOSWORTH. We will usually make an analysis for the administration on those types of issues. That is forwarded to the President by either Alfred Kahn or Charlie Schultze.

A few months ago it was mainly Mr. Schultze because he was Chairman of the Council on Wage and Price Stability.

Representative HECKLER. It is my understanding that the average American consumed 92.7 pounds of sugar last year and that an increase in the price of sugar will virtually affect costs in almost every product line since the American taste becomes sweeter and sweeter.

Now, the end result of all this has to be an increase in food prices, which is the runaway factor aside from energy, which has some rational basis.

The increase in food prices is the runaway factor in your scenario as you, yourself, admit. How can this Government then not deal with the inflationary impact of an increase in sugar prices which will affect so many food items and the food budget itself?

How can the President, on the one hand, say that we are going to fight inflation and on the other hand propose an increase in sugar prices that creates food inflation in the most sensitive area of the whole economy where the inflation is already out of hand?

How can you justify these inconsistent and contradictory policies?

Mr. BOSWORTH. I think in terms of national policy you cannot.

Even the administration's proposal to Congress on the sugar situation is inflationary. There is no doubt that it will raise sugar prices.

This issue has a long history between the administration and the Congress. The administration last year tried to get a much lower sugar price.

The administration's interest in the issue principally has to do with the International Sugar Agreement. The administration has been unable to get the Congress to consider this agreement unless it would first agree to a sugar bill.

Sugar is very important to some people in the Congress who have a strong say in what our program is going to be. If you are trying to work out an agreement to resolve this issue of sugar, the industry and many of its congressional proponents are talking of introducing a bill calling for 17 or 18 cents for sugar.

The administration had earlier sought a much lower price for sugar. We tried to resolve that difference through compromise.

The latest proposal by the President is inflationary in and of itself. But it comes down to the action that is taken in terms of the alternatives available to the administration, and I don't see that they have much choice. It depends on what they can get through the Congress.

Representative HECKLER. If I might interject, it seems to me that in view of the enormous impact of inflation on the American consumer and taxpayer, inflation should be the No. 1 priority. Is the implementation or the future of a sugar agreement more important than fighting food price inflation for the consumer of America?

Mr. BOSWORTH. I would remind you that about 4 years ago for a short period of time we had 80 cents a pound sugar because of a sharp world shortage. The purpose of the International Sugar Agreement is to work out an agreement between the producers and the consumer nations to establish a reserve to meet such needs.

Domestically, only about 15,000 producers, but they are 15,000 very influential producers up here on Capitol Hill. The domestic cost of producing sugar in the United States is currently about 15 cents to 16 cents a pound if you made a full allowance for the price of land.

The question basically is whether or not the United States will have a domestic sugar industry. The argument made by some people in the Congress is that there is too much exposure if the United States becomes completely dependent on the world market. The domestic producers say that they need a sugar price of at least 16 or 17 cents.

Representative HECKLER. Are you saying that the sugar agreement is more important than food price inflation for Americans?

Mr. BOSWORTH. It is part of the food price inflation. If we do not have some sort of international agreement to stabilize the sugar market, we will get more inflation the next time around. We are trying to avoid the large swings in sugar prices.

You are absolutely right, however, that the implication in the short fall is that the price of sugar will be higher than it otherwise would be for the next year or two. What the implications of this agreement will be over the next 10 years can very well be that, on average, sugar prices will increase less.

Representative HECKLER. Well, we are dealing with the problem of inflation today as the No. 1 problem in America.

Mr. BOSWORTH. Right.

Representative HECKLER. Now, in terms of going from the question of the President's supporting an inflationary increase in the price of sugar which affects the commodities across the spectrum and foods across the marketplace, the fact of the matter is that I question how really effective you are, even how effectively you are approaching this whole question of food prices. I am really sur-

prised to have you testify today that what happens is the traditional answer, or the reason for increases in food prices, whereas in Boston one of our leading supermarkets, the Star Market, itself recognized the increase in pricing of all food products and initiated a new labeling system in which it made the consumer aware that the new goods were exceeding your guidelines.

This was happening on such a flagrant basis—I think in anticipation of a wage freeze or a price freeze later—that this supermarket took it upon itself to inform the consumer that the prices were exceeding the guidelines.

Now, this is not a question of whether we are looking at cattle or at traditional elements of the boom-or-bust farm cycle problem; we are looking at a policy of many companies that indicates to me—and I don't know their size, whether they are within the large, medium, or small range—that they are virtually ignoring your guidelines.

While we don't expect overnight success, if you have passive acceptance and this increase in sugar which will affect hundreds of products, you are going to produce inflation yourself.

Now, what are you doing in terms of this food inflation that goes beyond farm factors which are not necessarily the pivotal questions or the questions of current and runaway food prices? What monitoring system have you instituted?

Mr. BOSWORTH. No. 1, I guess I would disagree a little bit. I think that the problem in the last few months and over the last year has been farm prices.

Farm prices are 30 percent of the consumer's food bill.

While that is only one-third, it has been increasing at very rapid rates. In the food marketing area the Council does have standards to control the margins with respect to the amount of increase in price over and above the farm prices.

For the first 3 months ending in December the average annual rate of increase in those margins has been less than 6 percent.

We do have a standard. We are trying to monitor these food processors to make sure that the increase in the cost of goods they purchase does not bring them more than 6½ percent in additional profits over the next year.

So far, the industry appears to be cooperating with the program. I would also say that the next 3 months is not over yet and we will have to wait and see what develops further.

In sugar, I think that you are right. In the short run it is absolutely inflationary.

It is an issue of long-range effect because we cannot be concerned about inflation in the next few months; we have to be concerned only about next year as well.

Basically, this conflict is over whether or not the United States should have a domestic sugar industry. The conflicts are not going to be limited to sugar. We are going to have basic questions in the next year from the energy area too.

Representative HECKLER. Mr. Bosworth, let me raise another subject just briefly. I think there must be some misunderstanding, but I did not hear your testimony.

I understand that one of the causes that you attributed for the lack of productivity in the American wage force was the introduc-

tion of more minority individuals and women into the wage force; is that correct?

I cannot believe that you think that women are less productive in the wage force than men.

Mr. BOSWORTH. Let me be clear. What we have is a very rapid growth of new entrants into the work force, partly of women and partly because of the postwar baby group.

When people first come in to work for the first couple of years, until they develop job skills, they tend to be less productive.

Now, the demographics in the 1980's will go in our favor because then these people who entered now, women and teenagers, will be experienced workers and their productivity should increase.

We argue that it has been a factor holding down current rates of productivity but it has nothing to do with their sex, or their age per se. Rather, it is the fact that there is rapid new entry to our labor force.

Representative HECKLER. Thank you, Mr. Chairman.

Senator BENTSEN. Thank you, Congresswoman Heckler.

I am committed to let you gentlemen finish at noon, so I now call on Congressman Brown.

Representative BROWN. Thank you.

It is nice to see you here and we appreciate your views.

Let me ask a fundamental economic question. Given the situation in which we find ourselves now, is this the time to stimulate demand or supply in our system?

Mr. Keyserling, maybe I had better start with you as the senior officer present.

Mr. KEYSERLING. It is now the time to stimulate both, through selective programs that deal with both.

There is nothing more damaging to national economic policy than the fallacy of the thinking which concentrates on one point to the neglect of most others, and this is the trouble that I find in this administration, in contrast with those administrations which were successful in dealing with all of these problems. That is what planning under the Humphrey-Hawkins Act means.

When we hear people coming up here and saying that they have not talked to the President, that may be all right but they ought to talk with the President.

In other words, the President has to have the command to get a unified economic policy and he is doing an injustice to the Congress when they can't find out from his representatives where he really stands.

This is the essence of a unified economic policy.

Now, during the Truman administration we had Mr. Charles E. Wilson as an aid to mobilization during the Korean war. I was not subordinate to him; I worked for the President.

But President Truman insisted not only that I sit with the Wilson group but that I brief them every week so that we had a unified economic policy—covering demand, supply, production, wages, prices, and all basic elements of national economic policy.

Now, let me answer part of this question by Congresswoman Heckler, because I believe she is right on everything she says and I agree with her on everything she says.

In the first place, as to the women entering the labor force—

Representative BROWN. Wait a minute. Congresswoman Heckler has had her time. You are perfectly welcome to do that but not on my time.

I asked you if you think we need to stimulate demand or supply, one more than the other. Now your answer was, I guess, that we ought to stimulate both.

Mr. KEYSERLING. All right.

Let me continue to answer that. This was my intent, I am sorry to have caused you to infer otherwise.

Representative BROWN. I want to get the other gentlemen's answer, too, and we only have 10 minutes.

Mr. KEYSERLING. Fine.

This is one of the problems. We have to stimulate both supply and demand, and the President's program is trying to cut back on both. He is trying to cut back on housing; he is trying to cut back on other sources of supply; he is trying to cut back on demand.

This is inimical to the whole American economy, and it is the worst thing that we can do with respect to inflation because stagnation and recession always produce more inflation.

An automobile running 30 miles an hour burns more gas per mile than one running 50. It also burns more gas per mile at 90 miles per hour than at 50.

The official economists think if we get it to 30, it burns less than at 50. They found that an economy running at a real economic growth rate of 9 percent generated more inflation pressures than at a 5-percent rate. So they are now trying to reduce the growth rate to a 2.7-percent average during 1979 and 1980 to reduce inflation. They are as wrong as they can be.

Representative BROWN. All right.

Mr. Weintraub.

Mr. WEINTRAUB. On the question you raise, I would distinguish between stimulating money demand—for output—from real demand and money-oriented supply and real supply.

The question involves rates of pay. Are we going to pay \$500 a week or \$200 a week or \$800 a week? So, I would say that the time is long past for stimulating both real demand and real supply, but not money demand and money supply market output schedules.

Money supply, money demand refers, in my arguments, to money income aggregates.

Representative BROWN. Mr. Mitchell.

Mr. MITCHELL. I guess I have a problem in responding. I don't think that we really have instruments currently that turn supply on and off.

We have instruments of monetary fiscal policy but unless you were talking about some very thoroughgoing system of national planning, something of that type, it does not seem to me that we really can talk about a supply policy except in some very specific areas.

Possibly in the farm or agriculture area we have some instruments.

Representative BROWN. Let me comment.

It seems to me that we can sell more farm goods abroad at anywhere close to reasonable prices and that we therefore in a year's time very quickly stimulate the supply of those goods pro-

duced in this country which reduces for the American consumer the cost of those goods. This occurs because we are proliferating our market, reducing our unit costs to production and winding up with our domestic consumers better off because of the drop in that unit cost of production.

Also, we are dealing with the farmer and his perceptions of his needs in terms of total economic return. I guess the first step in that, then, is to institute the policy that might stimulate foreign demand for American products but the reduction in price or rather the stabilization in price—the reduction probably is too optimistic—comes from the stimulation of the supply; does it not?

Mr. MITCHELL. I think the agriculture area is one where the Federal Government can influence supply.

I think most economists would agree that you could increase output and that would be beneficial.

Representative BROWN. Now, I have expressed this concern to people like Chairman Miller of the Federal Reserve Board.

As a small businessman, we are finishing our fiscal year about now and I have begun to look at the cost of replacement of the products with which we try to make money, I mean, the machinery with which we try to make money.

I discovered that with respect to the tax policy, under which I can deduct depreciation as related to machinery, if I could take a higher depreciation rate reflecting real cost of replacement of those producing pieces of equipment, then my taxes are reduced. However, the tax policy does not allow me to take a real cost of replacement as my depreciation rate; it allows me to take something that is outdated by maybe one-third or two-thirds of the real cost of replacement.

So, I paid a higher tax in my company so a profit could be made and yet when it comes time for me to replace that equipment or expand, I don't have the resources unless I go out and borrow money to do that because I have not made the money from profits because the profits have been taxed away because of the depreciation rate.

When I get to the bank to try to get the additional money I need, I find that my competitor is the Federal Government which is borrowing that money or using it up in some form to meet its deficits and its expenditures.

The interest rate is high and the availability of market funds for my whole business is quite low.

Do you understand my problem and where that puts me with reference to the effort to increase supply and thus reduce the cost of the product that we produce?

Mr. MITCHELL. I understand your concern.

Representative BROWN. About what?

Mr. MITCHELL. I think there would be some problems at this point on generalized tax cuts of large amounts for business or anybody else.

Representative BROWN. I never mentioned tax cuts in all that; did I?

Mr. MITCHELL. Pardon me.

Representative BROWN. Did I mention tax cuts?

Mr. MITCHELL. You mentioned some form of tax—

Representative BROWN. Well, an increased depreciation rate, something that the IRS says merely reflects the real cost of replacement.

We were told yesterday we are going to draft the steel legislation. We have had pricing ills for a long time on steel—de facto, not de jure.

So, the profit from the steel industry has not gone back into the replacement of those steel plants.

What do we do about that? I mean, is there some other method by which we get relief?

Should we nationalize that industry and subsidize it rather than tax-cut it?

Are you following my concerns here?

Mr. MITCHELL. I am following your concerns but I think you have me out of my element.

Representative BROWN. In the steel industry?

Mr. MITCHELL. Yes.

Representative BROWN. I don't know what your element is but maybe Professor Weintraub can help us.

Mr. WEINTRAUB. Could I go back a bit, Congressman? On your farm illustration, I would say the exports do tend to improve our foreign balance through some strengthening of the dollar. That would be fine.

On the other hand, if we have the unchanged domestic spending without the exports, it would seem to me that would lower the price level here. But then the question is what you have—

Representative BROWN. My time is up, but if we had an expansion of both supply and foreign demand, wouldn't the unit cost of production tend to come down?

Mr. WEINTRAUB. That plus the augmented output by and of itself, and with the same amount of income to do the purchasing.

Representative BROWN. Did you want to pursue it further?

Mr. WEINTRAUB. With respect to plant modernization, I think this gets us to an enormous issue. We should be all out for modernizing our plants. The calamity is that Japan and Germany have outstripped us in modernization, in steel and in autos where we have enjoyed this enormous technological lead, and where we have been having complaints about imports.

The whys and wherefores are the issues. It would seem to me that we must do something to get back that lead once again.

We have been derelict on this problem in many ways. Words such as "tax cuts," "subsidies," and so on, are met with abuse even without examining the proposal.

Yes, we should be in the van of technology in all of those fields, in steel and electronics. Why not? We have the engineers, we have the know-how. In altering our laws, there can be some differences in approach. But this is a major problem. It would seem to me deserving of the highest priority.

Representative BROWN. Let me conclude with a comment. It seems to me in the past we have had the very heavy investment in the development of plant in the United States starting with the period before we set the tax rates and the tax methods that we now have. During that period of time the rate of inflation in this country was relatively low and the rate of new job development

was relatively high, and now these are the things that are afflicting us in the society.

It seems to me that in our total policy area—not just this temporary means of trying to deal with the inflation until the next election—that there has got to be some answer for the future of our society.

The Japanese are outstripping us in growth; the Germans are outstripping us in growth; and now the French and the British are also outstripping us in growth. I am a little concerned about what that implies for the United States in the year 2000.

I don't like to be a second-class power, and I sure don't want to be a third-class power.

Mr. WEINTRAUB. I agree. It is, I think, all closely tied to productivity and to the inflation issue.

We have invited stagflation through our monetary policies. These have created the economic downturn in housing and in investment. Yes; I do feel that these questions are bound together. Yes, this is the economic calamity that has befallen us. Where we once were in the technological forefront, we are now lagging.

Representative BROWN. Thank you.

Senator BENTSEN. Thank you, Congressman Brown. You have expressed the concerns of all of us on that.

I think the diversity of the comments and the so-called proposed solutions are an aid to the problem.

I am appreciative of the strong views that were expressed and the comments that you have made. It has been helpful to us.

Thank you very much for your attendance.

[Whereupon, at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, February 28, 1978.]

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF BARRY P. BOSWORTH TO ADDITIONAL WRITTEN QUESTIONS POSED BY REPRESENTATIVE HAMILTON

Question 1. A recent study by Alan Blinder and William Newton, for the National Bureau of Economic Research, demonstrated that after the 1971-74 wage-price controls were removed, prices rose so fast that they were actually about one percent higher than the level which would have prevailed if there had been no controls at all. Based on the results of this study, Blinder said, "The Carter controls program should be scrapped. There's not much of a short-run payoff, and in the long run, prices end up higher than in the absence of controls." What is your own evaluation of the Blinder-Newton study?

Answer. In the 1971-74 period, wage and price controls were substituted for responsible fiscal and monetary policy. Pressures created by expansionary monetary and fiscal policies during the control period caused rapid price increases when controls were lifted. In contrast, prudently restrictive monetary and fiscal policies are the essential foundation of the President's anti-inflation program. Under these policies, future removal of voluntary wage and price standards should not result in escalating prices.

Question 2. You and Chairman Schultze have repeatedly stated that in the early 1970's mandatory wage and price controls were a failure. At the end of 1972, approximately 4,000 people in the Federal government were employed to administer the program.

Under the President's proposed budget for fiscal year 1980, the total size of the CWPS staff should be increased to approximately 150. But at the February 23rd Joint Economic Committee hearing, you announced your intention to step up monitoring of intermediate and small companies. Admittedly, President Carter's standards are voluntary while President Nixon's were mandatory; but on the other hand, inflation is much worse today than it was in the early 1970's.

In short, how can 150 succeed if 4,000 failed?

Answer. During the 1971-74 period of wage-price controls, prices were contained despite expansionary monetary and fiscal policies and a fourfold increase in the price of OPEC oil. Wage-price controls were a failure because underlying inflationary forces, created by stimulative monetary and fiscal policies, quickly came to the fore when controls were lifted. In addition, the approach to wage-price controls, which attempted to control each and every price in the economy and which did not allow relative prices to adjust, created serious inefficiencies and market distortions, some of which, like beef, we are still experiencing. However, 4,000 people were able to control individual prices in the economy during the control period.

The current wage and price standards are easier to administer than the Nixon controls for a number of reasons. The standards apply to average prices rather than individual product prices. The price standard is aimed at decelerating rates of price increase and thereby avoids the great difficulties associated with administering controlled prices based on cost-pass-through considerations. Finally, the current monitoring effort is focused on larger companies and on industries in the excessively high rates of price increase. The President's fiscal year 1980 budget requests a total of 233 staff for the Council on Wage and Price Stability. These staff will be assisted by staff of certain other executive agencies in the price monitoring effort. We believe that the projected effort will be equal to the task.

Question 3. Wage and price controls: Many commentators have suggested that labor and business still expect that we will have mandatory wage and price controls, in spite of President Carter's statements to the contrary; as a result of this expectation, they may attempt to obtain large wage settlements and price increases now, defeating the President's program. Alan Greenspan has suggested that in order to end this speculation about controls, President Carter should state in advance that he would veto any legislation which would give him the power to impose controls. Do you agree with Mr. Greenspan that the President should take this step?

Answer. I would hope that the Congress would not take unilateral action to provide such authority or to impose mandatory controls and I expect that Congress will not.

Question 4. Mr. C. Jackson Grayson, Jr., Chairman of the American Productivity Center, has charged that the anti-inflation wage-price guidelines "could seriously curtail some of the most effective productivity improvement programs in America" because productivity gains may be counted as offsets to pay increases for labor under union contract only. What is your response to this allegation?

Answer. The voluntary pay and price standards were designed to be consistent with the goals of increased economic efficiency and improved productivity. These standards are not counterproductive as often claimed. They have been designed to encourage efficiency and avoid the dampening of investment incentives. This is evident in several aspects of the standards.

First, the notion of a price standard based on a cost-passthrough principle was rejected at the outset. Under the 1971-1973 program of price controls—administered by Mr. Grayson, Chairman of the American Productivity Center—price limitations were based on a percentage passthrough of costs. This approach provided no incentive for firms to search for cost efficiencies, since any decrease in costs would have to be reflected in reduced prices. In contrast, under the present price standard, if the price deceleration goal is achieved, no limitations are placed on profits. This encourages firms to take cost-reducing actions, with the resultant profits available for investment and capital accumulation—a major determinant of productivity growth.

Second, the price controls of the early 1970's applied to individual product prices, and this approach tied companies into a pricing straight-jacket that prevented them from reacting rationally to changing cost and market conditions. In contrast, the current price standard applies to the average rate of price change across all product lines of a company. Companies are free to adjust relative prices in response to changing market conditions so long as they meet the overall deceleration objective.

Third, the standards do not limit dividend payments. These payments, which were limited during the earlier controls program, help companies attract funds needed for capital investment.

We intentionally rejected the notion of a differential pay standard for differing rates of productivity growth at the firm level. In designing and revising the pay standard, we received outside advice and comments from numerous compensation experts and labor-relations experts, and these individuals overwhelmingly recommended against such a general productivity-adjustment clause. Their primary concern was that, since productivity is extremely difficult to measure, the existence of a general adjustment would create a significant loophole, preventing the placement of

any effective limitation on pay-rate increases. The experience of the Cost of Living Council during the controls period bears out this belief.

However, there is a more fundamental objection to a general productivity-adjustment clause. There is no theoretical, empirical, or ethical justification for the notion that wage-rate increases should be directly linked to productivity growth at the firm level. The disparities between productivity growth rates across industries are not attributable to differences in the diligence of the workers; rather, they are due to the fact that there is more potential for productivity-improving innovations in some industries (for example, manufacturing) than in others (for example, services). Rapid productivity growth in some industries is primarily the result of the embodiment of new, more advanced technologies, which can in turn be traced back to general scientific progress. The productivity growth rate for the economy as a whole determine the rate at which real wages can increase on average, but there is no reason why the distribution of real-wage increases across industries should correspond to the distribution of productivity increases across industries. Rather, disparities in productivity growth rates across industries are reflected in divergent price trends; price increases are relatively low in high-productivity-growth sectors and relatively high in low-productivity-growth sectors.

The pay standard does not afford special treatment to firm-level productivity incentive plans. There are economists who would argue that these plans have any significant value in increasing aggregate productivity or in prompting individual workers to work hard. Under these plans, all workers benefit when performance improves, including those who make no extra effort; thus, these plans provide little individual incentive. Further, the performance criterion under these plans (for example, under Scanlon plans) is most often measured in dollars rather than units of output. Thus, an increase in price is often called a "productivity increase" under these plans. The absence of these plans is not a cause of our long-term decline in productivity, and they should be given no special treatment under the pay standard.

The pay standard has given special treatment to productivity only where it is clearly and directly measurable and only where it is clearly tied to a demonstrable improvement in the diligence of the individual workers.

This occurs in two cases:

Pay-rate increases that are traded for work-rule changes that result in demonstrable improvements in productivity are not counted against the 7-percent standard. This exception applies only to collective-bargaining situations, in which a company has no alternative means of eliminating outdated work-rule restrictions other than a buy-out using additional wage-rate increases.

In cases in which an individual's pay is directly linked to physical measures of his or her own industriousness, such as piece-work pay and sales commissions, the 7-percent standard does not apply to pay increases related to increased physical output per hour worked.

The Council appreciates your concern about this important matter; we hope our explanation and suggested course of action will be helpful to you.

THE 1979 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 28, 1979

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

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

Present: Senators Bentsen and Javits; and Representative Brown.

Also present: Richard F. Kaufman, assistant director-general counsel; John M. Albertine and Deborah Norelli Matz, professional staff members; Mark Borchelt, administrative assistant; Katie MacArthur, press assistant; and Mark R. Policinski and Stephen J. Entin, minority professional staff members.

OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator BENTSEN. Gentlemen, this hearing will come to order.

Gentlemen, we are very pleased to have you here this morning. We will get started, although some members of the committee will not be here for awhile.

Governor Snelling, when he was discussing this issue with me earlier this week, said that he felt that the Governors should have a chance to express their points of views publicly in hearings before the Congress, and we are reciprocating. Fortunately, we already had this hearing planned, but we are delighted to let them present their side of the issue.

I would like to say that the President, as part of his anti-inflation program, has proposed a rather austere budget. Yet, it would still result in a \$29 billion deficit in fiscal year 1980, if we accomplish what he has called for. At its 1978 annual meeting, the National Governors' Association (NGA) called for a balanced Federal budget, and this sentiment was affirmed at the Governors' meeting yesterday, so I assume that our witnesses today will be prepared to recommend additional budget cuts.

I have had some of them say the reason I proposed a curtailment or cut off in the Federal revenue sharing to States was in response to the Governors' calling for a balanced budget. That simply is not the case. I have a long record of voting against revenue sharing; I opposed it from the very beginning.

Let me also say that our system of Federal intergovernmental aid has grown at an extraordinary pace in recent years. In 1960, the Federal Treasury disbursed \$7 billion to State and local governments. This figure has soared to \$82.9 billion in the fiscal year 1980

budget. Thus, while State and local governments are giving consideration to reducing their local taxes and expenditures, they are more dependent than ever on the Federal Government. In fact, in 1977, for each dollar of revenue raised by State governments, States received 46 cents from the Federal Treasury.

What is more, State expenditures, according to the National Governors' Association data, increased by an astounding 25 percent between 1977 and 1978, and are expected to increase another 14 percent between 1978 and 1979.

We have some charts attached to my opening statement for reference on that.

Thus, it appears that the deficit-ridden Federal Government is assisting States to hold the line on local taxes, while increasing local expenditures greatly. I realize that these expenditure increases are in part caused by inflationary pressures over which State officials have little control, but these excessive expenditure increases are also fueling the national inflation, and though it might be painful, must be curtailed.

That is why I introduced legislation to prohibit State governments from receiving general revenue sharing (GRS) funds. At this point in time, no State is projected to incur a budget deficit and, in fact, according to NGA data, States will realize a \$4.3 billion surplus in fiscal year 1979. It simply makes no sense to me for the Federal Government to be providing \$2.3 billion to the State government sector which is in relatively healthy fiscal condition. I hasten to add that State tax revenue between the years of 1975 and 1978 increased by 42 percent; well outpacing the combination of inflation and population growth. In fact, between 1977 and 1978, State governments realized a 14-percent increase in per capita tax revenue without even counting the revenue from tax-rate increases.

If we are to balance the Federal budget, additional cuts are essential. You just can't have it both ways. You can't call for a balanced Federal budget, yet oppose efforts to curtail Federal outlays to State governments.

I realize that many Governors believe that categorical grants rather than general revenue sharing funds should be cut. However, I have yet to see a list of which programs and how much should be trimmed.

In the past, when I have made this comment, I have been referred to a National Governors' Association memorandum to Jim McIntye. As far as I am concerned, that memorandum offers little more than platitudes calling for elimination of waste through program consolidations. I am still awaiting, and anxious to review, a list agreed upon by our Nation's Governors which recommends actual categorical program cuts.

Instead of a list of cuts, however, the NGA has endorsed the administration's proposal to provide a new \$150 million energy impact assistance program to assist States suffering from economic boom.

I am certainly not adverse to cutting categorical grants. Last year, I voted for over \$24 billion in budget cuts. But I do not believe the choice is whether general revenue sharing or categorical programs should be cut. I think they both ought to be cut. With

the pressure on State and local governments to reduce taxes and pressure on the Federal Government to balance its budget, the bottom line is that general revenue sharing as well as categorical grants must be reduced.

I turn to you, our Nation's Governors, for suggestions on which programs and how much should be cut.

[The charts and the National Governors' Association memorandum referred to in Senator Bentsen's opening statement follow:]

State Government Fiscal Condition

Fiscal Years 1977-1979

	DOLLARS IN BILLIONS			
	1977	1978		1979
		ESTIMATED	ACTUAL	ESTIMATE
Total Funds Available	\$88.5	\$96.6	\$113.0	\$123.0
Expenditure	83.6	92.5	104.1	118.7
Surplus	4.9	4.1	8.9	4.3

Source: NGA & NASBO Fiscal Survey of the States.

State Government Expenditures

	DOLLARS IN BILLIONS	PERCENT CHANGE
1977	\$ 83.6	—
1978	104.1	25
1979 (Estimate)	118.7	14

Source: NGA & NASBO Fiscal Survey of the States.

Federal Expenditures

	DOLLARS IN BILLIONS	PERCENT CHANGE
1977	\$401.9	—
1978	450.8	12
1979	493.4	9

State — Own Source Tax Revenues

	STATE TAX REVENUE PER CAPITA	ADJUSTED PER CAPITA INCREASE ¹
1975	\$3 75.	—
1976	4 15.	8.1
1977	4 66.	10.4
1978	5 32. ²	14.2

¹ Adjusted for population growth and tax rate changes.

² For year ending September, 1978.

Sources: Advisory Commission on Intergovernmental Relations; Bureau of the Census.

National Governors' Association
National Conference of State Legislatures

November 28, 1978

MEMORANDUMTO JAMES T. McINTYRE, JR.

Members of the National Governors' Association and the National Conference of State Legislatures have given careful consideration to the federal FY 1980 budget. Review of the federal budget is certain to continue within our organizations, and our views will be made available to you on a continuing basis.

Traditionally, NGA and NCSL committees have made program by program spending recommendations without indicating any order of priority. This document reflects an early attempt to add a new element to our recommendations: suggesting criteria for curbing spending in a way that minimizes the adverse effect on state and local governments.

Three points should be made at the outset:

1. We strongly support the President's determination to restrain inflation, and we are working closely with the Administration to undertake joint efforts to achieve this objective. A necessary element of the overall strategy to curb inflation is fiscal prudence in the development of the FY 1980 federal budget.
2. We believe that the state-federal programs noted in this report are of the highest priority. Other key state-federal program recommendations which have already been made to you (or will be made shortly) by NGA and NCSL should also receive strong support in the budget process.
3. We consider it essential to terminate the myth of a large state "surplus" which has been widespread during 1978. Such a surplus does not exist and should not be permitted to confuse consideration of the FY 1980 budget.

There are a number of issues on which our groups do not have a position. Where this document is silent on broad priorities (such as reported Administration proposals to increase defense spending, for example) we in no way intend to indicate tacit support for these priorities.

We urge you to ensure that the FY 1980 budget proposed by the Administration incorporates the policy and program recommendations we have outlined in this document.

I. BALANCED FEDERAL BUDGET

The National Governors' Association and the National Conference of State Legislatures support the President's efforts to balance the federal budget by FY 1981. NGA has emphasized its support by renewing its call for a balanced budget at the 1978 NGA annual meeting. While NCSL has not taken formal action, a poll of the NCSL membership taken in February showed that 68 percent of those responding felt that the federal budget should be balanced if unemployment did not rise.

The details of the FY 1980 budget and the proposals which the President will make to Congress on how to achieve significant reductions in the deficit next year are of immediate concern to both organizations. We have convened a joint working group to consider the issue and have given it considerable thought. As a result, we have developed policy and program recommendations which we urge you to incorporate in the proposals you make to the President. The extent to which these policies are reflected in the budget will determine the level of active support which NGA and NCSL can commit to the President's proposals for achieving a balanced budget.

II. RECOMMENDATIONS

A. Overall Budget Policy

1. Budget savings in intergovernmental programs should be accompanied by increased administrative flexibility for state and local governments. Program reductions should be accompanied by major administrative reforms, such as program consolidation, reducing mandates on state and local governments, and streamlining procedures and paperwork. Between 1975 and 1978, the number of separate federal categorical programs has increased from 442 to 492, and the last major block grant program was enacted in 1974. The Administration should recognize that program consolidation, reduced mandates, and other administrative reforms are responsive to the public's concerns about inflation and government inefficiency, duplication, and waste.
2. Funding decisions should result in real savings to taxpayers. Cut-backs in programs administered by state and local governments cannot be equated with cuts in other sectors of the budget. A reduction by the federal government in a program area of exclusive federal responsibility is virtually certain to result in reduced government spending. A cut by the federal government in an area of joint federal, state and local responsibility--such as welfare or education--may simply result in the transfer of costs from the federal government to state and local governments. The effect may be not a reduction in the overall level of government spending but a transfer of the burden from the federal income tax to a state sales or income tax or even to the local property tax. Such a cut at the federal level is not really anti-inflationary; in fact, it may be the reverse.

Funding reductions in federal programs that are unaccompanied by administrative reforms are likely to have an adverse impact on the productivity of state and local government delivery systems, in effect driving up the per unit cost of services. Therefore, in considering reductions below current service levels in any program, the Administration should ensure that the reduction will result in real economies and will have the least adverse impact on the recipients of services and on state and local taxpayers.

3. Fiscal constraints should not delay the development of authorizing legislation for high priority programs which will have a limited impact on FY 1980 budget projections. A welfare reform proposal and a stand-by program of economic assistance to state and local governments are key examples here. A commitment by the Administration to action in these two areas are top state priorities.
4. The Administration should use budget-making techniques which preserve the fiscal choices of the states. In general, we will oppose federal cutbacks which are made by shifting funding responsibilities to state and local governments through reduced federal matching rates. Appropriation reductions, in spite of the dislocations they cause, maintain the states' option to reduce their participation in programs proportionate to the federal reduction, to retain a funding commitment equivalent to previous years' funding, or to increase their contributions to the program.
5. Intergovernmental assistance should not bear a disproportionate share of funding reductions below current services.
6. The impact of federal policies on state and local government should be determined before these policies are adopted. The President should ensure that no legislation or regulation will be supported by the Administration unless determination has been made of the impact it will have on state and local government.

The federal government has been criticized for placing unfunded mandates on state and local governments. Requirements for specific tests for safe drinking water, for specific state actions to ensure air quality, for special education, and for accessibility of programs and facilities to the handicapped are recent examples of mandates promulgated without adequate assessment of cost.

Unfunded mandates placed on state and local governments are a current point of intergovernmental conflict, but they are not the only issues of major concern between states and the federal government. The relationship of federal programs to existing state and local efforts is another important recurring question, and so is the amount of paperwork which the federal government requires of its grantees.

There have been notable attempts at the federal level to ensure more careful assessment of the impact of administrative requirements. Nevertheless, there are two areas where additional improvements could be made:

- a. OMB Legislative Analysis Checklist - The Office of Management and Budget should review its procedures for analyzing congressional and agency legislative initiatives to ensure that a determination is made of the effect legislation would have on state and local government before Administration support is extended.

As with the urban impact analyses, the OMB state and local impact analyses should be brief. They should cover the following points:

- effect of the initiative on present and future costs to state and local government;
- methods for financing these costs;
- timetable for implementation;
- the relationship of the proposed federal initiative to existing state and local programs and management practices;
- the method for ensuring that where overlap, duplication, or a potential conflict exists between the proposed federal initiative and state programs, adequate provision is made for coordination between the levels of government; and
- the paperwork implications of the administrative requirements of the proposed statute.

Any potential problems which appear during the course of this analysis should be resolved before Administration support is recommended for any legislation.

- b. Congressional Cost Analysis - Section 403 of the Congressional Budget Act of 1974 requires the Congressional Budget Office to review the cost of implementing any legislation which is reported by a congressional committee. This section has been interpreted by the Congress to require an assessment of the cost to the federal government; costs to state and local governments are deemed not to be covered by the statute. In the last session of Congress, an attempt was made to require CBO to assess the cost to state and local government as well as to the federal government. In light of the demands of citizens that government spending at all levels be controlled, and in light of the President's anti-inflation initiatives, the Administration should support such a rule change.

7. Prescriptive federal regulations should be revised to permit increased flexibility for states and improved targeting according to state and locally defined needs. State officials and others who have studied federal program administration have found that detailed regulations add significantly to the cost of running federally funded programs and hamper the targeting of funds to local needs. In general, we support the President's strategy to reduce prescriptive regulations through executive reorganization, improvement in federal planning requirements, and reforms in the joint funding simplification program.

The federal government is now undertaking a variety of demonstrations under which prescriptive regulations are revised to allow increased state and local flexibility. These demonstrations should be expanded to more sites and programs.

Among the demonstration projects we refer to here are:

- HEW Planning Grants. The Department of Health, Education and Welfare will be working with five states this year to determine whether existing state planning and budgeting systems can be substituted for federal plan requirements. HEW currently requires about 55 annual plans. The success of this project would mean major paperwork reductions and better targeting of federal funds to meet state priorities.
- Farmers Home Administration Coordinated Investment Strategy. FmHA and North Carolina have reached an agreement to work together to implement the state's balanced growth policy. The agency, which spends some \$500 million in North Carolina, has made a commitment to spend a portion of the funding for each of its programs in accordance with the state-developed strategy. FmHA has also promised to work with other federal agencies to assure their cooperation in funding projects which have been designated as top priorities by the state.
- HUD Rural Housing and Community Development Initiative. HUD will be working in two states (Washington and North Carolina) to simplify forms, provide special technical assistance, and develop a streamlined decisions process to make it easier for rural areas to obtain federal housing and community development aid. The aim of the pilot project is to ensure that the funding allocated to rural communities in the two states will be used in accordance with local needs.

8. The President should make public his position on some of the technical details of his plan to balance the budget before increased public pressure limits his choices. Among the issues on which a position should be developed are how capital expenditures should be budgeted and what provisions should be made to allow for decisive federal action during times of economic downturn or rising unemployment. The President could ensure that these questions are addressed in a neutral public forum by requesting that they be examined by a Presidential task force.

B. Program Recommendations

1. General Revenue Sharing should be reauthorized with little change. - For more than a decade, Governors and State Legislators have strongly supported the concept of General Revenue Sharing. It is viewed as a centerpiece in the federal-state-local system of shared powers and responsibilities. In light of the increased pressure on state and local budgets, continuation of the current program is of the highest priority to state elected officials. Failure to fund the program would result either in the discontinuation of many state and local services or the shift of additional burdens to the very taxes which the nation's taxpayers appear to like least. NGA and NCSL view the General Revenue Sharing program as an indispensable element of the federal-state-local partnership. We do not endorse any major changes in the revenue sharing program.
2. Welfare reform should be addressed in the President's budget. The Administration should renew its commitment to welfare reform in the 1980 budget. This commitment could have a much reduced budgetary impact than that of the original Administration proposal and still make badly-needed and extensive changes in the existing welfare program. The programmatic alterations to be made under reform legislation should be implemented only after adequate lead time for all administering governments.

In keeping with recent Administration pledges, such legislation should provide interim fiscal relief which precedes implementation of the programmatic alterations. Therefore, the changes in the rate of federal matching for the welfare programs should take effect in 1980. This would have an approximate additional federal cost of \$2 billion. However, most programmatic alterations should be made effective in federal Fiscal Year 1981, with the result that no additional programmatic costs will be incurred in FY 1980.

NGA and NCSL will pursue legislation modeled on some of the provisions of the 1978 compromise proposal developed by the New Coalition. These components, with an estimated annual cost of \$7-8 billion, include:

- establishing a national minimum benefit of \$4200 for eligible recipients;
- providing transitional cash assistance in all states to two-parent families as they seek work;
- providing supplemental cash assistance to all working two-parent families whose incomes do not reach levels where assistance benefits are provided to families eligible for welfare;

- moving toward greater uniformity of rules and eligibility standards;
- simplified administration;
- strong assistance to all unemployed or underemployed recipients able to work in finding suitable employment; and
- fiscal relief of approximately \$2.0 billion to state and local governments for welfare expenses.

3. A permanent stand-by program of economic assistance to state and local governments should be enacted for use during recessions. Such a program need not involve major budget expenditures in the FY 1980 budget. If current economic projections are accurate, a stand-by program should entail only nominal expenditures. If economic conditions deteriorate, however, states and localities will need economic assistance to avoid laying off public employees and curtailing services or increasing taxes. The Administration should propose a program of stand-by economic assistance in the FY 1980 budget.

C. Recommendations for Efforts Which Can Produce Savings, Administrative Improvement, and Increased Effectiveness in the Intergovernmental System

1. The Administration should propose major program consolidations as part of the FY 1980 budget. The National Conference of State Legislatures and the National Governors' Association support extensive grant consolidation to provide more efficient use of state and federal resources and to create administrative savings. The following are three program consolidation proposals which we urge the Administration to consider; they are illustrative of the consolidation initiatives we support.

- a. Economic Development - NGA has developed an economic development block grant proposal which would cover the following programs:

Grants and Loans for Public Works (Title I, PWEDA)
 Business Development Assistance (Title III)
 Technical Assistance (Title III)
 Public Works Impact Projects (Title IV)
 Special Economic Assistance and Economic Adjustment (Title IX)
 Emergency Financial Assistance (Title X)
 Local Public Works

Excluding the Local Public Works Program, the categoricals proposed for consolidation are authorized at a level of 2.5 billion; appropriations have been about \$750 million. Attached is a copy of the legislation we have drafted to implement this block grant.

- b. Environmental Program Grants - EPA is developing a proposal which would allow states to apply for consolidated program grants specially tailored to their needs. Grants to states for air and water pollution control, safe drinking water, and solid waste planning could be included in consolidation proposals submitted by states.
- c. Airport Development Aid Program (ADAP) - The seven categorical programs of the ADAP program are candidates for consolidation. We suggest that the states be given authority to set priorities and spend funds for all airport construction and improvement projects except for those affecting the largest airports. These large facilities would continue to deal directly with the federal government.

The consolidation plan should create significant savings. A Federal Aviation Administration study in 1974 compared the cost of federally funded airport construction projects with projects funded by other sources and found non-federal projects to be 30 percent cheaper. The added expense is attributed to poor coordination of federal resources with state and local funding and inflationary increases which occur while federal approval is being sought.

In addition, the drop in the number of grantees under the consolidation plan from over 4,000 to about 100 may create the possibility of staff reductions in FAA by as many as 40 people. Using OMB guidelines (which set the average cost of each federal position at about \$25,000) the administrative savings from staff reductions alone would be \$1 million.

In addition to the three consolidation grants proposed above, we support block grants in health, energy conservation, and planning programs.

We urge the Administration to consider the block grants we have identified and to develop additional consolidation proposals. As a starting point to this effort, we have attached a list describing the consolidations mentioned in the paragraph above and consolidation proposals made by the Advisory Commission on Intergovernmental Relations in 1977. Although some program changes have been made by Congress since the time the ACIR list was compiled, particularly in the areas of vocational rehabilitation, programs for older Americans, and transportation, the list is still valid and deserves consideration. ACIR might be asked to update it to take into account changes which have occurred.

- 2. Hospital cost containment legislation should be re-introduced by the Administration. In light of recent efforts to combat inflation, hospital cost containment should be one of the highest priorities presented in the budget message. Rapidly rising medical costs have

placed a major strain on the federal budget; federal outlays for health care have grown at an annual rate of 20 percent since 1967. Hospital costs have been among the major sources of health care cost inflation. Over the past ten years, total hospital expenditures have quadrupled, rising at an annual rate of more than 15 percent--about 2.4 times the average increase in the CPI.

In response to the problem of hospital cost inflation, the Senate passed a compromise bill which

- established a voluntary hospital cost containment program to be backed up by a mandatory system if the voluntary effort fails;
- insured that the mandatory program, if triggered, would apply equitably to all costs and all payers; and
- assured that the federal program would not preempt ongoing state cost containment systems.

Estimates indicate that the bill would have saved between \$30 and \$35 billion over the next five years, of which \$11 to \$12 billion would have been federal savings and \$1.5 to \$2 billion would have been savings for state and local governments.

3. The FY 1980 budget should contain proposals for advance appropriations of federal program funds. As part of his anti-inflation effort, the President should support advance appropriations for major construction programs. One area where advance appropriation is most needed is in the \$4 billion program for construction of wastewater treatment facilities. Uncertainty about funding levels delays the lengthy planning and construction process for treatment facilities, and these delays result in significant inflationary cost increases. The FY 1980 budget should contain a proposal for advance appropriation of the wastewater treatment construction grant program.

In addition, the President should renew proposals he made last year for providing advance appropriations for vocational rehabilitation, maternal and child health, and programs for the aging.

III. CONCLUSION

The National Governors' Association and the National Conference of State Legislatures support the Administration's effort to balance the federal budget. We have prepared the material in this report to alert you in advance to our major concerns and to the criteria by which we will be measuring your specific budget proposals.

Attachments

ATTACHMENT: OPTIONS FOR GRANT CONSOLIDATION1. Health

At the time the "Federal Assistance for Health Care" block grant was introduced, some state officials expressed interest in the consolidation if medicaid were excluded. The other programs that were included in the proposal were:

Community Health Centers	Maternal and Child Health
Alcohol Project and State Formula Grants	Family Planning
Veneral Disease	Migrant Health
Immunization	Emergency Medical Services
Rat Control	Health Planning
Lead Paint Poisoning Prevention	Medical Facilities Construction
Community Health Centers	Developmental Disabilities
State Health Grants (314d)	

These fifteen programs, which have a combined budget authority level of about \$2 billion, are potential candidates for consolidation.

ACIR has suggested that a similar, but not identical list of health programs be consolidated. Categoricals on the ACIR list which were not included in earlier presidential proposals are:

Narcotic Addiction, Drug Abuse and Drug Dependency Prevention and Rehabilitation: Drug Abuse Education	Communicable and Other Disease Programs: Other Diseases
Communicable and Other Disease Programs: Tuberculosis	Drug Abuse Prevention and Treatment: Basic Grants
Communicable and Other Disease Programs: Measles Control	

Obligations for these programs in FY 1977 were about \$84 million.

2. Energy Conservation: State Energy Management Program

The Department of Energy has developed a consolidation proposal for the core energy conservation programs. The proposal would fold together the following programs:

State Energy Conservation Programs (EPCA)

Supplemental Program (ECPA)

Energy Extension Service

The proposed authorization for the program is \$105 million, approximately \$30 million below the authorization level of the three programs. States have opposed the \$105 million figure because it is lower than current authorizations and because new responsibilities (including data collection and capacity building) would be required of consolidated grant recipients.

The program provides that two years after the grants are consolidated states may submit requests to consolidate additional energy programs which are either in existence at the time the block grant goes into effect or are created by future legislation.

3. Planning/Capacity Building

Duplicative, overlapping planning requirements have been the subject of increasing criticism. One block grant option is to create a package of planning aid out of programs like the following:

Comprehensive Planning and Management Assistance (Sec. 701)

State Economic Development Planning (Sec. 302)

Substate Economic Development District Planning

Rural Development Planning (Sec. 111)

Intergovernmental Personnel Act

State Science, Engineering and Technology

4. ACIR Consolidation Recommendations

The following list was compiled by the Advisory Commission on Intergovernmental Relations in 1977. Although some program changes have been made by Congress since the list was put together, particularly in the areas of vocational rehabilitation, programs for older Americans, and transportation, the list is still a valuable resource.

In addition to the health block grant mentioned earlier, ACIR has recommended that the following categorical programs be consolidated into block grants:

(Funding levels provided are FY 1977 obligations)

a) Child Nutrition and School Meals: \$2.8 billion

Child Nutrition Programs:
Commodity Distribution Differential
Payments

Child Nutrition Programs: Special
Assistance for Free and Reduced
Price Lunches

Child Nutrition Programs: Non-food
Assistance

Child Nutrition Programs: Special
Food Service for Children in Service
Institutions

Child Nutrition Programs: School
Breakfast Program

Child Nutrition Programs: Special
Milk Program

Child Nutrition Programs: School
Lunch Food Assistance

Child Nutrition Programs: State
Administrative Expenses

b) Vocational Rehabilitation: \$769 million

Vocational Rehabilitation and Other
Rehabilitation Services: Special
Federal Responsibilities: Rehabil-
itation Facilities Construction
Grants

Vocational Rehabilitation and Other
Rehabilitation Services: Special
Federal Responsibility: Training
Services for the Handicapped

Vocational Rehabilitation and Other
Rehabilitation Services: Special
Federal Responsibilities: Initial
Staffing Grants

Vocational Rehabilitation and Other
Rehabilitation Services: Vocational
Rehabilitation Services: Basic Grants
to States

Vocational Rehabilitation and Other
Rehabilitation Services: Special
Federal Responsibilities: Facilities
Planning Grants

Vocational Rehabilitation and Other
Rehabilitation Services: Vocational
Rehabilitation Services: Innovation
and Expansion Grants

Vocational Rehabilitation and Other
Rehabilitation Services: Special
Federal Responsibilities: Facility
Improvement Grants

c) Programs for Older Americans: \$351 million

Older American Programs: Area
Planning and Social Services

Older American Programs: Nutrition
Program

Older American Programs: Model
Projects

Older American Programs: Planning,
Coordination, Evaluation, and
Administration

d) Child Welfare Services: \$83 million

Child Abuse and Neglect Prevention
and Treatment: Assistance to
States for Developing, Strengthening
and Conducting Programs

Child Welfare Services: Basic Grants
Developing Local Facilities for
Runaway Youth

e) Domestic Volunteer Services: \$57 million

Domestic Volunteer Services: Foster
Grandparents Program

Domestic Volunteer Services: Senior
Health Aides

Domestic Volunteer Services:
Retired Senior Volunteer Programs
(RSVP)

f) Forest Lands Management: \$33 million

Assistance to States for Tree
Planting and Reforestation

Cooperative Production and Distribution
of Tree Planting Stock

Cooperative Forest Fire Control

Promoting Research in Forestry

Cooperative Forest Insect and
Disease Control

g) Highway Beautification: Funding Level N/A

Highway Beautification: Control
of Junkyards

Highway Beautification: Landscaping
and Scenic Enhancement

Highway Beautification: Control
of Outdoor Advertising

h) Transportation Safety: Funding Level N/A

Highway Safety: Basic Grants

Highway Safety: Projects for High
Hazard Locations

Highway Safety: Eliminating
Railroad Crossing Hazards

Highway Safety: Special Bridge
Replacement

Highway Safety: Incentive Grants:
Reduced Traffic Fatalities

Motor Vehicle Diagnostic
Inspection Demonstrations

Highway Safety: Elimination of
Roadside Obstacles

Highway Safety: Incentive Grants:
Seatbelt Law

- i) Comprehensive Urban Transportation: Funding Level N/A
- | | |
|---|--|
| Highways: Federal Aid Primary and Secondary Extensions Within Urban Areas | Urban Mass Transportation Basic Grants |
| Federal Aid Urban Systems | Urban Mass Transportation Grants For Managerial Training |
| Carpool Demonstration Projects in Urban Areas | Urban Mass Transportation: Grants for Technical Studies |
| Special Urban High Density Traffic Program | Urban Mass Transportation: Facilities and Equipment |
| Transportation Planning in Urban Areas | |
| Urban Area Traffic Operations Improvement | |
- j) Comprehensive State Transportation: Funding Level N/A
- | | |
|---|--|
| Education and Training Programs for Highway Personnel | Highways: Interstate System |
| Highways: Emergency Relief | Highways: Priority Primary Routes |
| Highways: Federal Aid Primary System in Rural Areas | Highways: Public Land Highways |
| Highways: Federal Aid Secondary System in Rural Areas | Surveys, Research, Planning and Development for Highways |
| Highways: Forest Highways | |
- k) Water Pollution Prevention and Control: Funding Level N/A
- | | |
|---|--|
| Safety of Public Water Systems; Special Studies and Demonstration Programs | Water Pollution Prevention and Control: Pollution Control Programs |
| Solid Waste Disposal: State, Interstate and Local planning | Water Pollution Prevention and Control: Waste Treatment Works Construction |
| Water Pollution Prevention and Control: Areawide Waste Treatment Management and Planning Grants | Preparation of Plans for Rural Water and Waste Disposal |
| Water Pollution Prevention and Control: Planning Agency Administrative Expenses | |

1) Public Library Aid: Funding Level N/APublic Library Programs:
ConstructionPublic Library Programs: Inter-
Library CooperationPublic Library Programs: Library
ServicesStrengthening Instruction in
Science, Math, Languages, and Other
Critical Subjects: Equipment and
Minor RemodelingStrengthening Instruction in Science,
Math, Languages, and Other Critical
Subjects: Expansion and Improvement
of Supervisory Services and Adminis-
trationSchool Library Resources and Text-
booksm) State Education Assistance: Funding Level N/AVocational Education: Consumer and
Homemaking EducationVocational Education: Cooperative
ProgramsVocational Education: Curriculum
DevelopmentVocational Education: Research
and Training: Basic GrantsVocational Education: Work-study
ProgramsVocational Education: Exemplary
Programs: Basic GrantsVocational Education: Special
Programs for the DisadvantagedVocational Education: State Advisory
CouncilsVocational Education: State
Vocational Education Programs

Senator BENTSEN. We have three very able and eloquent Governors before us this morning, and I am delighted to now turn the testimony over to Governor Thompson.

STATEMENT OF HON. JAMES R. THOMPSON, GOVERNOR, STATE OF ILLINOIS

Governor THOMPSON. Thank you, Mr. Chairman. I wonder if I might, at the outset, respond just for a moment to the concerns you have expressed, because I think they are not only relevant, but pointed.

I speak now just for myself as Governor of the State of Illinois, and I will attempt to illustrate how we in Illinois, for the last 2 years during my administration, have been trying to do just what you would have us do, and why it is important to us that at least for the moment Federal revenue sharing be kept. I will limit these introductory remarks to just that one subject.

When I became the Governor in January of 1977, we forecast that a yearend balance in our general revenue fund, our bank accounts, our surplus, would be just \$52 million. That had to be one of the lowest, if not the lowest, surpluses in any State in the Nation. It had been spent down from half a billion to \$52 million, so I inherited a State that was literally on the edge of bankruptcy.

By holding my requests for spending increases in the next full fiscal year to an average of one-third the size of those over the past decade, we were able to improve the surplus position of the State and avoid cash flow problems. I did not want to say Illinois was a deadbeat when it came to paying bills of citizens for services and goods. I have held to that budget line each year, and my budget submission for next year will be for spending less than the growth of inflation in this coming fiscal year.

If all goes well with our spending plans this year, and we enter no recessionary mode that drives up the cost of public aid and related medicaid spending and drives down tax revenues, we will end this fiscal year with a surplus of \$136 million. I don't intend to let it go beyond that. Even that surplus was fueled in significant part by the receipt this year of one-time entitlement revenues that won't be repeated in the next fiscal year.

This year, Illinois will receive about \$115 million of general revenue sharing funds. If that \$115 million were to be subtracted from the \$136 million in surplus that we will have at the end of the year, we would be worse off than when I began our careful budgeting program 2 years ago and we would be near bankruptcy. We are bringing down the growth of capital spending in Illinois. We are being very conservative. But it is not correct to include Illinois as one of those States that has massive surpluses. Although there are hues and cries all over the State for tax relief, we simply cannot afford it, and I refuse to promise people something as illusory as tax relief, when there is no revenue to support it.

I might begin by saying that in the interest of the committee's time and in the interest of my two fellow Governors, I have shortened my prepared statement, which is available to the committee, as is this analysis of the President's budget prepared by the National Governors' Association which I will submit for the record.

In my view, this committee has an important role to play in this most critical year, for this committee—alone in this Congress—has the mandate to take the broadest possible view of the Federal budget for what it is: The economic and programmatic game plan for how this nation intends to conduct the business of the people next year.

I'm sure I speak for most Governors in expressing the hope that you will use that mandate to encourage other committees to look beyond the nuts and bolts of this document and focus on the premises on which it is based—and in particular on how it views the Federal-State-local service delivery system.

To judge by the tone and content of the meeting of the Nation's Governors over the past 3 days, we will not be beating on your doors this year to plead poverty. But we will be pleading for rationality in Federal policy.

Whether you as Senators and Congressmen, or I as a Governor, like it or not, Federal aid is, in fact, the lifeblood of the Federal-State-local system. When you cut, we bleed. If you cut crudely, we bleed badly. But if the incision is clean—and sewn up properly—we can survive.

Also whether we like it or not, we—the States and their localities—are junior partners in the Federal system. And we are concerned that our senior partner is not providing the leadership, or the wherewithal, or the freedom—and that's most important to us—to show our stuff, to prove that we can carry out our role effectively for the greater good of the firm.

The state of the Union may well be basically sound, as the President has suggested. But the state of the States is nervous.

Mr. Chairman, when we met with the President late last year to talk about the preparation of the budget, he told us that we were the only group that had come to see him that day, and perhaps even that week, maybe even that year, that was not asking for more, that in fact said we will take a little less if we can get some programmatic improvements that will allow us to survive the cutting of our funds somewhat. He was most grateful for our attitude.

I would like to repeat that for the committee today, and the Congress. We are not saying, "Give us more." We are not saying, "Don't cut us." What we are saying is that there are some tradeoffs that Congress can make, that make programmatic sense, which I will try to demonstrate in a minute.

To this end, there are five giant steps that Congress could take—and we believe should take now. Their enactment would at once improve services to people, help stop the inflationary trend in Government spending at all levels, and bolster the private sector economy.

None of these suggestions is based on bold, new ideas. But all of them are long overdue. And if ever the time was right for the Congress to take a new look at them—and to act—it is now, in this era of the taxpayer revolt.

I apologize for a litany that has been offered too often in the halls of this building, and will be forever more on behalf of Governors. We deeply believe in it.

First, consolidate more Federal-State-local categorical programs into single-purpose block grants.

Time and again, Governors, mayors, the Advisory Commission on Intergovernmental Relations and others have put forward laundry lists of proposed consolidations for programs embracing every facet of governmental activity—in health, transportation, planning, social services, vocational rehabilitation, jobs, water and air pollution control, and more.

Not only have we been turned down, we've seen no fewer than 50 more narrow categorical programs added in the last 3 years alone. Governors and mayors now have 492 different sources of Federal funding among which to window shop—and sometimes get lost—when we come to Washington for help.

When Governors and mayors besiege the Congress for yet more categorical grant programs, it isn't because we like the system. It's because we're realists. If that's the only way we can get Washington's ear, that's the way we'll ask for Washington's help.

Meanwhile, back home, Governors try to practice what they preach in Washington. Two-thirds of all State budget expenditures are for locally oriented functions. And in the last 12 years, the proportion of State-generated funds given out to localities in the form of general-purpose block grants has risen by almost 50 percent. It would no doubt be much higher if we didn't have to tie up so many State dollars in Federal redtape before sending them on their way to meeting people's needs at the local level.

To consolidate Federal categorical grants would be to shift power away from the unelected bureaucracy and toward elected officials at all levels of government—including the Congress. And I don't say that in any perjorative sense, because most of my time in public service, now exceeding almost 20 years, has been in appointed positions.

To continue to go the other way—as we have been in recent decades—would be to perpetuate the myth that Washington has a monopoly on integrity, expertise, and concern for the problems that Governors and mayors must grapple with every day. And it would be to say that Governors and mayors don't have priorities, don't have commonsense, and aren't in touch with the concerns and needs of their people.

The cost of general revenue sharing has risen at an average annual rate of only 3 percent since the program began, while categorical grant spending has jumped nearly 15 percent annually over that same time. If nothing else, these figures demonstrate the power of special interests—and the inability of the 300 committees and subcommittees of this Congress to say no to them.

There's something wrong with a system that supports so many lobbyists in Washington that there is a need for an association of associations and a market for a newsletter on newsletters.

If Congress is to control spending, it's obvious that it must at least simplify the ways public dollars are spent. General revenue sharing has proven that point, and shown the way Congress should be going.

To argue, as many do, that not all States and localities need their fare share of general revenue sharing funds is to miss the point of the program—and to miss the point of the argument over categorical grant funding. Revenue sharing funds are the only Federal moneys States and cities can use as they see fit—in ways

they deem appropriate—to meet needs they identify, which can shift from year to year. It can be education one year, it can be the cries of abused and neglected children next year. It can be relief for the elderly the third year. Revenue sharing gives the States the flexibility they need to meet programmatic priorities that they find whether it is in a prison system in revolt, or the need to do more for those who cannot help themselves, like children and the aged.

For example, consider the priorities of the 16 States represented on this committee which together receive about half of the \$2.28 billion in general revenue sharing funds going directly to State governments.

Nine of your States have decided to pass all or a large part of these funds directly on to local governments. The other seven use most of these funds to offset State costs in such areas as transportation, education, capital spending, and similar programs which directly or indirectly benefit local governments. Nationally, at least 40 percent of the States' share of these funds are passed through to the local level.

Thus to cut the State share of revenue sharing would have a direct local impact in virtually every State—or result in pressures for increased State taxes to make up the difference.

Our second proposal, which complements the first, is to give States and localities more latitude to do things their way under existing Federal categorical grant programs.

The Federal Register last year brought us over 61,000 pages of new rules—more than 90 million words telling State and local government and private service providers and businesses precisely what they can and cannot do.

You have heard time and again of the havoc these words can create—and you will keep hearing it until there's no reason for Washington to print the equivalent of a daily Bible.

Time and again, States and cities have demonstrated to Washington that they can have a better idea. In Illinois, for example, we've started a "no frills" job program that we expect will place welfare recipients in private sector jobs at a much higher rate than any federally inspired—and profusely regulated—program.

We seldom get Federal help for such projects—and we rarely seem to get Federal attention to the better ideas we prove workable. In this demonstration project, we're showing that our case-workers don't need a 4-foot shelf of rules and rubrics to get someone off the rolls and into the economy. They need a will to work at it—and time to do it right. They don't need to squander that time on Federal formalities.

In my view, Washington's role should be to set broad national goals and general policies designed to meet them. Our role should be to work within those policies to fashion the ways and means of programs best suited to the particular needs of our people.

Our third suggestion is for the administration and the Congress to give States a more direct role in coordinating programs and funds now flowing directly to our cities and towns from Washington.

A major disappointment in this budget is the lack of a cohesive urban policy in general—and of a new mechanism for State involvement in urban policy in particular.

The Governors had high hopes last year that Washington was going to get more serious about putting some sense into programs affecting our cities and towns. We still have hopes that Congress will see the need for such a thrust and meet it in the coming year.

Local governments are, after all, creatures of their States, and I don't say that in the 19th century way in which perhaps that phrase is thought. We have gone beyond the old common law rules that municipalities are creatures of the State and serve at will of the State government. The balance of power has shifted much in the last 100 years. Philosophies of home rule and metropolitan government have chipped away at the old notions that cities don't count for anything without the say so of the State, but there are programmatic reasons why the Congress should reexamine programs through which significant Federal funds flow to municipal forms of government without significant State input.

Economies don't end at city borders. Roads don't end at city borders. There is a massive movement of people between cities and suburbs and rural areas. Industries cut across lines. Tax structures of municipalities are dependent on State law so the relationship is still significant, even if it has lost many of its 19th century vestiges. And yet Washington likes to leapfrog State capitals and deal directly with local governments—even with neighborhoods. Governors have little or nothing to say—and therefore can't dovetail State programs with Federal activities—in crucial program areas like economic development, community development, and jobs programs.

We're not asking for the power of the purse. We are asking for the power of preview and persuasion—to give States a coordinating role in what's going on within their own borders.

Our fourth suggestion speaks for itself: Washington should be forced by law to weigh the fiscal impact of its actions on States and local governments and the private sector.

Here, I am talking about a philosophy that goes between the fiscal note process we have in some of our States, including Illinois, and a rule that the Congress fund mandated programs fully. I am not quite sure what the acceptable mechanism is. I know the Congress will want to weigh this kind of suggestion very carefully, because of the magnitude. What I am speaking mostly toward is a philosophy that stems the Congress. I confess we have been guilty of this on the State level for many years towards our local units of governments, setting into being broad new social programs—entirely worthy social programs, ones that no fair person would quarrel with—access to public facilities by the handicapped, for example—without any idea on anybody's part—Congress, the administration, the State and local governments or the taxpayers—as to how much it will cost and who is going to bear the financial burden. Now we find ourselves with mandated programs not only in those areas, but others. We are very uneasy. In fact, we are more than uneasy about our ability and the ability of the Federal Government to pay the costs of funding those programs as quickly as the law suggests they should be implemented.

Government at all levels is already devouring two-fifths of this Nation's income and employing 1 in 5 of its work force. It's also

placing a sometimes necessary—but too often frivolous—array of burdens on the private service and business sectors.

Commonsense suggests, for example, that we don't need every one of the 2,100 reporting regulations the General Accounting Office has found imposed on businesses. Commonsense suggests that hospital administrators are right in questioning why more than 100 Federal, State, and local regulatory agencies may be looking over their shoulders at any time. Commonsense suggests that we're demanding too much of an Illinois businessman if he has to be put through 6 months to 1 year of bureaucratic hoops before he can certify his product as eligible for bidding on a Government procurement contract. And commonsense suggests that the State of Illinois should not have to send every one of the 100 State plans to Washington to spell out what it's doing for children and families.

Before a law is enacted or a rule is written that will mandate someone, somewhere to do something, someone in Washington should be forced to demonstrate that the real cost, the ultimate cost, balances with the real benefit. When something must be done as a matter of public policy—like cleaning up our water and air or opening access to facilities and services for the handicapped—no one will argue the merits of the goal. Where there is room for argument is in how the goal is to be reached, when it must be reached—and who is to bear the cost.

These arguments should be settled up front, before the statute or rule becomes the law of the land.

Finally, our fifth suggestion, which also speaks for itself. Pass "sunset" legislation to force periodic hard looks—and hard choices—the same hard choices you spoke of in your opening statement, Mr. Chairman, on laws and rules already on the books.

We think this is an idea whose time has long since come. More and more States are doing it—we hope to enact it in Illinois this year—and the Congress came close to accepting it last year.

Over the past half-century, we've seen variations on the zero-based budgeting theme come and go. None has made an impact, for none has had the help that Congress could give, were it to force the bureaucracy—and itself—to occasionally rethink what seemed to be good ideas at the time they became Federal policy.

We're confident that a "sunset" policy would ultimately lead the national administration to accept the Governors' arguments for a more effective State role in a more productive Federal-State system.

The Nation's Governors will, of course, be talking with other committees of this Congress, and with their own delegations in the months to come, about the line-by-line concerns we have with this budget proposal. And we have many such concerns, in addition to the broad issues I have outlined here.

I suppose the last point I would like to leave the committee with is to please remember that States are not only partners with the Federal Government, but are the original sources of the powers of both the Federal Government and local governments. Sometimes we are made to feel like we are foreign nations, and not the founding source power in this Nation, on the dole instead of asking for rationality of programs which return not the Federal Govern-

ment's dollars or our dollars, but our citizens' dollars to them in the form of services.

I have a very fundamental belief in the commonsense of the citizens of the United States. Even with all the current clamor over balanced budgets and constitutional amendments and constitutional conventions, I suspect that our citizens share a deep-seated knowledge that won't be easily overturned about what they get in return for their taxpayers' dollars.

We had an election in Chicago yesterday that, in the end, turned more on the delivery of services to people than it did on any clamor currently in vogue as it may be for tax cuts. That is an interesting thing to reflect upon.

The Governors in conference this week, despite great pressures, not only rejected a call for a constitutional convention, but rejected any resolutions that would have proposed a constitutional amendment to force Congress to balance the budget. Despite our occasional harsh rhetoric, especially when we all get together, we retain a deep-seated belief in the wisdom and the ability of this Congress to set its priorities and to make the hard choices that we have to make on the State level every day, and to legislate the balanced budget through the process which brings you here as our representatives.

I think if we approach it in that spirit and if the Congress will give a genuine look at the concerns I have expressed this morning, we can be more effective partners with you. We can help you and the President get that budget down, and we can achieve a balance between what people pay for in terms of taxes, and what they receive in the form of services, to leave them with a decent feeling toward Government and its elected representatives. Thank you, Mr. Chairman.

Senator BENTSEN. Thank you very much. I agree with much of what you have said, and appreciate your statement. I, too, feel that Benjamin Franklin and Thomas Jefferson did a pretty good job on the Constitution, a constitutional convention would have every interest group in the country trying to rewrite the Constitution. Our Constitution has brought us to this point very effectively and I believe the present system works very well.

[The prepared statement of Governor Thompson and the analysis of the President's budget prepared by the National Governors' Association follow:]

PREPARED STATEMENT OF HON. JAMES R. THOMPSON

This Committee—alone in this Congress—has the mandate to take the broadest possible view of the Federal budget for what it is: the economic and programmatic game plan for how this Nation intends to conduct the business of the people next year.

I'm sure I speak for most Governors in expressing the hope that you will use that mandate to encourage other Committees to look beyond the nuts and bolts of this document and focus on the premises on which it is based—and in particular on how it views the Federal-State-local service delivery system.

To save time—and to spare you a litany of complaints and caveats that I and other Governors have with individual items in this budget proposal—I will limit my remarks to the most general of our concerns. And I will offer some specific suggestions from the Nation's governors for actions the Congress might consider to meet those concerns.

For the record, I offer a detailed analysis of the budget prepared by the NGA which I believe will be helpful to Members of the Joint Economic Committee in understanding the States' point of view.

To judge by the tone and content of the meeting of the Nation's governors over the past three days, we will not be beating on your doors this year to plead poverty. But we will be pleading for rationality in Federal policy.

Whether you as Senators and Congressmen or I as a Governor like it or not, Federal aid is, in fact, the lifeblood of the Federal-State-local system. When you cut, we bleed. If you cut crudely, we bleed badly. But if the incision is clean—and sewn up properly—we can survive.

Also whether we like it or not, we—the States and their localities—are junior partners in the Federal system. And we are concerned that our senior partner is not providing the leadership, or the wherewithal, or the freedom—and that's most important to us—to show our stuff, to prove that we can carry out our role effectively for the greater good of the firm.

The State of the Union may well be basically sound, as the President has suggested. But the State of the States is nervous.

We are on the front lines of the tax-and-spending cut battle. Governors and mayors are the first targets of the general malaise our people are feeling toward government at all levels—because we're closest to home.

In State after State—and Illinois is one of them—the people are demanding that more be done with less, that taxes and spending be stabilized or cut, that government stop promising more than it can deliver, and that it deliver what it promises.

Next week, I will be presenting my administration's proposed budget for what will be—if the General Assembly makes it so—a watershed year in the history of Illinois State and local government.

We will not only balance our budget for the third year in a row, we will also be grappling with the question of how to clamp a ceiling on taxes and spending at the State and local level.

This will not be easy—as Members of this Committee well know. No one in the world is against balancing income with outgo and controlling spending in principle. But no two will agree on precisely how to put that principle into practice.

Part of the problem for us in Illinois—and for every other State and local government in this Nation—is related to the fact that nearly a quarter of our spending, and much more than a quarter of the laws and rules that govern all of our spending, flow from Washington.

Thus if we are to have true reforms and efficiencies in government programs back home, we have to look for reforms in Washington to trickle down to us before we can make much more sense of the dollars we spend to meet people's needs.

I was one of a delegation of Governors who met with the President last December to press this point.

We said the States are ready and willing to help the national administration and the Congress cut deficit spending and cure some of the ills of the Federal-State-local system that lead to waste and contribute to inflation. But to do our part, we said, Washington must give the States a stronger role in the Federal system.

We offered several suggested steps to this end, which I will elaborate on in a few moments. Among these steps:

Consolidate scores of categorical aid programs into block grants;

Give States a central role in major grant programs now sending funds directly to local governments; and,

Ease the timetables on some of the monstrously expensive mandates that Washington has imposed on States and their localities.

No one of these steps is being taken, and no one of these issues is addressed to any meaningful degree in the budget proposal now before Congress. The President has said, again, that his administration will consider some consolidations, some reduction in red tape and some review of Federal mandates. But not this year. In effect, States and local governments are being told—in this document—that the administration expects us to do the people's business as usual, but with less help from our senior partner.

To add insult to injury, some officials of the administration and some Members of the Congress are pointing to State and local governments as primary causes, rather than victims, of what ails the Federal-State-local system.

We are told, for example, that we can survive major cuts in Federal aid because the 50 States are running a cumulative budget surplus of \$4.3 billion this year.

That argument is nonsense. It ignores the fact that States are constitutionally bound to balance their budgets. It ignores the fact that the combined surplus is only

3.6 per cent of all State spending. It ignores the fact that more than half of it is sitting in the treasuries of three States—California, Texas and Alaska.

It also ignores the fact that the 50 States have long term capital debts of nearly \$90 billion, that they have unfunded pension liabilities of as much as \$175 billion, and that they owe \$5.4 billion to the Federal unemployment compensation trust fund.

In Illinois—with total appropriations of more than \$11 billion—our “surplus” will be only \$136 million, or just over one per cent this year.

For cash flow purposes alone, an operating surplus of one per cent is less than a corner grocery store would need in the till every morning to make change for its customers. For emergencies, there should be more.

No government should be run on a basis that generates massive surplus revenues. A government that does is taxing too much, and should put that cash back in the people's pockets—or, better still, not take it out in the first place. But no State government can run responsibly without some extra cash in the till. We can't print it—any more than we can foresee what crisis it may be needed for.

We are also being blamed in some quarters for the failure of social services programs in general—and for the failure of delivery systems to make sense in particular.

We will, of course, accept our fair share of the blame. But to a very large degree, we are what Washington makes us when it comes to delivering services to the people.

If Washington says it has 492 categorical ways to help—as it now does—States and localities have to organize 492 ways to get their fair share. That's one big reason why our workforces have grown—and the primary reason why we have to send people in need from pillar to post to get help.

When States try to reorganize—as my administration has been moving to do over the past two years—we run time and again into solid walls built of minutiae by the Federal bureaucracy dictating the who, what, where, and when and how of human service programs and spending.

One example from our experience in Illinois. Last year, Members of the Senate Budget Committee suggested that we develop a block grant proposal to show how a State like Illinois would organize services for children—if it had a free hand to use Federal funds and its own matching funds any way it saw fit.

In the process of drawing up this proposal—which is proving vastly more difficult than we imagined—we're finding some startling symptoms of what's wrong with the Federal-State-local system.

For example, eleven of our agencies find they must draw Federal funds from a total of 171 distinct sources, all aimed at some distinct target population among children and families in Illinois.

To apply for and keep track of those funds, these agencies have to pay more than 1,000 employees nearly \$20 million each year to write more than 100 separate “State plans” to tell Washington how they intend to spend not only the Federal aid, but also State money used to match it.

Any taxpayer could suggest far more productive ways for us to use the time and talents—and the salaries—of those employees.

Which brings us to the heart of the question before this Committee and this Congress.

Most of the Nation's Governors, as I noted earlier, are more concerned this year with the quality of the Federal-State relationship than with the quantity of Federal funds flowing into their States and localities.

We told the President—and we'll repeat it to the Congress: We want to help curb spending and improve government services. But we can't be expected to survive massive cuts in the flow of Federal funds into our programs until and unless Washington acts to restore the States to their rightful places as full and effective partners in the Federal system.

To this end, there are five giant steps the Congress could take—and we believe should take now. Their enactment would at once improve services to people, help stop the inflationary trend in government spending at all levels, and bolster the private sector economy.

None of these suggestions is based on bold, new ideas. But all of them are long overdue. And if ever the time was right for the Congress to take a new look at them—and to act—it is now, in this era of the taxpayer revolt.

First, consolidate more Federal-State-local categorical programs into single-purpose block grants.

Time and again, Governors, Mayors, and Advisory Commission on Intergovernmental Relations and others have put forward laundry lists of proposed consolida-

tions for programs embracing every facet of governmental activity—in health, transportation, planning, social services, vocational rehabilitation, jobs, water and air pollution control, and more.

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To consolidate Federal categorical grants would be to shift power away from the unelected bureaucracy and toward elected officials at all levels of government—including the Congress.

To continue to go the other way—and we have been in recent decades—would be to perpetuate the myth that Washington has a monopoly on integrity, expertise and concern for the problems that Governors and Mayors must grapple with every day. And it would be to say that Governors and Mayors don't have priorities, don't have common sense, and aren't in touch with the concerns and needs of their people.

The cost of General Revenue Sharing has risen at an average annual rate of only 3 per cent since the program began, while categorical grant spending has jumped nearly 15 per cent annually over that same time. If nothing else, these figures demonstrate the power of special interests—and the inability of the 300 committees and subcommittees of this Congress to say no to them.

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To argue, as many do, that not all States and localities need their fair share of General Revenue Sharing funds is to miss the point of the program—and to miss the point of the argument over categorical grant funding. Revenue sharing funds are the only Federal monies States and cities can use as they see fit—in ways they deem appropriate—to meet needs they identify.

For example, consider the priorities of the 16 States represented on this Committee which together receive about half of the \$2.28 billion in General Revenue Sharing funds going directly to State governments.

Nine of your States have decided to pass all or a large part of these funds directly to local governments. The other seven use most of these funds to offset State costs in such areas as transportation, education, capital spending and similar programs which directly or indirectly benefit local governments. Nationally, at least 40 per cent of the States' share of these funds are passed through to the local level.

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A major disappointment in this budget is the lack of a cohesive urban policy in general—and of a new mechanism for State involvement in urban policy in particular.

The Governors had high hopes last year that Washington was going to get more serious about putting some sense into programs affecting our cities and towns. We still have hopes that Congress will see the need for such a thrust and meet it in the coming year.

Local governments are, after all, creatures of their States. They don't exist in a vacuum. Their roads and rails don't stop at their borders. Their local industries affect the economy at large. Their tax structures are dependent upon State law.

And yet, Washington likes to leapfrog State capitals and deal directly with local governments—even with neighborhoods. Governors have little or nothing to say—and therefore can't dovetail State programs with Federal activities—in crucial program areas like economic development, community development and jobs programs.

We're not asking for the power of the purse. We are asking for the power of preview and persuasion—to give States a coordinating role in what's going on within their own borders.

Our fourth suggestion speaks for itself: Washington should be forced by law to weigh the fiscal impact of its actions on States and local governments and the private sector.

Too often, laws and rules are put on the books without a long look down the road to see if their end result will be to send States or cities or businesses down the fiscal drain.

Government at all levels is already devouring two-fifths of this Nation's income and employing one in five of its workforce. It's also placing a sometimes necessary—but too often frivolous—array of burdens on the private service and business sectors.

Common sense suggests, for example, that we don't need every one of the 2,100 reporting regulations the General Accounting Office has found imposed on businesses. Common sense suggests that hospital administrators are right in questioning why more than 100 Federal, State and local regulatory agencies may be looking over their shoulders at any time. Common sense suggests that we're demanding too much of an Illinois businessman if he has to be put through six months to a year of bureaucratic hoops before he can certify his product as eligible for bidding on a government procurement contract. And common sense suggests that the State of Illinois should not have to send every one of those 100 State plans to Washington to spell out what it's doing for children and families.

Before a law is enacted or a rule is written that will mandate someone, somewhere to do something, someone in Washington should be forced to demonstrate that the real cost balances with the real benefit.

When something must be done as a matter of public policy—like cleaning up our water and air or opening access to facilities and services for the handicapped—no one will argue the merits of the goal. Where there is room for argument is in how the goal is to be reached, when it must be reached—and who is to bear the cost.

Those arguments should be settled up front, before the statute or rule becomes the law of the land.

Finally, our fifth suggestion, which also speaks for itself. Pass "Sunset" legislation to force periodic hard looks—and hard choices—on laws and rules already on the books.

This is an idea whose time has long since come. More and more States are doing it—we hope to enact it in Illinois this year—and the Congress came close to accepting it last year.

Over the past half-century, we've seen variations on the zero-based budgeting theme come and go. None has made an impact for none has had the help that Congress could give were it to force the bureaucracy, and itself, to occasionally rethink what seemed to be good ideas at the time they became Federal policy.

We're confident that a "Sunset" policy would ultimately lead the national administration to accept the Governors' arguments for a more effective State role in a more productive Federal-State system.

The Nation's Governors will, of course, be talking with other Committees of this Congress and with their own delegations in the months to come about the line-by-line concerns we have with this budget proposal. And we have many such concerns, in addition to the broad issues I have outlined here.

For many Governors, this is a back-track budget—on urban and rural policy, on jobs programs, on law enforcement, on energy in general, and on coal technology development in particular

We may differ among ourselves over some particulars, but we are agreed on the larger concerns I have cited here.

The States are not foreign governments. Federal aid for our programs is not a dole handed out to help us along. The billions at issue here came straight from the pockets of the people who elected all of us—Senators, Representatives, Governors, and Mayors—the same people who depend on all of us to use those dollars rationally and equitably for the services they demand.

The Proposed Fiscal '80 Federal Budget: Impact on the States

National Governors' Association
Washington, D.C.



THE NATIONAL GOVERNORS' ASSOCIATION, founded in 1908 as the National Governors' Conference, is the instrument through which the governors of the fifty states and the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands collectively influence the development and implementation of national policy and apply creative leadership to state problems. The National Governors' Association membership is organized into eight standing committees on major issues: Agriculture; Criminal Justice and Public Protection; Executive Management and Fiscal Affairs; International Trade and Foreign Relations; Human Resources; Natural Resources and Environmental Management; Community and Economic Development; and Transportation, Commerce, and Technology. Subcommittees which focus on principal concerns of the governors operate within this framework. The Association works closely with the Administration and the Congress on state-federal policy issues from its offices in the Hall of the States in Washington, D.C. Through its Center for Policy Research, the Association also serves as a vehicle for sharing knowledge of innovative programs among the states and provides technical assistance to governors on a wide range of issues.

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FOREWORD

Presenting the views of the Governors on the fiscal year 1980 federal budget to the administration has been a major project of the Committee on Executive Management and Fiscal Affairs this year. Representatives of the National Governors' Association have met with the President and the Director of the Office of Management and Budget to urge that the budget contain major initiatives to consolidate federal programs and to achieve other reforms in the grant-in-aid system. The points we have raised are summarized in part four of this document.

The analysis that follows examines domestic programs of significant concern to Governors and presents information that each Governor needs to judge the impact of the budget proposals on his or her state.

The entire NGA policy staff contributed to the analysis. Their work was coordinated by Deirdre Riemer, staff director for the Committee on Executive Management and Fiscal Affairs.

I hope that you will find this budget analysis a valuable reference tool.

Governor Richard A. Snelling
Chairman, Committee on Executive
Management and Fiscal Affairs

CONTENTS

Summary.....	1
I. Overview of the Budget.....	3
II. Economic Outlook.....	9
III. Congressional Outlook.....	11
IV. Administration Response to the Governors' Recommendations.....	13
V. Selected Program Highlights.....	18
Revenue Sharing and Fiscal Assistance.....	18
Natural Resources and Environmental Protection....	19
Community and Economic Development.....	26
Law Enforcement and Justice.....	30
Transportation.....	31
Health.....	34
Income Maintenance, Social Services, and Nutrition Programs.....	38
Employment and Training.....	46
Education.....	50
Energy.....	55
Emergency Management.....	62
Agriculture.....	63
Other Programs.....	64
VI. Glossary.....	66
VII. Appendix.....	68

SUMMARY

President Carter's FY 1980 budget reduces the federal deficit by \$8.4 billion to \$29 billion and proposes cuts in current services of \$12.5 billion when all programs are fully adjusted for inflation. If the economic assumptions underlying the budget prove accurate and if Congress follows the president's recommendations, outlays would rise to \$532 billion from \$493 billion, up 7.7 percent, and receipts would rise to \$503 billion from \$456 billion, up 11 percent. As a percentage of gross national product, federal expenditures would decrease from 22.1 percent in fiscal 1978 to 21.2 percent in fiscal 1980.

In real dollars, grants to state and local governments would decline significantly. Outlays for grants-in-aid would rise to \$82.9 billion from \$82.1 billion, but this 1 percent increase clearly does not accommodate the administration's projected 7.4 percent rate of inflation. As a percentage of state and local expenditures, federal grants would decline in one year to 23.6 percent from 25.4 percent. This trend--a major reversal from the pattern of the last 20 years, when grants increased at an annual rate of almost 14.6 percent--is projected to continue in the future.

The president's budget does not respond to the recommendation of the Governors that cuts in spending be accompanied by comprehensive reforms in the federal aid system. Although the budget proposes some consolidation of federal grants, the trend is toward categorical spending. Other major aspects of grants reform--such as review of mandates and a stronger state role in intergovernmental programs--are not addressed. The administration has committed itself, however, to include more reforms along the lines recommended by the Governors in the 1981 budget.

The response of the budget to the specific program recommendations of the Governors is excellent. The budget provides for welfare reform and hospital cost containment legislation, proposes a stand-by program of economic assistance, and funds the general revenue sharing program, although it also indicates that no decision has yet been made on continuing the program beyond 1980.

The budget is austere for federal domestic spending generally and for grants to state and local governments in particular. It reflects decisions to cover inevitable increases (caused by factors such as previous commitments and automatic cost increases); to phase out most of the economic stimulus programs (such as some public service jobs and local public works); and to freeze the remainder, allowing for a few new initiatives to be offset by cutbacks in other programs.

Among the spending reductions which will be of particular concern to Governors are those made in the CETA program, wastewater treatment construction grants, housing programs, health professions education, rural development, and planning/technical assistance. Requests for the state incentive and soft public works proposals, key portions of last year's urban policy, were not renewed.

New policy and program proposals of interest (in addition to those already mentioned) include targeted fiscal relief, changes in the administration and funding of the food stamp program, consolidations in environmental, mental health, and transportation programs, expansion of coverage in the Medicaid program, and the national development bank.

I. OVERVIEW OF THE BUDGET

President Carter's FY 1980 budget proposes a real decrease in federal assistance to state and local governments. Grant outlays of \$82.1 billion in the current fiscal year would have to grow to \$87.8 billion just to reflect the cost of 7.4 percent inflation. Instead of this increase of \$5.7 billion, the budget provides for an increase of \$0.8 billion for state and local assistance. Put another way, state and local governments would, under the budget proposals, be required to absorb 100 percent of the costs of inflation for their share of various programs and also put up about 85 percent of the inflation impacts on costs previously paid by the federal government.

The low growth in spending recommended for grant programs and the decline in real purchasing power of federal grant dollars stem from a number of causes, including:

- phasing out of some economic stimulus programs, such as some public service job slots and local public works;
- assumed cost-saving effects of administration initiatives on health care and welfare costs;
- selective real increases in a few grant programs and sharp reductions in a relatively small number of others; and
- decisions to freeze virtually everything else at about the same dollar levels as FY 1979.

The president's proposal would reverse a trend of growth in federal grant programs. Over the past ten years, federal assistance to state and local government has grown more rapidly than the federal budget as a whole and more rapidly than the rate of inflation. This expansion has resulted from:

- sharply increasing costs for such services as welfare (AFDC) and Medicaid;
- continuing expansion of grant programs in some areas such as education and health;
- the recent use of grant programs (such as CETA and countercyclical revenue sharing) to stimulate the economy; and
- the use of grants to pursue other national goals through state and local governments rather than through direct federal programs.

In the FY 1980 budget, grant programs show an increase of 1 percent over FY 1979. This is markedly lower than the increase between 1965 and 1978 when the average annual increase in grants was 16.0 percent.

There are very few changes in grant outlays that account for the slight increase in funding between FY 1979 and FY 1980. These are shown in the table below.

CHANGES IN GRANT OUTLAYS BETWEEN FY 1980 AND FY 1979¹

<u>Change</u>	<u>Amount (\$ billion)</u>
Total grants, 1979 estimate	82.1
Payments for individuals:	
Medicaid	.6
Housing Programs	.5
Other	<u>.1</u>
Subtotal	1.3
Economic stimulus grants:	
Local public works	-1.7
Temporary employment assistance	- .6
Anti-recession fiscal assistance	<u>- *</u>
Subtotal	-2.3
Other:	
Sewage treatment plant construction	.5
Community development block grants	.4
Office of Education	.5
Social services- retroactive claims	-.5
Other	<u>1.0</u>
Subtotal	1.9
Total grants, 1980 estimate	82.9

*\$50 million or less

The decreases are concentrated in economic stimulus programs that the president feels are no longer necessary because of the state of the economy. They include the effect of spending most of the local public works money in or before FY 1979 and reductions in CETA job slots. The negative entry for social service reimbursements reflects that it will not be necessary for the federal government in FY 1980 to repeat the one-time social service reimbursements made in FY 1979.

Many of the increases are the result of factors not under the administration's control, such as increasing health care costs, rather than deliberate decisions to expand programs. For example, outlays for sewage treatment plant construction go up because of commitments of prior year appropriations, while budget authority to make new commitments is recommended for reduction.

¹ In this and other tables in this analysis and in the budget documents themselves, detail may not add precisely to totals because numbers are rounded in detail but totals are added without rounding.

The near freeze in the growth of federal grant spending can be seen from the distribution of changes from FY 1979 as shown in the table below.

GRANT OUTLAYS BY MAJOR FUNCTION
(\$ billion)

<u>Function</u>	<u>FY 1979</u>	<u>FY 1980</u>	<u>Change</u>
Natural Resources and Environment	4.0	4.6	+15%
Transportation	9.9	10.3	+ 4%
Community and Regional Development	6.4	5.4	-16%
Education, Training, Employment and Social Services	22.7	22.3	- 2%
Health	13.8	14.5	+ 5%
Income Security	14.7	15.3	+ 4%
General Purpose Fiscal Assistance	8.8	8.7	- 1%
All Other Functions	1.8	1.8	0
TOTAL	82.1	82.9	+ 1%

The increase in natural resources shown on the table is attributable primarily to spending funds that have already been committed. Spending increases in health and income maintenance result principally from cost increases that the federal government cannot control rather than from decisions to spend more. The sharp drop in community and regional development reflects the ending of local public works spending.

In the FY 1980 budget, the administration has presented estimates for grants for FY 1981 and FY 1982 that provide detailed back-up for tables showing that the budget can be balanced in FY 1981. These estimates suggest that the administration, if it retains its balanced budget target, will be proposing decreases in real grant spending for the next several years. The projections are shown below, along with recent history which provides a sharp contrast.

GROWTH OF FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS
(\$ billions)

<u>Year</u>	<u>Total</u>	<u>Increase</u>
1976	59.1	19%
1977	68.4	16%
1978	77.9	14%
1979 estimated	82.1	5%
1980 recommended	82.9	1%
1981 forecast	88.0	6%
1982 forecast	91.9	4%

This projection of slow growth in grants is not a result of slow growth in overall federal spending. For example, between 1981 and 1982, while grants would be held to a 4 percent increase, overall spending would increase by 7 percent.

Several points in the budget, including a new section dealing with population change, suggest that the population is aging rapidly, with a reduction in the numbers of children to be educated and a higher ratio of retired persons to active workers. This development, the budget indicates, will tend to relieve fiscal pressures on state and local government while increasing pressures on the federal government, suggesting that continued rapid growth in federal assistance to state and local governments would be inappropriate.

The main problem is that the principal outlays of the federal government for aging programs are social security payments from a trust fund to which most state and local governments are contributing increasing amounts of money and to which federal general revenues contribute little. (Federal contributions are made only for military employees.) The federal government faces increasing retirement costs for its own employees, but so do state and local governments.

The Budget and State and Local Fiscal Situations

If the president's budget is enacted as proposed, the proportion of state and local spending that is financed by the federal government will drop in 1980. The figures in the table below show how important federal support has been to state and local governments in the past several years and the situation projected in the budget for 1980.

GRANTS AS A PERCENTAGE OF STATE AND LOCAL SPENDING

<u>Year</u>	<u>Percent</u>
1976	24.5
1977	26.4
1978	26.7
1979 est.	25.4
1980 est.	23.6

How much impact this reduction will have on the percentage of state and local budgets financed by federal funds is dependent upon the actions taken by state and local governments in spending for specific functional areas and on their overall fiscal situation. Assuming no recession between now and the end of FY 1980, the state/local sector is unlikely to have either large balances or major deficits during that period. During the recession of the mid-1970's, the fiscal position of state and local governments deteriorated substantially. This triggered responses such as lower spending, higher taxes, and expanded federal assistance which, along with recovery from recession, improved the state and local financial situation considerably in 1976-78. However, the Fiscal Survey just completed by the National Governors' Association and the National Association of State Budget Officers

indicates that state unobligated balances are likely to decrease dramatically in 1979. As a percentage of general fund expenditures, state balances are projected to decline from 8.5 percent in fiscal 1978 to 3.6 percent in fiscal 1979.

Defense and International Spending

One of the critical issues that dominated the debate within the administration during the preparation of the budget was the inherent conflict in trying to maintain current services on the domestic front, provide the real increases in defense spending to which the president was committed, and, at the same time, shrink the deficit and seek to reduce the share of the gross national product taken by the federal government.

Domestic programs clearly came up the loser in this debate. The total federal budget (measured by outlays) increased by 7.7 percent. However, fixed commitment programs (social security, federal employee retirement, interest on the national debt, and Medicare) increased by 11.2 percent, reducing the amount available for either defense or domestic outlays. If what remained available, given the president's decision on the size of the total budget, had been equally divided between the remaining domestic programs and defense and international programs, each would have increased by 5.2 percent. Instead, the president's budget recommends an increase of 11.2 percent in outlays for the defense and international programs and 1.6 percent for domestic programs.

Tax Policy

Last year Congress enacted major changes in the tax code. In his budget, the president chose not to make proposals for a fundamental overhaul of the tax system or for changes in tax rates.

The president, as expected, did recommend a "real wage insurance" proposal which the budget estimates would cost about \$2.5 billion. The insurance would provide a tax credit for persons whose wages increased at or below the wage-price guideline rate of 7 percent. The wage insurance plan basically would hold such persons harmless from increases in the Consumer Price Index of more than 7 percent. The administration is having difficulty drafting details of this proposal to cover complex situations, such as when a person held more than one job in a year, was unemployed for part of the year, and the like. Some congressional sources have suggested that the plan is unlikely to pass.

The president also proposed a number of initiatives under the rubric of "cash management." The substance of these changes is to move money into the federal treasury faster (thereby increasing revenues) at the expense of whoever would otherwise be holding the money--a category that includes state governments.

One proposal, which the administration is attempting to implement by regulation, is to accelerate the payment of state and local deposits of social security taxes. The plan to accelerate the payment of individual income taxes by the employers who withhold them from employees will also affect state and local governments. Other changes would affect individuals and corporations filing estimated taxes.

The budget indicates that the administration will seek legislation to prevent programs in which state and/or local governments act as intermediaries in providing mortgage credit for middle and higher income families. Such programs involve use of the tax-exempt borrowing authority of states or cities to provide mortgage money that, because of the lower rate on tax-exempts, can be provided at significantly lower cost than regular home mortgage money. A number of states have been considering such a program.

Urban Policy

The president made a number of urban policy proposals in March of 1978. These included a new state incentive program to induce states to participate more heavily in dealing with the problems of distressed areas, continuation of the counter-cyclical revenue sharing program as supplemental fiscal assistance, and a new national development bank. Congress did not pass these initiatives during 1978 although it did pass other elements of the president's program. In the FY 1980 budget, the president:

- dropped the state incentive program completely;
- dropped the so-called "soft public works" program;
- scaled back the size of the supplemental fiscal assistance program and indicated that it would be targeted more toward very distressed areas; and
- renewed his call for enactment of the national development bank.

The budget indicates that consideration is being given to having the bank included as part of a cabinet department rather than as a new free-standing agency and that it might be given responsibility for some programs now administered elsewhere.

II. ECONOMIC OUTLOOK

The economy is one of the strongest forces that shape the federal budget. When the economy is healthy, costly federal programs triggered by high unemployment and undesirably low investment levels consume fewer resources, and the budget has more room for new spending initiatives and reduction of the deficit. When the economy weakens, the need for remedial programs limits a president's ability to propose new programs other than those designed to temporarily stimulate the economy.

Fundamental budget decisions hinge on economic projections, and one of the most heated debates throughout the budget process revolves around which federal spending policies seem most appropriate in light of differing projections of economic conditions.

The 1979 debate is already under way. A number of private economists are forecasting a slowdown in economic growth or even a recession (two consecutive quarters of decline in real gross national product) sometime in 1979. Others are less sure that a recession will come this quickly, given the strong growth in the economy in late 1978, but argue that growth in 1979 would simply postpone a recession until 1980 rather than prevent it. As shown in the table below, the administration's estimates do reflect an economic slowdown in 1979 but an upturn in 1980. The unemployment rate is expected to increase somewhat, which is consistent with the slowdown forecast for real growth.

THE ADMINISTRATION'S ECONOMIC ASSUMPTIONS

	(percents)		
	<u>Calendar Year</u>		
	<u>1978</u>	<u>1979</u>	<u>1980</u>
Real Gross National Product Growth Rate	4.0	2.2	3.2
Inflation (December over December Consumer Price Index)	9.2	7.4	6.3
Unemployment Rate (fourth quarter)	5.8	6.2	6.2

Compared to many private projections, the administration's forecast presumes a somewhat lower rate of inflation, reflecting more confidence within the administration than outside about the probable success of the voluntary wage and price guidelines.

A higher-than-expected inflation rate would help the budgetary picture by increasing revenues faster than expenditures, but it would increase

pressures to strengthen the wage-price guidelines and to follow monetary policies that would cause interest rates to rise.

A lower-than-expected growth rate or an unusually high unemployment rate would likely cause the administration to consider policies to stimulate the economy. If such economic weakness appeared while Congress was considering the budget in 1979, it could increase the likelihood that Congress would continue countercyclical programs (such as part of CETA) at current levels and would accept a larger deficit than that proposed by the president. High inflation rates also spell trouble for the many state and local governments whose revenues are tied to taxes (such as property taxes and cents-per-gallon gasoline taxes) that do not respond as rapidly or as completely to inflation as their expenditures do.

III. CONGRESSIONAL OUTLOOK

Fiscal austerity is expected to be the major force shaping the budget that Congress approves for FY 1980. If economic conditions worsen, budget-cutting sentiments may be tempered by counter-pressure to stimulate the economy, by traditional coalitions protecting popular programs, and by inflationary increases in revenues which permit increased spending without enlarging the deficit. Congress, however, is likely to accept the general outline of the Carter budget, if not the specific proposals the administration has made.

The Influence Exerted by the Congressional Budget Process

In this climate, the budget committees of both houses will play key roles in congressional spending decisions. The committees, which recommend spending levels for each major functional category in the budget, have priority-setting responsibility that is of central importance when there is pressure not to fund all of the programs that the authorizing committees wish to enact. The congressional process is explained in the appendix to this report.

Although Congress cut President Carter's proposed fiscal 1979 deficit by \$10 billion, most observers agree that this was accomplished largely by revising the president's tax reform package and by using lower estimates for the outlays of federal agencies. (See appendix table for a comparison between the administration's budget and Congress's budget.) The budget committees did present Congress with some authentic budget-cutting decisions, however. The victories won as a result of the relatively new budget process point to greater influence for the budget committees in FY 1980 when many members may see a need for even more reductions in order to keep their campaign promises.

The Influence Exerted by Economic Conditions

An economic downturn could cause Congress to reevaluate its spending policy, however. The current pattern of continuing growth in employment, production, and personal income represents one of the longest expansionary periods in the peace-time history of the United States economy. Nearly all economic observers seem to agree that this expansion will slow and perhaps end in a period of economic decline. The unknown factors are when the slowdown will begin, how long it will last, and how serious it will be.

Congressional action on the budget will be heavily influenced by the economic situation in the spring and summer. Continuing growth would strengthen the president's initiatives to reduce the size of the deficit. If the economy slows and unemployment rises, however, the budget deficit is likely to grow for two reasons:

- (1) slowed growth is likely to reduce estimated revenues and thus increase the deficit even without any spending increases; and
- (2) signs of economic distress will create pressure in Congress for costly economic stimulus measures.

Still another scenario could develop if inflation exceeds the projections by a significant margin. In that case, Congress will have the tempting option of both holding the deficit at or below the president's figure and expanding spending beyond the levels recommended by the president. This possibility would result from the substantial impact that high inflation has on increasing revenues from the progressive income tax.

If decisions by the 95th Congress indicate a trend, even severe economic problems are unlikely to lead to substantial new aid to state and local governments in FY 1980. Last year, Congress rejected proposals for supplemental fiscal assistance, welfare reform, and public works programs which would have funneled increased funds to states and localities. Congress preferred tax reductions as the method to stimulate the economy. It seems likely that measures taken this year in response to any signs of economic weakness will reflect this skepticism toward the effectiveness of using federal spending to increase economic growth.

The Influence Exerted by Key Rules Changes

Last year, across-the-board reduction measures were proposed for budget resolutions and appropriations bills. In a tight budget year, with Proposition 13 sentiment high, some members might be tempted to resort to across-the-board reductions in budget resolutions without specifying exactly where such cuts should be made. This approach avoids deciding where to make the cuts, while requiring that the cuts do get made. Such an approach is criticized by some congressional leaders involved in the budget process because it sidesteps hard decisions and transfers power from Congress to the executive branch, if the executive branch is given the responsibility for making the reductions.

When Congress convened this month, the House, but not the Senate, made a change in rules so that amendments to cut budget resolutions will also have to specify the detailed cuts that add up to the proposed change in total.

Conclusion

Some informed observers speculate that Congress will decrease the president's defense request and increase other categories of spending for FY 1980. Others believe that anti-spending sentiment will preclude increases for any programs.

The competition among some of the major forces shaping the budget -- including the budget process itself, the economy, and program advocates -- will be fierce. The complicated dynamics seem to point to a middle ground. The general outlines of the budget submitted by the president may define the compromise.

IV. ADMINISTRATION RESPONSE TO THE GOVERNORS' RECOMMENDATIONS

During the fall and winter of 1978, Governors met with President Carter and his budget director to present their recommendations on the FY 1980 budget. The suggestions of the Governors were divided into two broad categories: overall budget policy recommendations and specific program recommendations.

The administration's budget incorporates the Governors' specific program recommendations virtually intact. However, the responsiveness of the budget to the overall policy recommendations is limited.

The recommendations of the Governors are listed in this section and underlined. The response provided in the budget is listed below each recommendation.

I. OVERALL POLICY RECOMMENDATIONS

1. NGA supports the president's efforts to balance the federal budget by 1981. The deficit proposed by the administration is \$29 billion, almost \$10 billion less than the deficit for FY 1979. Projections provided by the president show the deficit shrinking to \$1 billion in FY 1981 and turning into a surplus in FY 1982.

2. Budget savings in intergovernmental programs should be accompanied by increased administrative flexibility for state and local governments. In particular, major program consolidations should be pursued. Although the president has proposed several small grant consolidations that reflect the Governors' recommendations, major grant consolidations are noticeably lacking in the budget. There is a possibility, however, that a consolidation of some economic development programs will be recommended at a later date. Some consolidation of surface transportation is also taking place, along with the merger of subunits dealing with highways and mass transit in the Department of Transportation.

On balance, however, the consolidations (energy management, environmental regulatory and planning activities, and certain mental health programs, some initiatives in transportation, and the possibility of consolidation in economic development) do not add up to a major move in the direction the Governors suggested.

In addition, the budget reflects greater reliance on categorical grants rather than broad-based ones. Broad-based and general purpose grants (basically, block grants and revenue sharing), which are much more flexible and less expensive to administer, have declined as a proportion of federal grants to state and local governments by 15 percent since President Carter took office. (In 1977, such grants totaled 26.1 percent of intergovernmental aid; in 1980, they are estimated at 21.9 percent, a relative decline of 16 percent.) This is shown in the table below.

OUTLAYS BY TYPE OF FEDERAL GRANT
Percent of Total

<u>Type of Grant</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
General Purpose Grants	13.9	12.3	10.9	10.6
Broad-Based Grants	12.2	14.7	13.9	11.3
Other Grants	73.9	73.0	75.2	78.1

By failing to include substantial program consolidations, the administration has not pursued an opportunity to ensure that substantial portions of the reductions in federal spending come out of administrative overhead costs, as the Governors recommended. Because the level of service provided by the proposed budget would decrease while only limited efforts are being made to reduce administrative costs through consolidation, the budget may actually raise the costs of delivering services on a per-unit basis.

In his budget message, the president refers to future proposals for reorganization and consolidation in economic development, natural resource management, and surface transportation. Since the administration has not yet settled upon plans for economic development and natural resources, it is impossible to tell whether such proposals will involve consolidation of federal agencies, federal programs, or both. In the message, the president also makes a general reference to further consolidations.

In a briefing on January 20, OMB Director James McIntyre was asked how the proposed budget responded to the recommendations of the Governors. McIntyre said the budget contains "some small program consolidations" and "one major consolidation," referring to a proposal that some business loans and grants which are shown in the budget as administered by other agencies might be consolidated under the administration's proposed national development bank. McIntyre said the Governors' recommendations were

"meritorious and worthy of pursuing" but would affect "some groups, congressional committees and federal agencies" with whom the administration would want to consult before undertaking a major consolidation effort. McIntyre went on to say that the Governors' proposals "have a lot of thought put behind them" and that "we will pursue them in developing the 1981 budget."

Some of the specific consolidation proposals that are referenced in the budget have some excellent features that would be useful in other consolidation legislation. For example, participation in the proposed environmental management consolidation would be voluntary, and participants would be able to combine the included categorical programs in whatever way best meets their needs. Participants would have the flexibility to shift funds among priorities, and the role of the state relative to local governments is well-defined.

3. Funding decisions should result in real savings to taxpayers.

Some of the administration's budget reductions are clearly designed to decrease actual spending of both the federal government and state and local governments that share costs with the federal government. The health cost containment proposal is an example of this approach. In other cases, however, the effect of the federal decision to cut spending, or to cut purchasing power by holding the FY 1980 spending to prior year levels, would be to inflict costs on state and local government. For example, the administration recommendations would prevent the scheduled increase in the federal share of costs for education of the handicapped that federal legislation mandates for state and local government. Other federal savings, such as having the FBI leave investigation of bank robberies to state and local government, represents a transfer of costs, not savings.

4. The administration should use budget-making techniques that preserve the fiscal choices of the states. In general, federal cutbacks should not be made by shifting funding responsibilities to state and local governments through reduced federal matching rates. In general, the budget does not change matching rates for existing programs. One exception is the support of state economic opportunity offices, where the state share would increase from 20 percent to 50 percent.

5. Intergovernmental assistance should not bear a disproportionate share of funding reductions. This criterion was not met by the budget. The total outlays are recommended to increase by over 7 percent while outlays for intergovernmental assistance will increase by only 1 percent. Defense outlays increase by about 11.2 percent.

6. The impact of federal policies on state and local government should be determined before these policies are adopted. The budget fails to discuss the impact of federal spending and legislative proposals on state and local government. For the Medicaid program, for example, new coverage is proposed for up to 2 million people. The impact of this major expansion on state governments is not discussed. No explanation is provided in the budget to suggest that the administration will do more to gauge the impact of its proposals on state and local governments than it has in the past, although the urban impact statement procedure started by the president last year could be helpful if applied in the context of the budget. The budget document contains no proposals to review or revise mandates that have been imposed on state and local governments in the past.

7. The budget should contain proposals for advance appropriation of federal programs. The administration was not responsive to the Governors' general desire for advance appropriations as a means to produce more certainty about future federal program levels. Such appropriations are continued for a few transportation programs, but were not requested by the administration for other programs, despite a major recommendation from the Governors that wastewater treatment grants be advance funded and despite legislative authority for such appropriations for a number of nutrition and education programs. Some of the education programs are forward funded in the budget, as they have been in the past.

II. PROGRAM RECOMMENDATIONS

The Governors recommended that:

- Full funding for the general revenue sharing program be included in the budget

It was, although the administration has not yet made recommendations on the program's renewal.

- Welfare reform be addressed in the budget.

It was, although the amounts upon implementation are less than would be required under many of the earlier reform proposals. No fiscal relief was projected for FY 1980.

- A permanent stand-by program of economic assistance be proposed.

It was.

- Hospital cost containment be included in the budget.

It was.

V. SELECTED PROGRAM HIGHLIGHTS**Revenue Sharing and Fiscal Assistance**GENERAL REVENUE SHARING

The proposed budget recommends the full entitlement (\$6.9 billion) for the revenue sharing program. The current authorization for the program expires at the end of FY 1980, and the budget states that "no final decisions have been made on the desirability of extending general revenue sharing... beyond September 30, 1980."

ECONOMIC ASSISTANCE

The proposed budget contains \$150 million in outlays for a targeted program of assistance to jurisdictions in economic distress. The president proposes to request a supplemental appropriation of \$250 million in order to begin the program this year. The legislation for this budget item has not been developed, but the aid is expected to be highly targeted. The proposal is expected to exclude states from eligibility in the program.

The president will also propose a stand-by program of economic assistance, to be triggered when the economy weakens. The administration assumes that the economy will remain relatively healthy in FY 1980 and that the program will not have to be implemented, so the budget contains no funding for it. Both state and local governments would probably be eligible to participate in this program.

Congressional approval of these two economic assistance programs is viewed by many observers as difficult to achieve.

Natural Resources and Environmental Protection

ENVIRONMENTAL PROTECTION

The major characteristics of the FY 1980 Environmental Protection Agency budget requests are (1) temporary slowdown in the funding of new sewage treatment facilities construction; (2) increased research efforts to identify the health effects of environmental pollution; (3) significant increases for the agency's premarketing review and testing program for toxic substances; and, (4) selected changes in funding levels for various state grant programs.

FY 1979 and FY 1980 Budget Authority and Outlays
for Grants to State and Local Governments for Pollution Control
and Abatement
(\$ millions)

	FY 1979 (Est.)	FY 1980
Budget Authority	7.1	7.1
Outlays	6.2	6.2

Water/Sewer Construction Grants

The administration is requesting \$3.8 billion for construction of municipal sewage treatment facilities, down from FY 1979 appropriations of \$4.2 billion. The administration argues that slowing the pace of new project planning is needed to integrate recent statutory changes in the 1977 Clean Water Amendments into EPA's management system and to phase in new state management capacities authorized by the law.

In its budget proposals, the administration reemphasizes its long-term commitment to the program and suggests that this slowdown will result in substantial carryover funds to augment FY 1981 funding levels.

The administration did not request advance appropriations for the construction grant program, despite the strong urging of the NGA and local government officials. The administration cited the lack of congressional support and OMB concern over future program outlays as the reasons for not seeking advance funding.

FY 1979 and FY 1980 Budget Authority and Outlays for Sewage
Treatment Construction Grants
(\$ billions)

	<u>FY 1979 Est.</u>	<u>FY 1980</u>
Budget Authority	\$4.2	3.8
Outlays	3.1	3.6

EPA contemplates two legislative initiatives in connection with the construction grant program. First, a one-year extension of the current reallocation period for previously-allocated construction funds will be requested, starting with FY 1978 funds. Various program delays, resulting from the 1977 Clean Water Amendments, may cause up to 30 states to lose a portion of their current funds to reallocation under current requirements. EPA fears that without this proposed extension, states may commit funds to lower priority projects rather than lose them through reallocation.

The second proposal, currently under study, would tie state management assistance grants to a maximum of 2 percent of construction grant authorization levels rather than to appropriation levels, as is currently the case. This would stabilize the funding when decreased levels of construction appropriations occur.

In addition, the administration proposed \$75 million in FY 1980 budget authority for a rural technical and financial assistance program under Section 35 of the Clean Water Act. This program is designed to assist landowners controlling the most critical non-point sources of water pollution in rural areas. Under this initiative, USDA would share pollution control and conservation costs required by state water quality plans developed under the Federal Water Pollution Control Act.

State Grants

Selected highlights of proposed funding for state and local grant programs are:

- funding for state air quality programs will increase by \$5.6 million, but grants to local government for required air quality planning have been eliminated from EPA's budget and would be funded through the Department of Transportation's planning program under the Urban Mass Transit Authority. However, no specific earmark of these funds (which totaled \$50 million in FY 1979) appears in DOT's budget.

- Increased funding is requested for states' hazardous waste management activities but a significant reduction in state solid waste management activities is proposed as part of a planned five-year phase-out of Subtitles C and D grant funding under the Resource Conservation and Recovery Act.

Consolidated Environmental Assistance

In response to the Governors' expressed support for categorical program consolidation initiatives, the administration will submit legislation to Congress that would authorize interested states, on a voluntary basis, to combine two or more of EPA's categorical programs into a single integrated environmental plan. The bill would incorporate current categorical funding formulae, establish a supplemental authorization to provide incentive funding of \$25 million for FY 1980, and permit applicants' flexibility to shift funds among covered programs by to 20 percent of the level provided under the categorical approach. Funding could be used for any activity within EPA's mandate except construction grants, even in the absence of currently authorized funding for some of those programs. Local governments would be eligible for state pass-through to encourage consolidated environmental planning, where appropriate. The proposal, according to the administration, would provide increased flexibility at the state and local level in determining environmental protection priorities and allocating resources; encourage integrated planning, implementation, and management across media program lines; and improve and simplify the administration of state and local grants by reducing paperwork, duplication of effort, and reporting requirements.

The bill probably will be referred to the Senate Committees on Public Works, Agriculture, and Government Affairs, and to House Committees on Public Works, Commerce, Agriculture, and Government Operations. The congressional outlook is uncertain. Opposition can be expected from those who view the proposal as a threat to existing categorical arrangements. States that support the thrust of the proposal must develop arguments that would highlight potential cost-savings and better management capabilities that would result from the consolidated approach.

Environmental Protection Agency

State Grant Programs

Budget Authority
(\$ in millions)

	<u>1979</u>	<u>1980</u>
<u>Air</u>		
Section 105.....	\$80.0	\$85.6
Section 175.....	50.0	...
<u>Water Quality</u>		
Section 106.....	52.4	48.7
Section 208.....	41.0	40.0
Clean Lakes.....	14.7	15.0
<u>Drinking Water</u>		
Public Water Systems		
Program Grants.....	26.4	29.5
Underground Injection		
Control Program.....	7.6	7.8
Special Studies & Demos.....	2.0	1.4
<u>Solid Waste</u>		
Solid Waste Management.....	15.2	10.0
Hazardous Waste		
Management.....	15.0	18.6
Resource Recovery.....	15.0	14.0
<u>Pesticides</u>		
Pesticides Enf Grants.....	8.8	8.8
<u>Interdisciplinary</u>		
Consolidated Grants.....	...	25.0
TOTAL.....	\$328.2	\$304.3

WATER RESOURCES

Bureau of Reclamation budget authority for water resources planning, development and operations programs in the 17 western states would increase by \$170 million under the president's budget request of \$757,461,000.

The administration is requesting \$510 million to continue construction of 70 western water projects previously authorized for which Congress appropriated \$401 million for FY 1979.

The FY 1980 budget requests funding for only one new Bureau of Reclamation construction start, in line with President Carter's water policy proposals to provide full funding for such projects. This proposal is certain to provoke continuing congressional opposition to the water policy proposals in view of the traditional congressional approach of funding a larger number of new water projects on an annual, piecemeal basis.

FY 1979 and FY 1980 Budget Authority and Outlays for Bureau
of Reclamation
(\$ millions)

	FY 1979 Est.	FY 1980 Est.
Budget Authority	598.3	757.5
Budget Outlays	624.3	638.1

Budget authority for construction activities of the Corps of Engineers is expected to increase from \$1.3 billion in FY 1979 to almost \$1.8 billion in FY 1980, primarily to maintain a reasonable construction pace on projects that have previously been started. Limited new starts are also contemplated for the Corps.

State Water Management Plans

The administration proposes to increase state matching grants under Title III of the Water Resources Planning Act from \$3 million to \$50 million as part of the Carter water policy proposals. The increased grants would help states develop comprehensive water management programs that would emphasize conservation, integration of water quantity and water quality planning, and technical assistance to local governments for more efficient water use. The congressional outlook is uncertain, given the continuing debate over proposed national water policy reforms.

Land and Water Conservation

While a significant overall reduction is proposed for the land and water conservation fund, the bulk of the cut would come from federal land acquisitions. Matching grants to states would be reduced from the FY 1979 outlay level of \$369.7 million to \$359.3 million for state out-

door recreation planning, land acquisition, and outdoor recreation facilities development.

Urban Parks

A supplemental 1979 appropriation of \$37.5 million, plus FY 1980 funding of \$150 million, will be requested for 70 percent federal - 30 percent local matching grants to urban governments for the rehabilitation of existing urban recreation facilities under 1978 urban parks legislation (PL 95-625).

Historic Preservation

A 25 percent reduction in matching grants-in-aid is requested for state planning and individual projects under the Historic Preservation Fund. Although this reduction would be spread equally among states under current distribution guidelines, smaller state programs would have greater difficulty absorbing the 25 percent reduction.

FY 1979 and FY 1980 Budget Outlays for the Heritage
Conservation and Recreation Service (HCRC)
(\$ millions)

	<u>1979</u>	<u>1980</u>	<u>Increase (+) or Decrease (-)</u>
Salaries & Expenses	\$ 15.3	\$ 18.5	\$ + 3.1
Land and Water Conservation Fund	737.02	610.0	- 127.0
Historic Preservation Fund	60.0	45.0	- 15.0
Urban Park and Recreation	37.5	150.0	+ 112.5
TOTAL	\$850.0	\$824.0	\$ - 26.3

Coastal Zone Management

Since the planning phase of the Coastal Zone Management Program is, for the most part, completed, the FY 1980 budget request for program development grants is significantly reduced (\$8.5 million in FY 1979, \$2.6 million in FY 1980). The overall budget authority request, however, is increased from \$57.3 million in 1979 to \$66 million in FY 1980. Major increases are proposed for program administration and management grants.

Community and Economic DevelopmentCOMMUNITY DEVELOPMENT BLOCK GRANTS (CDBGs) AND
URBAN DEVELOPMENT ACTION GRANTS (UDAGs)

For FY 1980, the administration is requesting \$3.9 billion in budget authority for the community development block grant program, a \$150 million increase in the budget authority provided for FY 1979. FY 1980 outlays for CDBGs are expected to be \$3.3 billion, about \$400 million more than the \$2.9 billion anticipated during FY 1979.

For urban development action grants (UDAGs), the administration is requesting \$400 million in budget authority for FY 1980. This amount is identical to that requested and received from Congress for FY 1979. Outlays for UDAGs, however, are expected to increase from \$44 million in FY 1979 to \$162 million in FY 1980.

State governments have indicated to the administration that they are able and willing to participate extensively in the administration of the small cities CDBG program. Budget authority in FY 1980 for this program is \$690 million. At the present time, the administration does not intend to submit legislation to Congress permitting states to play a significant role in the administration of this program (e.g., assisting HUD in establishing funding priorities for the small communities).

ECONOMIC DEVELOPMENT ADMINISTRATION (EDA)

The administration is submitting a request of \$759 million in budget authority for the Economic Development Administration in FY 1980, a substantial increase, \$210 million, in FY 1979 budget authority of \$549 million. During FY 1980, EDA's outlays are expected to decrease from those of FY 1979. Outlays for FY 1980 are anticipated to be \$832 million, \$1.6 billion less than the FY 1979 total of \$2.43 billion. The principal reason for this significant decrease is the completion of Rounds I and II of the local public works program.

EDA's proposed budget for FY 1980 is something of a mixed bag for state governments. On the one hand, the administration intends to request \$150 million in budget authority for an energy impact assistance program long sought by states. On the other hand, the 301 and 302 programs are being cut by about \$9 million. States, sub-state districts, and municipal governments are the beneficiaries of these planning and technical assistance programs. Further, the administration's reactions to the NGA economic program consolidation legislation, which would consolidate a number of EDA's categorical programs and distribute economic development grant funds on a state-by-state formula basis, are not yet clear.

HOUSING (HUD)

The Department of Housing and Urban Development's proposed budget for FY 1980 provides \$27 billion in budget authority for subsidized housing programs, particularly the Section 8 and public housing programs. This amount represents a \$3.9 billion decrease in budget authority from the \$30.9 billion provided in FY 1979. The administration estimates that the FY 1980 budget will permit production of 250,000 units of Section 8 rental assistance housing and 50,000 units of public housing. This total of up to 300,000 units would be a decrease of 60,000 units of housing permissible under the FY 1979 budget. Outlays for subsidized housing programs in FY 1980 are expected to total \$5.3 billion, nearly \$870 million more than in FY 1979.

State governments do not do particularly well in the administration's FY 1980 housing budget. For example, it is expected that the number of Section 8 rental assistance housing units allocated to state housing finance agencies will be reduced from 53,000 for FY 1979 to 40,000 for FY 1980. In addition, the administration apparently does not intend to permit financially troubled state public housing projects to be eligible for the \$91 million in assistance funds requested for FY 1980. The administration's stance seems to contradict commitments made to state housing authorities last year that states would be able to participate in the troubled projects program.

As part of its tax policy recommendations, the administration has decided to press for legislation that would limit the ability of states or cities to use tax-exempt bonds to finance mortgages for middle and higher income persons. Use of tax-exempt financing for low and moderate income housing would continue to be permitted.

NATIONAL DEVELOPMENT BANK

The administration intends to reintroduce legislation creating a national development bank. The bank would use financial incentives to encourage private businesses to locate in distressed and declining communities. These incentives would include direct grants, guarantees of loans made by financial institutions, interest rate subsidies, and a secondary marketing facility for loans made by financial institutions to firms locating in distressed areas.

The administration intends to request \$3.5 billion in budget authority for the national development bank in FY 1980. Outlays for FY 1980 are expected to be \$195 million.

The administration has not yet decided whether the bank should be an independent agency or an entity within an existing department and whether some existing programs should be administered by the bank. The role of state governments in the operation of the bank's programs also remains undecided.

PLANNING AND TECHNICAL ASSISTANCE PROGRAMS

For FY 1980, the administration is requesting \$40 million in budget authority for the HUD 701 planning program, no money at all for the Farmers Home Administration Section III planning program, and \$6.5 million for the

EDA 301 and 302 planning programs. The table given below compares these and other planning and management budgets for FY 1979 and 1980.

BUDGET AUTHORITY FOR PLANNING AND MANAGEMENT

(\$ millions)

	FY 1979	FY 1980
HUD Comprehensive Planning (701)	53.0	40.0
FmHA Rural Development Planning (111)	5.0	0.0
EDA Economic Development Planning (301 and 302 state portions)	6.5	6.5
Intergovernmental Personnel Act (IGA)	20.0	20.0
NSF State Science, Engineering, and Technology	2.5	0.0
Total	87.0	66.5

This proposed reduction of \$20.5 million in planning and technical assistance funds could have severe implications for Governors and their planning staffs, which are major recipients of these funds. The administration's argument for cutting these planning programs is that state and local governments have already developed the capacity to engage in comprehensive community and economic developmental planning. Consequently, fewer federal dollars are necessary. Further, because state and local governments now have the ability to prepare comprehensive plans and to administer complex programs, the federal government argues that they should use their own funds for these purposes. However, during a time of fiscal stringency at the state and local governmental levels as well as at the federal level, it is questionable whether states and localities will accept a \$20.5 million reduction in federal planning and capacity building programs.

REGIONAL COMMISSIONS

The administration is seeking reauthorization of the Appalachian Regional Commission (ARC) and the eleven regional commissions established under Title V of the Public Works and Economic Development Act of 1965. For FY 1980, the administration is requesting \$359 million in budget authority for ARC and \$74 million in budget authority for the Title V commissions. These amounts represent a \$10 million reduction for ARC and a \$11.2 million increase for Title V commissions. The increased budget for Title V commissions reflects the provision of start-up funds for the Mid-Atlantic, Mid-America, and Mid-South Commissions and greater funding of the Southwest Border Commission. During FY 1980, budget outlays for ARC will increase from \$281 million in FY 1979 to \$296 million. Outlays for the Title V commissions will increase from \$68 million in FY 1979 (including funds carried over from previous fiscal years) to \$70 million in FY 1980.

RURAL DEVELOPMENT

The administration's FY 1980 budget proposes \$275 million in budget authority for Farmers Home Administration water and sewer and rural development grants, an \$18 million decrease from the FY 1979 level. The administration also is requesting \$950 million in water, sewer, and community facilities loans and \$1 billion in business and industrial loans administered by FmHA. These amounts represent reductions of \$200 million and \$100 million respectively from obligations in FY 1979.

For rural housing programs, the administration has requested \$1.65 billion in budget authority for FY 1980. This is a \$175 million reduction from the \$1.82 billion provided in FY 1979. However, reflecting spending from prior commitments, outlays for rural housing programs are expected to increase from \$218 million in FY 1979 to \$362 million in FY 1980.

Law Enforcement and JusticeLAW ENFORCEMENT ASSISTANCE ACT

The administration has proposed \$2.4 billion in budget authority for the Department of Justice, a reduction of \$111.6 million from FY 1979 levels. State and local programs within the Justice Department are scheduled for a reduction of \$122 million. LEAA, which has suffered budget cuts of \$248 million from FY 1975 to FY 1979, is slated for another reduction of \$100.1 million in FY 1980. Approximately \$87 million of this reduction will come from state and local programs.

This decrease in federal funds will have an impact on most state criminal justice programs. For example, funds for planning and administration will be cut by \$15 million, criminal justice formula grants will be reduced by \$39 million, and the juvenile justice formula program will receive a 50 percent reduction from its present level of funding, to \$33 million. Overall, the direct assistance programs controlled by the state and local units of government were reduced by \$87.0 million, or over 21 percent. However, collateral assistance programs (those programs controlled and operated in Washington) decreased by only 10 percent.

It should be remembered that LEAA must be reauthorized by statute this year, and the administration will again propose legislation that would create a new Office of Justice Assistance, Research and Statistics (OJARS). LEAA would be a part of this office, along with a Bureau of Justice Statistics and the National Institute of Justice. Funding under this structure would be as follows: LEAA would receive \$497,936,000 and the Bureau and the Institute together would receive \$48,411,000. The legislation proposes to reduce "red tape" and paperwork by requiring (among other things) the submission of state plans every three years rather than annually.

The community anti-crime program, currently a function of LEAA, will be funded at \$10 million, an increase of \$3 million over FY 1979. In addition, \$10 million is requested to implement the president's urban crime initiative. The \$20 million for these programs will be subtracted from the LEAA portion (\$497,936,000) of the overall OJARS budget (\$546,347,000).

Transportation

The president's transportation budget, overall and in programs of particular interest to state governments, recommends funding increases that fail to keep pace with inflation. Using the Department of Transportation's measure of activity, the program level of the department will increase by about 5 percent. Actual outlays will increase more slowly.

The budget reflects an overall tone of austerity, regulatory reform, and applying user charges to defray many transportation costs. The budget contains the comment:

"...the federal government cannot continue to subsidize inefficiencies within the transportation sector that lower productivity and cause a constant drain on national resources. These inefficiencies are caused in part by outdated regulations and in part by poor management or an inability to respond to changing transportation patterns. Federal operating subsidies to private firms and local governments sometimes make it too easy to continue these inefficiencies."

The budget indicates that the president intends to submit legislation in 1979 to deregulate rail and bus lines.

In addition to reflecting the president's austerity approach to FY 1980, the Department of Transportation budget does reflect some concepts of the type that the Governors presented to the president in late 1978. Where choices could be made, the administration consistently has favored assistance programs to state and local government that are considerably more flexible than narrower categorical approaches. To facilitate state and local planning, advance appropriations are provided in mass transit. Changes in legislation in 1978 and in organization in 1979 are designed to make it easier to consider mass transit and highway policy in an integrated fashion.

In almost every transportation function, basically level funding by the administration will trigger some reductions in construction activity and/or service levels unless state and local governments are prepared to meet inflationary costs with their own funds. Maintaining funding for highways at last year's ceiling in the face of costs for highway construction that have been increasing more rapidly than the overall rate of inflation is expected to reduce construction activities. Level subsidies for mass transit probably will slow construction activities and shift the higher operating costs onto some combination of transit users and state and local governments. Constant rail subsidies are expected to force consideration of reductions in Amtrak's long-distance routes and possible elimination of unprofitable Conrail routes. This, in turn, is likely to increase pressures on states to provide funds to continue some of these services.

HIGHWAYS

Budget authority for highway improvement and construction is expected to increase by about 2.5 percent while outlays will actually drop slightly. The administration has decided to continue the FY 1979 ceiling on federal-aid highway programs at \$8.5 billion.

Within this funding level, the budget proposes to omit funding for "a series of smaller highway programs that can be funded within existing federal-aid highway authorities or that can be supported satisfactorily by states and localities." Funds affected by this decision include those used for some highway beautification activity, construction of roads not listed on any federal-aid highway system and "most aid identified for specifically identified highway projects." No funds are requested for the highway beautification program pending a departmental review of it.

The Department of Transportation proposes funding for continued work with the states in motor carrier safety.

MASS TRANSIT

While mass transit outlays will rise substantially, reflecting spending related to prior-year programs, budget authority for mass transit is expected to be \$2.5 billion, an increase of 2 percent from the FY 1979 level. Under the Surface Transportation Assistance Act of 1978, the administration of highway and mass transit programs will be more closely linked. To facilitate this program linkage, the Department of Transportation is planning to combine its Urban Mass Transportation Administration and the Federal Highway Administration. Consistent with its "same as last year" approach to transit funding, the administration does not request funds for several new categorical grant programs established by the Surface Transportation Act, such as bus terminal construction.

RAILROADS

Proposed funding for railroads reflects a reduction in both budget authority and outlays. The budget justifies the level of funding proposed for railroads as follows: "We cannot continue to ask the general taxpayer to pay the cost of an uneconomic railroad system, a system largely sustained by outdated federal regulatory policies." The funding levels recommended for both Amtrak (\$760 million) and Conrail (outlays of \$440 million in FY 1980 under a supplemental appropriation) are explicitly designed to force each to make reductions in service. The same level of funding as in FY 1979, \$67 million, was recommended for the Rail Service Assistance Program, a program of aid to states to prevent abandonment of essential rail lines.

AIR TRANSPORTATION

The administration plans to offer legislation to continue the airport and airway trust fund by which many federal aviation activities are funded through charges to the users. The budget appears to contemplate some reductions in airport development grants to small airports in FY 1980 but spending is expected to increase to about \$800 million a year in FY 1981, which is consistent with the new trust fund legislation. Within a context of little change in funding,

the Federal Aviation Administration will implement a variety of steps to reduce the likelihood of mid-air collisions. The budget also contemplates a shifting of service to smaller communities from larger carriers to commuter airlines. There is no provision for the consolidation of the Airport Development Aid program, as the Governors had recommended in the fall.

Health

The president's budget proposes to spend \$52.2 billion on health programs administered by the Department of Health, Education and Welfare. This represents an increase of \$4.1 billion (8.5 percent) over the estimated expenditures for FY 1979.

HEALTH PROGRAM OUTLAYS FY 1979 AND FY 1980
DEPARTMENT OF HEALTH, EDUCATION AND WELFARE

(\$ in Millions)

	<u>FY 1979</u>	<u>FY 1980</u>	<u>Change</u>
Public Health Service	\$ 7,157	\$ 7,683	+ 7.3%
Health Care Financing Administration			
Total HCFA	41,005	44,553	+ 8.7%
Medicare	(29,149)	(32,080)	(+10.1%)
Medicaid	(11,751)	(12,354)	(+ 5.1%)
Other HCFA	(105)	(119)	(+13.3%)
Total HEW Health	\$48,162	\$52,236	+ 8.5%

The bulk of the increases in HEW health outlays will occur in entitlement programs (Medicare and Medicaid). In the portion of the budget in which more discretion can be exercised by the president and Congress (the Public Health Service), there is an overall increase which is relatively smaller (7.3 percent) than that for the entitlement programs (8.7 percent). The budget figures for a number of health programs of interest to the Governors are summarized in the table on the next page.

BUDGET AUTHORITY FY 1979 AND FY 1980
SELECTED HEALTH PROGRAMS

(\$ in Millions)

<u>Program</u>	<u>FY 1979</u>	<u>FY 1980</u>	<u>Percent Change</u>
Medicaid ⁽¹⁾	\$11,842.0	\$12,696.0	+ 7.2%
Maternal and Child Health	345.5	357.4	+ 3.4
Community Health Centers	351.0	381.0	+ 8.5
Community Mental Health Centers	278.3	241.1	-13.4
Health Planning	152.5	154.5	+ 1.3
Health Maintenance Organizations	39.5	73.6	+86.3
Drug Abuse Formula Grants*	40.0	-0-	-100
Alcoholism Formula Grants*	56.8	-0-	-100
Public Health Grants (314(d))*	90.0	52.0	-42.2
Mental Health Block Grant*	--	99.0	proposed
Prevention Formula Grants	--	18.0	new
Family Planning	145.0	145.0	-0-
Migrant Health	34.5	41.4	+20.0
Immunization	50.0	33.5	-33.0
Adolescent Pregnancy Prevention	7.0	60.0	new
Health Professions Education (Capitation)**	144.0	-0-	-100
Hospital Closure/Conversion	--	30.0	proposed
Home Health Services	6.0	.8	-86.7

* See discussion of grant consolidation.

** See discussion of education budget.

(1) Reflects proposed legislation.

HEALTH GRANT CONSOLIDATION

The budget proposes major changes in the health block grant authorized by Section 314 (d) of the Public Health Service Act and in the formula grants for state drug abuse and alcoholism programs. The block grant appropriation would be decreased by more than 42 percent, and the formula grants would not be funded. In place of the formula grants and a portion of the 314 (d) program, the administration will propose legislation to create a mental health block grant. The overall effect of the consolidation will be to decrease funds 10 percent below the level available last year. The reduction will be felt more deeply than the figures suggest because the program spending levels have not been adjusted for inflation.

BUDGET AUTHORITY FY 1979 AND FY 1980
 MENTAL HEALTH BLOCK GRANT AND CONSOLIDATED PROGRAMS

(\$ in Millions)

<u>Program</u>	<u>FY 1979</u>	<u>FY 1980</u>	<u>Change</u>
Health Block Grant*	\$ 13.5	--	abolished
Drug Abuse Formula Grants	40.0	--	abolished
Alcoholism Formula Grants	56.8	--	abolished
Mental Health Block Grant	--	99.0	new
Consolidated Programs	110.3	99.0	-10.2%

* Under present law, 15 percent (\$13.5 million) of the Section 314 (d) grant to each state is allocated to the state mental health authority.

As a result of the consolidation of existing formula and block grants, the budget proposes a net decrease of \$36 million in these programs. (The public health block grant will decrease by \$24.5 million, and the mental health and substance abuse programs will be \$11.3 million lower than the FY 1979 budget authority.) The president's budget also proposes budget authority of \$18 million to implement a program of state formula grants for preventive health services. This program was authorized by P.L. 95-626, which also authorized an expansion of the Section 314 (d) block grant program.

MEDICAID

The estimated outlays for Medicaid will increase significantly during FY 1980, and the president will seek legislation to slow the rate of increase. In addition to new hospital cost containment legislation (see below), the budget assumes the passage of legislation limiting reimbursement for hospital-based physicians (saving \$7 million), disallowing reimbursement for chiropractic services (\$1 million), and requiring common Medicare and Medicaid audits (\$28 million). Administrative changes will also be undertaken to increase provider efficiency (saving \$8 million) and to limit the payment through Medicaid for hospital malpractice insurance premiums (\$40 million).

The budget also includes \$288 million to cover the cost of a Child Health Assessment Program (CHAP). This program, to be introduced in the 96th Congress, will require states to expand Medicaid eligibility to more than 2 million children and to 100,000 low-income pregnant women. The CHAP legislation will establish a national income standard for eligibility (the higher of the state's AFDC standard or 55 percent of the national poverty threshold) and would require states to provide dental, hearing, prescription drug, and ambulatory mental health benefits to all Medicaid-eligible children.

HOSPITAL COST-CONTAINMENT AND HEALTH PLANNING

The president's budget assumes significant savings to the Medicare and Medicaid programs from the enactment of hospital cost-containment legislation during 1979. Following up on the guidelines under the anti-inflation program, the administration will propose federal legislation establishing voluntary goals for hospital expenditures and standby controls if the goals are exceeded. The voluntary goals established under the anti-inflation program suggest that hospital expenditures be held to a 9.7 percent increase between 1978 and 1979. The administration would write the anti-inflation program goals into its hospital cost-containment legislation for introduction in the 96th Congress.

The major existing program focused on medical care cost containment -- the health planning program -- is slated for a small increase in the FY 1980 budget (\$2 million). The president proposes no funding for the regional health planning technical assistance centers but will propose legislation to aid in the conversion or closure of excess hospital capacity. The new program would include \$30 million in new budget authority and would be designed to demonstrate the efficiencies that would result from the removal of unneeded hospital beds from the system.

CONGRESSIONAL OUTLOOK

The hospital cost containment and child health initiatives will probably receive the majority of the administration's attention. A hospital cost bill, similar to the one that will be proposed this year, made its way through the Senate in the closing days of the 95th Congress. Opposition from the hospital industry has not abated, and the imposition of a voluntary goal significantly lower than the industry's own goal of 11.6 percent is likely to increase the pressure against passage. The fiscal mood of the new Congress and a more flexible approach by the administration may help to secure enactment of a hospital cost-containment statute.

The new CHAP proposal will probably receive early and favorable action in the 96th Congress. Many of the modifications made in this year's proposal reflect amendments to the administration's proposal which were attached by committees of the 95th Congress. There is no strong or organized opposition to the program. Some could develop if it is expanded radically, causing a significant increase in costs.

The proposal to consolidate the mental health and substance abuse grants is likely to stimulate some opposition as it is considered in the 96th Congress. Advocates of each program have traditionally opposed consolidation, and the net reduction in funds will not help to garner support from other groups.

The proposal to eliminate capitation grants to health professional schools will stimulate vigorous opposition from a number of quarters. The debate will probably result in a compromise which should set the stage for the reauthorization of the health manpower legislation scheduled for the second session of the 96th Congress.

Income Maintenance, Social Services, and Nutrition Programs

WELFARE/PUBLIC ASSISTANCE

Federal costs of benefits under the two major cash assistance programs, the Aid to Families with Dependent Children (AFDC) state-federal program and the federalized Supplemental Security Income (SSI) program (which many states supplement), are expected to rise in FY 1980. AFDC expenditures will increase by about \$350 million to \$6.3 billion, and SSI spending will increase \$400 million to \$5.6 billion in FY 1980.

As is the case with all individual entitlement programs, the president's budget is of importance when it contains proposals to alter the terms of the programs, or it proposes to change the way in which state administrative expenses are computed. There are only a few such proposals in the 1980 budget, none of which should be significantly troubling to state and local governments. Several of the proposals have considerable appeal. The proposals are as follows:

AFDC

1. Although current plans call for incorporation of AFDC into the welfare reform proposal the administration plans to submit to Congress, the administration will likely propose an effective date of FY 1980 for a provision to simplify and standardize the AFDC work expense allowance within the earned income disregard. It is expected that the administration's proposal will be modeled after the provision in the Food Stamp Amendments of 1977. The administration estimates that this provision will save \$81 million in federal outlays in 1980. States will also realize savings.

2. Legislation will be proposed to revise the calculation of AFDC benefits in cases where a stepparent lives with an eligible AFDC family unit, so that a stepparent's income in excess of an amount reserved for his own support (and that of any of his dependents) will be counted in determining AFDC eligibility and benefits for stepchildren. This proposal, if enacted, will reduce federal outlays by \$100 million in FY 1980 and will also provide savings for states.

3. The administration will propose that Congress make permanent the increased federal participation and limit the reimbursement ceilings to \$52 million for public assistance programs in Guam, Puerto Rico, and the Virgin Islands established for one year by the 95th Congress. This measure would result in \$29 million in additional FY 1980 outlays.

SSI

Legislation will be proposed to:

- shift the accounting system from quarterly prospective to monthly retrospective (no FY 1980 outlay impact);
- prohibit the disposal of assets to qualify for benefits (\$6 million reduction in FY 1980 outlays);

- eliminate windfall benefits when an applicant receives retroactive Title II Social Security benefits for the same time period (\$19 million reduction in FY 1980 outlays);
- increase the legal responsibility of sponsors of legally admitted aliens who become dependent on SSI (\$2 million reduction in FY 1980 outlays); and
- improve equity and simplify the SSI program (\$7 million increase in FY 1980 outlays).

States supplementing SSI benefits may also realize some savings if the proposals are enacted. However, several of the OASDI cost reduction proposals will increase SSI FY 1980 outlays by \$20 million.

Child Support Enforcement Program

Through the Child Support Enforcement program, states (with 75 percent of their costs assumed by the federal government) locate absent parents, establish paternity, and obtain child support payments from delinquent parents. Currently, state and federal administrative costs are approximately three-fifths of the total child support collections resulting from the program. FY 1980 administrative costs and child support collections are proposed to increase to \$541 million and \$925 million, respectively. Several legislative amendments will be proposed. None of these are expected to have a profound program impact, although each is designed to increase collections and reduce administrative costs; none of the proposals are inconsistent with state interests. The administration expects these measures to reduce FY 1980 outlays by \$60 million.

Refugee Assistance Programs

Under current policy, assistance varies for each of the different refugee groups:

- Assistance under the Cuban program will be gradually phased out -- the 1980 budget would pay 75 percent of assistance costs, and the program would end after 1983.
- Assistance for refugees who entered from Indo-China in 1975-1977 will be phased out in the 1980 budget. However, legislation will be proposed to extend this program to provide assistance for the first 3 years after a refugee's entry into the U.S. Costs of cash and medical support for refugees who entered after 1977 are financed at 100 percent.
- Under the Soviet and Other Refugee program, in the FY 1979 and 1980 budgets the federal government would pay 50 percent of support costs, while voluntary agencies would pay the remaining 50 percent.

The administration's budget (and its estimated expenditures for 1979) are based upon the estimates of new refugees entering the United States shown in the table below. No provision is made for the implications of providing assistance to new groups of refugees or higher entrance levels for currently-assisted groups of refugees.

Complete phase-out of assistance for the Cuban and Indo-Chinese Refugee Assistance programs will place a burden on states, particularly where concentrations of refugees are highest, and in those cases where assimilation into the culture has proceeded more slowly than anticipated. States have held that where presence of refugees results from a large-scale federal refugee policy, the full cost of that presence, until the refugees are fully self-supporting, must be borne by the federal government, regardless of the length of time for which assistance must be provided.

Budget proposals for the refugee assistance programs are summarized in the chart below.

FY 1978, FY 1979 AND FY 1980 BUDGET AUTHORITY
REFUGEE ASSISTANCE PROGRAMS

(\$ in Millions)

	<u>1978</u>	<u>1979</u>	<u>1980</u>
Cuban Programs (new refugees)	\$ 71 (--)	\$ 57 (--)	\$ 53 (--)
Indo-China Program (new refugees)	\$122 (--)	\$148 (65,000)	\$ 90 (25,000)
Soviet/Other Program (new refugees)	--	\$ 20 (20,000)	\$ 20 (20,000)

Welfare Reform

The president's FY 1980 budget makes concrete his commitment to develop and propose legislation to pursue meaningful reforms of the welfare system. Although the description of the reform proposal is sketchy, the FY 1980 budget documents do make clear that the reform legislation will:

- be fully implemented in FY 1982 at a federal cost of \$5.5 billion above that of current programs projections to that date. Sufficient room is left in projections for FY 1981 to allow for additional expenditures of \$1.5 billion resulting from reforms implemented in that year;

- standardize and simplify the work expense deduction component of the earned income disregard for AFDC, which will become effective for FY 1980 (see commentary under Welfare/Public Assistance -- AFDC);
- switch the method of computing AFDC eligibility and benefits from prospective accounting to mandatory one-month retrospective accounting;
- establish a national minimum benefit level for the AFDC program;
- make alterations in eligibility criteria (e.g., assets test and income definitions) in the AFDC program to make them uniform with the food stamp program;
- transform the unemployed father component of the AFDC program into assistance for unemployed parents, and extend it to all states;
- attempt to provide an employment and training opportunity for the principal earner in AFDC families for whom a private sector job cannot be found;
- maximize reliance on the enacted resources for the most severely disadvantaged under the CETA program and tax credits;
- further expand the earned income tax credit to increase incomes of working poor families and thereby strengthen work incentives and reduce welfare costs; and
- provide additional fiscal relief to state and local governments.

This is largely an encouraging and welcome pronouncement by the administration. During the coming weeks and months, careful attention must be given to the final design of the administration's proposal to ensure that it is acceptable and helpful to state governments and politically viable.

Despite frequent, continuing messages to the administration from the nation's Governors, particularly those from states with high welfare caseloads, that it is essential that state and local governments be provided with some immediate relief from the excessive and growing fiscal burden of welfare expenditures, the administration has made no provision in the FY 1980 budget for such relief. Although \$1.5 billion is included in projections for "welfare reform" in FY 1981, it is not specified whether part or all of this amount will be used to fund substitution of federal expenditures for state expenditures in the AFDC program. Relief from

the growing financial burden of welfare is essential for state and local governments. The Governors continue to take seriously earlier commitments by administration representatives that the administration supports immediate fiscal relief upon the passage of programmatic reform legislation and would include such a provision in its legislation. That relief must be available in both FY 1980 and FY 1981.

FOOD AND NUTRITION PROGRAMS

The administration proposed an \$800 million increase in food and nutrition programs in FY 1980. This request reflects proposed legislation which will provide for \$.35 billion in reductions from the levels that would otherwise be needed.

Food Stamp Program

As is the case with other entitlement programs, the budget projections are important to the degree they reflect legislative initiatives or possible effects on the entitlement nature of the program. This year, there are two such circumstances which will be of significant concern to state governments.

1. Public Law 95-113 established a ceiling of approximately \$6.2 billion for FY 1980 appropriations for food stamps. The Department of Agriculture estimates that, with no changes in current legislation (except for removal of this cap), normal expenditures would reach \$6.9 billion or more. Under the terms of P.L. 95-113, unless this cap is raised above the level of program need, food stamp benefits would be reduced across the board to account for the shortfall. Therefore, the expendable income of low-income individuals and families will drop accordingly, with state and local governments finding themselves on the firing line in local welfare offices when such reductions occur. The department will seek legislation to remove the cap or eliminate its impact in 1980. Final disposition of this matter will rest with Congress. The administration's proposal to eliminate the cap is consistent with the interests of state governments seeking to reduce, rather than increase, the welfare burden they carry.

2. The administration also will propose legislation to establish a quality control program with fiscal sanctions directed at state government administration of the food stamp program. Important decisions remain to be made concerning the details of this program and its sanctions. Virtually every state would be affected, however, under the program being considered. USDA is projecting federal savings of \$150 million. At this time, discussion is concentrating on instituting a quality control program resembling that which HEW will formally institute in the AFDC and Medicaid programs within the next 60 days. A target error rate will be set independently for each state, with sanctions imposed for failure to perform at, or better than, the established target. This proposal is particularly worrisome in view of the expected results from implementation during calendar year 1979 of food stamp program changes mandated by the 95th Congress, especially elimination of the purchase requirement, which both federal and state officials believe will lead to higher error rates.

School Lunch and Other Nutrition Programs

Outlays for the school lunch program and other nutrition programs that financially assist states are estimated to increase by only \$68 million, or 1.8 percent, over the FY 1979 level of \$3.831 billion. The administration expects to save \$358 million through proposed legislation that would better target these resources to needy children. This legislation would:

- reduce lunch and breakfast subsidies by 5 cents for children from families with incomes above \$13,845;
- revise eligibility requirements for free and reduced-price meals;
- end subsidies for special milk programs in schools in which the federal government already pays for milk; and
- prohibit private sponsors of summer food programs from using private food vendors.

State administrative costs for FY 1980 would be increased from the FY 1979 level of \$32 million to \$34.9 million for child nutrition programs. However, funding would be reduced for equipment assistance to states from \$24 million in FY 1979 to \$20 million in FY 1980.

The budget for the Women, Infants and Children program is estimated to increase by \$200 million in FY 1980 to \$750 million. The administration also requested additional FY 1980 funds for the commodity supplemental food program. The FY 1980 budget for this program is proposed at \$21.5 million, an increase of \$202.5 million over FY 1979.

SOCIAL SERVICES

The FY 1980 social services budget, including Title XX, aging, child welfare services, and rehabilitation services, is basically a current-services budget that allows for neither expansion nor the impact of inflation on programs that, because of their "labor intensive" nature, are peculiarly sensitive to increases in the cost of living. Cuts have been made primarily in research and demonstration projects and in training. See the chart at the end of this section for a summary of the president's spending decisions.

Title XX Grants to States

The president's budget would increase the permanent entitlement ceiling for Title XX to \$2.9 billion from the current lid of \$2.5 billion. This represents no real increase above current services since Congress approved funding at the \$2.9 billion level for FY 1979. It is expected that Congress will make this amount permanent early in the session. In addition, the budget eliminates the \$200 million "earmark" for child day care services which has existed for the past two years. This will become part of the \$2.9 billion ceiling and revert from its special 100 percent funding level to the 75 percent/25 percent match

(90 percent/10 percent for family planning) required under Title XX. For some states, this will mean an increase in expenditures to maintain services previously funded under their allotment of the 100 percent "day care" monies. The administration also will propose legislation to provide a separate funding authority of \$16.1 million for the territories so they can plan more adequately for their service programs. Currently, the territories can spend up to that amount but the funds must come out of whatever is left under the ceiling after all state programs have been funded.

Title XX Training

Over the past two years, states have sought modification of regulations limiting their ability to adequately develop Title XX training programs to meet a number of objectives. These objectives include retraining personnel as a result of: deinstitutionalization programs; a reallocation of resources and services resulting from the implementation of the Title XX planning process; increased demands for greater accountability; and changes in client populations. The states have therefore identified training as an integral component of efforts to move toward more rational, comprehensive social services systems. In FY 1980, however, the president is proposing a "cap" on training funds (currently funded outside the Title XX ceiling) of 3 percent of the state's total allotment. This figure is based on the level of training over the past few years and would allow for no growth to respond to the added flexibility called for by the states. In fact, for over a dozen states this would represent a cutback from current services. The administration justifies this cap on the basis of "the unprecedentedly rapidly growing state and local training program." Funding for Title XX training has grown only from \$60 million in FY 1976 to \$72 million in FY 1978. The administration estimates, however, that costs could reach over \$100 million in FY 1980 and therefore is requesting \$26 million less than the projected need.

Child Welfare Services

The president is calling for increased spending of almost \$85 million for child welfare services, up from the current level of \$56.5 million to a total of \$141 million in FY 1980. The administration will propose legislation similar to the bill it introduced in the last Congress and with provisions similar to those contained in the child welfare services/adoption subsidy sections of HR 7200. Last year's administration bill would have increased the funding for child welfare services from its current level to its fully authorized level of \$266 million over a period of years, provided that states make improvements in their reporting and tracking systems and use additional funding to expand protection for children in foster care. Although the last Congress did not act, there is a great deal of interest in pushing a child welfare services bill early in this Congress.

Programs for the Aging

The FY 1980 budget calls for no increases in programs for the aging, except for a \$23 million increase in nutrition programs (consistent with the thrust of the reauthorization of the Older Americans Act passed last year) and \$15 million for long-term care projects (see below).

Rehabilitation Services

The FY 1980 budget calls for no increase in basic state grants, although it does call for a \$2 million supplemental appropriation for FY 1979 and \$10 million for FY 1980 to fund the new independent living section of the Rehabilitation Amendments of 1978 for services to persons not capable of employment.

Long-Term Care

The president is calling for \$15 million to be spent by the Administration on Aging for long-term care projects. Under the proposal, projects in ten states will examine, improve, and develop state and community information and referral networks for identifying the long-term care service needs of aged, blind, or disabled persons and for streamlining services to meet those needs. The projects are to be developed jointly by AOA, the Rehabilitation Services Administration, the Social Security Administration, and the Public Health Service. In addition, an increase of another \$15 million is proposed for research and demonstrations, funded by the Health Care Financing Administration, that would focus on alternative methods of financing and delivering services and on alternative reimbursement and utilization review systems.

The following chart summarizes the major items in the president's social services budget.

FY 1978, FY 1979 AND FY 1980 BUDGET AUTHORITY
SELECTED SOCIAL SERVICES PROGRAMS

(\$ in Millions)

	<u>FY 1978</u>	<u>FY 1979</u>	<u>FY 1980</u>	<u>Change</u>
Title XX				
Basic Services	\$2,500	\$2,700	\$2,900	+200
Child Day Care (P.L. 94-401)	200	200	--	-200
Territories	--	--	16	+ 16
Training	72	72	75 ¹	+ 3 ¹
Total	\$2,772	\$2,972	\$2,991	+ 19
Child Welfare Services (Title IV-B)	56.5	56.5	141	+ 84.5
Programs for the Aging	509	521	559	+ 38
Rehabilitation Services	875	929	919	- 7

1. The Administration estimates that states will spend \$101 million in 1980; therefore, the budget request represents a cut of \$26 million.

Employment and Training

The administration is continuing to rely heavily on targeted job creation and training programs to ease unemployment. While there is a projected phase-down of the counter-cyclical public service employment component of the CETA program, the administration projects this will be partially offset by the private employers' increased use of the recently enacted jobs tax credit.

Two special youth programs reflect a major retargeting within the budget. The first is the phase-out of a congressionally mandated job entitlement experiment and has no major impact on the formula grants to state and local governments. The second cut is the proposed reduction by one-half of funding for the Young Adult Conservation Corps, of which the states are guaranteed 30 percent of the total for state-administered projects. The administration said it is reducing this program because it prefers to target job creation efforts on programs that serve the economically disadvantaged. This program has no income criteria attached to eligibility and therefore has not received the administration's support for maintenance of current levels of expansion.

The projected increase in the unemployment insurance program is consistent with the expectation of a downturn in the economy in the next year and the interaction of various program changes.

The chart below summarizes spending levels for federal employment and training programs projected for FY 1979 and proposed for FY 1980.

SUMMARY CHART
EMPLOYMENT AND TRAINING
(\$ millions)

	<u>FY 1979</u>		<u>FY 1980</u>	
	<u>Budget Authority</u>	<u>Outlays</u>	<u>Budget Authority</u>	<u>Outlays</u>
CETA	10,652 ^{a/}	10,292	9,154 ^{a/}	9,563
Older Americans	221	210	235	219
WIA	385	372	385	378
Fed/State ES ^{b/}	745	745	762	762
Program Support	91	90	86	79
Total	12,094	11,710	10,623	11,002

^{a/} includes reappropriated funds of \$7 million in FY 1979 and \$122 million in FY 1980.

^{b/} Total direct program costs for grants to states for UI and ES is \$1,797 million in FY 1980.

COMPREHENSIVE EMPLOYMENT AND TRAINING ACT (CETA)CETA FUNDING

(\$ millions)

	<u>FY 1979</u>		<u>FY 1980</u>	
	<u>Budget Authority</u>	<u>Outlays</u>	<u>Budget Authority</u>	<u>Outlays</u>
Title II ABC	1914	1875	2054	1948
Title III	372	659	326	404
Public Service Employment				
Title II D	2517	2284	2536.5	2359
Title VI	3475	3181	2190.5	2571
Total Youth (Titles IV and VIII)	1967	2243	1925	2131
Job Corps	(296)	(375)	(416)	(400)
Summer Youth	(740)	(681)	(411 ^{a/})	(545)
YCCIP	(107)	(140)	(134)	(140)
YIEPP	(107)	(148)	-	(43)
YETP	(500)	(592)	(798)	(850)
YACC (VIII)	(217)	(307)	(166)	(153)
Title VII	400	50	-	150
Total CETA	10,645	10,292	9,032	9,563

^{a/} An additional \$122 million will be requested to keep the program at current levels through FY 1980, bringing total CETA budget authority to \$9.1 billion.

Total CETA outlays under the budget request would decline by 7 percent in FY 1980. Most of the reduction comes from a decrease in Title VI from the current level of 358,000 PSE slots to 200,000 by the end of FY 1980. Title VI authorized funding for 20 percent of the number of unemployed over 4 percent nationally, which in FY 1980, with an unemployment rate of around 6.1 percent, would call for about 400,000 job slots. The 200,000 jobs represent only about one-half of the congressional authorization. Title II-D, the structural unemployment PSE program, is expected to remain at current levels, 267,000 job slots. Also included in FY 1980 funding request for II-D is \$175 million for 17,000 welfare reform demonstration job slots.

The youth employment programs are projected at about the same level as FY 1979, but have been re-targeted to the most "cost-effective" programs. The Youth Incentive Entitlement Pilot Projects program will be phased out in FY 1980, and outlays for Summer Youth and Young Adult Conservation Corps have been reduced by \$136 million and \$154 million respectively. These funds are

transferred to the Youth Employment and Training Program (\$258 million in outlays) and Job Corps (\$25 million increase in outlays). Total job slots for youth programs will decline by 228,700 from the current level of 1,224,000, reflecting, among other things, the 250,000 loss in Summer Youth slots. However, the Department of Labor has requested that \$122 million in FY 1979 unobligated funds be deferred for spending in FY 1980 for the Summer Youth Program.

Also reflected in the totals is an expected supplemental request by DOL for \$400 million in budget authority for Title VII, the private sector initiative program. This request will provide \$50 million in outlays in FY 1979, \$150 million in each of FY 1980 and FY 1981, and \$50 million in FY 1982. DOL expects that Title VII will provide 80,000 jobs by the end of FY 1980.

OTHER EMPLOYMENT AND TRAINING PROGRAMS

	<u>FY 1979</u>		<u>FY 1980</u>	
	<u>Budget Authority</u>	<u>Outlays</u>	<u>Budget Authority</u>	<u>Outlays</u>
Older Workers	221	210	235	219
WIN	385	372	385	378

The request for the Older Workers programs would maintain the current level of 47,500 job opportunities under Title V of the Older Americans Act (OAA). The 1978 amendments to OAA authorized an expansion in funding of up to \$400 million in FY 1980. The Work Incentive program is expected to remain at the FY 1979 level in FY 1980. The \$20 million increase appropriated in FY 1979 over the FY 1978 level of \$365 million, and again requested in FY 1980, will be used to improve employment and training strategies and for welfare reform models.

EMPLOYMENT SECURITY GRANTS TO STATES

Grants to states for the administration of unemployment insurance and employment service programs will increase by 4.7 percent, from \$1.715 billion in FY 1979 to \$1.796 billion in FY 1980. State administrative expenses for the UI program are projected to increase from \$996 billion in FY 1979 to \$1.055 billion in FY 1980. This figure reflects an increase of 560 staff years for state UI programs (a 1.2 percent increase in staffing). At the same time, the volume of UI claims is projected to rise from 2.2 million workers per week to 2.6 million workers per week (an 18 percent increase in claims volume).

State employment service programs are recommended to increase from \$719.6 million in FY 1979 to \$742 million in FY 1980 (a 3.1 increase), although ES staffing levels will be held constant at the 30,000 staff year ceiling, which has remained relatively constant over the past 14 years. Not less than \$80 million of the overall ES budget (10.8 percent) is to be earmarked for services to veterans.

Of the total budget for employment security grants to states, \$22.3 million is paid for out of general revenues; the balance of funding is provided by the federal unemployment trust fund.

UNEMPLOYMENT INSURANCE BENEFITS TO WORKERS

The economic projections for calendar year 1980 show the total unemployment rate averaging 6.2 percent for the year. Insured unemployment (that is, unemployment among workers covered by state unemployment insurance laws) is expected to increase from 3.1 percent in calendar year 1979 to 3.2 percent in calendar year 1980. Consistent with this change in unemployment, higher wages, and added coverage, total outlays for unemployment compensation benefits are projected to increase from \$9.3 billion in FY 1979 to \$11.3 billion in FY 1980 (a 21.5 percent increase). Of these total outlay figures, UI benefits paid under state laws are expected to amount to \$8.2 billion in FY 1979 and \$10.1 billion in FY 1980.

Although revenue projections show that the federal share of UI benefits can be financed without additional advances from general revenues to the federal trust fund, some states may be forced to draw on federal general revenue advances to meet the state portion of these increased benefit costs. Some 20 states continue to carry outstanding UI debts, totaling nearly \$4.5 billion, to the federal treasury from the 1975-76 recession.

CONGRESSIONAL OUTLOOK

Welfare reform will provide the backdrop for the legislative debate on employment and training this year. Although the 1980 budget does not reflect any outlays for a revised welfare reform program, it is known that the administration is planning to submit to Congress this year a revised welfare reform proposal containing a strong commitment to job creation. The administration is projecting a need for approximately 700,000 jobs and/or training opportunities for the "expected to work" welfare population. The administration estimates that almost half of this demand can be met by current CETA resources. Much of the debate will focus on how best to guarantee that CETA resources will be used for the welfare eligible population. This is important to the states who bear the cash cost of welfare reform but have no control over local CETA decisions or recipients of PSE jobs.

The congressional debate also will focus on the economic assumptions and appropriate program mixes of the counter-cyclical jobs program (CETA Title VI) and its adequacy to meet the goals of the Humphrey-Hawkins Full Employment Act. A major part of that debate will be on how much funding should be made available for programs serving the economically disadvantaged through direct job creation versus other types of grant-in-aid, such as counter-cyclical revenue sharing.

Congress may restore the proposed cuts in the Young Adult Conservation Corps since the program has always been popular on Capitol Hill.

Education

The education community will feel the president's move toward a balanced federal budget. FY 1980 budget authority for education is proposed at \$14.335 billion, or \$276 million below the FY 1979 level. FY 1980 budget authority for education programs within HEW is \$12.338 billion, \$382 million below the FY 1979 level. The budget reflects an overall commitment to:

- maintain the current level of funding for programs;
- make modest increases in selected programs to implement pre-announced policies; and
- cut or eliminate funding for certain programs previously opposed by the administration.

The impact of the president's budget on states will not be negative in the aggregate except that maintenance of current funding levels means a real cut in funding levels when inflation is taken into account. The negative impact, if any, will be felt by selected states, state agencies, or programs directly affected by selected budget proposals. The following are highlights of the budget for HEW's education programs.

ESEA

The largest part of this request is for Title I of the Elementary and Secondary Education Act, designed to serve low-income, low-achieving students. The administration is requesting that the basic Title I state grant program be continued at the FY 1979 level of \$3.1 billion in budget authority and outlays. Title I funds are for use in school year 1980-81. The actual amount available for basic grants, \$2.6 billion, is due to increased funding taken "off the top" for state programs and the increased cost of state administration. Additional funds of \$400 million are proposed for a new program authorized in the Education Amendments of 1978 to provide funding for areas with high concentrations of low-income students. A supplemental appropriation of \$258 million has been requested for this purpose in 1979. The Education Amendments authorized a new program to provide additional Title I funds to schools in states participating in an incentive matching program for state compensatory education programs. No funds, however, are requested for either FY 1979 or FY 1980 to implement this program, which was authorized at a \$200 million level by Congress.

Education for the Handicapped

The president's budget proposes funding for FY 1980 of \$1.028 billion for programs for the education of handicapped children, an increase of \$51 million from FY 1979. Funding for state grants under P.L. 94-142, the Education for All Handicapped Children Act, would be \$862 million, an increase of only \$58 million from the FY 1979 appropriations level. This funding level falls far short of the amount authorized for FY 1980, which would provide 30 percent of the average per-pupil expenditure for the costs of special programs for handicapped children (approximately \$1,700 per child) multiplied by the estimated 3.95 million handicapped children HEW anticipates being served in FY 1980. Based on the above figures, the total authorization should be somewhere around \$2.0 billion in FY 1980. The \$862 million proposed by the president represents slightly more than 10 percent of the costs, per pupil, thus shifting the additional costs to the states. States are faced with the requirement under P.L. 94-142 that, as of September 1978, they must be serving and providing full services to all handicapped children as a condition for receiving assistance under P.L. 94-142. With the exceptions of Pre-school Incentive Grants (-\$3 million), Early Childhood Education (-\$2 million), and Special Education Manpower Development (-\$2 million), funding for other programs benefitting handicapped children is requested at FY 1979 levels.

Impact Aid

The administration is requesting a cut of \$288 million in FY 1980 budget authority from FY 1979 levels for impact aid. The program provides assistance to local education agencies for the operating costs of educating children in areas in which local school costs are affected by federal activity. No budget authority is requested for payments for "B" children, children whose parents work or live, but not both, on federal property. States having a significant number of "B" children may need to generate additional state and/or local revenues to replace this portion of impact aid funding.

Other Elementary and Secondary Education Programs

Support and innovation grants to state and local education agencies will decrease by \$25.5 million to a FY 1980 level of \$197.4 million. Follow Through and environmental education funding are proposed at FY 1979 levels of \$59 million and \$3.5 million, respectively. The administration has requested that funds for bilingual education, basic skills improvement, and alcohol and drug abuse education programs be increased. Funds for bilingual education would be \$23.6 million above the FY 1979 level of \$150 million. Basic skills improvement, which represents a major transformation of the Right to Read Program, has been proposed to increase by \$8 million to \$35 million in FY 1980, with an additional \$2 million earmarked for a new program of Achievement Testing assistance. The administration's FY 1980 request of \$3 million for drug and alcohol abuse education is 50 percent greater than the FY 1978 amount. Indian education programs are proposed to be funded at \$4 million more than FY 1979 levels.

An increase of \$13 million in budget authority for FY 1979 to assist school districts engaged in desegregation is also proposed. Some \$700 million is proposed in FY 1980 budget authority for Headstart, with a supplemental appropriation of \$155 million for FY 1979.

VOCATIONAL AND ADULT EDUCATION

The administration has proposed FY 1980 budget authority for occupational, vocational, and adult education of \$772 million, \$10 million below FY 1979.

HIGHER EDUCATION

The FY 1980 administration request for higher education programs reflects an increase of \$14 million in budget outlays, but a decrease of \$307 million in budget authority relative to FY 1979. Of the requested FY 1980 budget authority of \$5 billion, \$2.4 billion is proposed to fully fund the basic opportunity grant program, for which families with incomes up to \$25,000 are eligible (a decrease from the FY 1979 level of \$2.6 billion). FY 1979 levels of \$340 million, \$77 million, and \$550 million for supplemental education opportunity grants, state student incentive grants, and the college work-study program, respectively, are also proposed. An additional \$960 million is requested to provide \$2.5 billion in loans under the guaranteed student loan program authorized by the Middle Income Student Assistance Act. The administration requested \$220 million for federal capital contributions to institutional loan funds under the National Direct Student Loan Program. This represents a \$94 million reduction in new budget authority from FY 1979. This is consistent with previous administration positions and reflects the administration's interest in proposing major changes in federal loan programs during the re-authorization of the Higher Education Act in 1979-80.

The FY 1980 budget request also includes \$130 million in budget authority for Talent Search, Upward Bound, and Special Services programs and for educational opportunities centers. This represents a \$15 million increase from the FY 1979 request, but \$10 million below the FY 1979 appropriation. Additional budget authority of \$18 million is proposed to assist minority students under the bio-medical sciences and the graduate professions opportunities program.

Programs proposed for no funding include: educational information centers, university community services and continuing education, and state postsecondary education commissions. Additional funding is proposed for activities such as international education and foreign language studies.

HEALTH PROFESSIONS EDUCATION

The president's budget continues previous administration policy of proposing substantial cuts in funding of health professions education programs, especially capitation grants to medical schools and other health professions institutions.

These changes are reflected in both rescissions of FY 1979 appropriations and elimination of funding for FY 1980 for several programs within the Health Resources Administration budget.

- Institutional assistance for the health professions (medicine, osteopathy, dentistry, veterinary medicine, podiatry, pharmacy and public health) is cut in half for FY 1979 and eliminated in FY 1980. The actual FY 1979 appropriation for capitation grants for these institutions is \$144 million. The budget calls for rescission of \$76.7 million of the FY 1979 funding and then zero funding for FY 1980. Approximately 55 percent of these funds go to public institutions. Because these funds currently provide basic support for the institutions, the cuts in the federal budget are likely to lead to the need for replacement of the funds by the states. This would mean additional state expenditures of approximately \$42.2 million in FY 1979 and \$37.0 million in FY 1980 if the proposed cuts are approved.
- Support for allied health education is maintained at \$13 million for FY 1979 but eliminated in FY 1980.
- Support for nursing education is reduced from \$37.9 million in FY 1979 to \$14.7 million in FY 1980, a cut of \$23.2 million.

Assuming that approximately 55 percent of the funds for allied health and nursing programs go to public institutions, the proposed health professions education cuts could mean a transfer of approximately \$100 million in costs to the states.

The table on the next page summarizes changes in education programs.

**FY 1979 and FY 1980 Budget Authority and Budget Outlays for
All Federal Education Programs***
(\$ millions)

	FY 1979		FY 1980		Change in Budget Authority		Change in Budget Outlays	
	Budget Authority	Budget Outlays	Budget Authority	Budget Outlays				
<u>Elementary, Secondary and Vocational Education</u>								
Elementary and Secondary	3,779	3,034	3,953	3,447	+174	4.6%	+413	13.6%
Indian Education	335	302	339	301	+4	1.2	-1	0.3
Impact Aid	816	800	528	619	-288	35.3	-181	22.6
Education for the Handicapped	977	525	1,028	814	+51	5.2	+289	55.0
Occupational, Vocational and Adult Education	782	808	772	840	-10	1.3	+32	4.0
Other	345	349	358	326	+13	3.8	-23	6.6
Child Development	731	699	751	758	+20	2.7	+59	8.4
Subtotal	7,765	6,517	7,730	7,106	-35	0.5	+589	9.0
<u>Higher Education</u>								
Student Aid & Institutional Support	5,332	4,696	5,013	4,702	-319	6.0	+6	0.1
Special Institutions	175	177	188	185	+13	7.4	+8	4.5
Subtotal	5,507	4,873	5,200	4,887	-307	5.6	+14	0.3
<u>Research & General Educational Aids</u>								
Special Projects and Training	113	101	118	104	-5	4.4	+3	3.0
National Institute of Education	92	89	98	90	-6	6.5	+1	1.1
Other Educational Research	33	29	33	26	0	0	-3	10.3
Cultural Activities	559	530	638	592	+79	14.1	+62	11.7
Other	541	523	518	519	-23	4.3	-14	2.7
Subtotal	1,339	1,272	1,405	1,330	+66	4.9	+58	4.6
TOTAL	14,611	12,662	14,335	13,323	-276	1.9	+661	5.2

*Includes some education programs not administered by Education Division within HEM.

Energy

Overall, energy program outlays are scheduled to drop in FY 1980 to \$7.9 billion from \$8.6 billion. This results from the interaction of four factors:

- (1) increases in outlays of over \$100 million each for solar research and technology, other energy supply technology, and conservation grants;
- (2) reductions in outlays of over \$100 million each for nuclear fission research, uranium enrichment, power marketing, and costs characterized as administrative expenses;
- (3) major increases in petroleum reserve receipts which are an offset to expenditures; and
- (4) other smaller increases and decreases in outlays.

Items of particular interest to the states in the FY 1980 budget include:

- ° establishment of the State Energy Management and Planning program, which restructures several existing grant activities and provides more flexibility for states;
- ° a significant increase in funding to develop technology to manage safely both commercial and defense-generated nuclear wastes;
- ° a realignment of the fossil energy development program to deemphasize large single technology demonstration facilities and to focus funding on most promising technologies; and
- ° additional emphasis on environmental assessment of emerging energy technologies at each stage of development.

SOLAR ENERGY

Solar energy receives considerable emphasis in the FY 1980 budget. Total outlays of all federal departments for solar energy are budgeted to rise by over thirty percent. Total costs of solar energy development (including tax expenditures) exceed \$800 million in FY 1980. These costs are to be distributed as shown on the next page.

FY 1980 COSTS (OUTLAYS AND TAX EXPENDITURES)

(\$ millions)

<u>Activity</u>	<u>FY 1979</u>	<u>FY 1980</u>
Solar research and technology development	\$333	\$465
Solar demonstration and applications	218	265
Solar tax credits (revenue loss)	88	74
Total Costs	\$639	\$804

ENERGY CONSERVATION

The Administration has requested a total budget authority of \$555 million for conservation research and development and grant programs. This represents a substantial reduction in budget authority, but outlays are expected to increase by 35 percent. Included is a 17 percent reduction from last year's funding for the Department of Energy's (DOE) conservation programs. Delayed passage of the National Energy Act caused many of the programs involved to get underway slowly so considerable budget authority from prior years can support increased outlays in FY 1980 despite a budget authority cut in FY 1980.

Weatherization programs are to be continued at the same level as in FY 1979 in terms of budget authority, but outlays will rise. Budget authority for schools, hospitals and other local government activities will drop sharply, but prior appropriations will fund increasing outlays.

Funds made available last year for the state energy conservation program, supplemental program, and energy extension service have been consolidated into one budget request for State Energy Management and Planning (SEMP). The legislative proposal for SEMP will restructure existing grant programs and consolidate grant administration procedures for other state energy conservation programs administered by DOE. The table on the next page illustrates the distribution of energy conservation funds to selected state programs.

SELECTED STATE ENERGY CONSERVATION PROGRAMS

(\$ millions)

	FY 1979 est.		FY 1980 est.	
	Authority	Outlays	Authority	Outlays
Schools and Hospitals Grant Programs	100.1	59.7	2.5	138.7 ^{1/}
Other Local Government Buildings Grant Program	29.8	18.0	0.2	17.0
Weatherization	199.0	128.5	199.0	174.0
State Energy Management	82.8 ^{2/}	78.6	110.0	96.4

1/ Carry-over funding from FY 1979 is expected to provide funding for this program in FY 1980.

2/ This figure represents the total budget authority for EPCA, ECPA, and the Energy Extension Service grant programs which will be merged into SEMP in FY 1980.

The administration's recommendation to consolidate the conservation programs is responsive to the Governors' recommendations to the president that broad grants are more effective than narrow categorical programs.

FOSSIL ENERGY PROGRAMS

The level of support provided for fossil energy programs suggests that the administration has reduced the budget from the level that would have supported all of the research efforts sought by the Department of Energy. Requests for synthetic gas demonstrations and petroleum research and development appear to have suffered the most significant cuts. Highlights of the fossil energy budget include:

- ° increases in research on fuel gas desulfurization and other environmental control techniques;
- ° a new initiative to test four industrial atmospheric fluidized beds; and
- ° completion of construction of pilot coal liquefaction plants in Texas and Kentucky.

The budget for the environmental program of the Department of Energy also contains funds for additional studies on coal combustion and conversion and expansion of research and assessment studies on the effects of increasing carbon dioxide in the atmosphere.

SURFACE MINING

Budget authority for surface mining programs is requested at a level that will sharply increase the overall level of funding for those programs in 1980. Outlays will nearly double to \$148 million in FY 1980.

The budget requests made by the Office of Surface Mining were not cut by OMB, with the exception of funding for the abandoned land reclamation program. If state regulatory programs are approved more quickly than is expected, there is a possibility that these funds could be restored through a FY 1980 supplemental appropriation.

Budget authority for the Office of Surface Mining programs is shown below:

SURFACE MINING ACTIVITIES

(\$ millions)

<u>Fund/Activity</u>	<u>Budget Authority</u>	
	<u>FY 1979</u>	<u>FY 1980</u>
General Fund		
State Regulatory Program Grants	\$ 20.9	\$ 22.7
Federal Regulatory Programs	28.5	37.8
Mineral Institutes	10.7	5.8
Small Operator Assistance Payments	4.0	15.0
Total Budget Authority, General Fund	\$ 64.1	\$ 81.3
Abandoned Mine Reclamation Fund (excluding funding adjustments)		
State Reclamation Program Grants	\$ 8.0	\$ 27.0
Federal Reclamation Program	55.7	51.5
Small Operator Assistance Payments	12.5	15.0
Total (excluding funding adjustments)	\$ 76.2	\$ 93.5
Abandoned Mine Fund		

The regulatory program grant levels will continue activities in the interim regulatory program and are expected to cover funding for the permanent programs which are supposed to be established by June 1980. The abandoned mines grant level anticipates that 27 states will have their programs for the use of these funds approved by the end of the fiscal year.

NUCLEAR WASTE MANAGEMENT

The Department of Energy's nuclear waste efforts are to be increased significantly in two areas in FY 1980:

- (1) the Spent Fuel Storage program for implementation of the president's October 1977 commitment to provide interim storage for commercially generated spent nuclear fuel; and
- (2) increased efforts in Defense Waste Management aimed at long-term solutions for defense nuclear waste disposal.

Separate legislation will be proposed in early 1979 to authorize the department to acquire and operate by 1983 spent fuel storage facilities for commercial nuclear fuel. This legislation also will authorize DOE to make a one-time spent fuel storage charge on users sufficient to cover all costs of storage and disposal incurred by the government. Some \$300 million will be requested in separate enabling legislation with FY 1980 estimated offsetting revenues of \$100 million.

The \$115 million increase in Defense Waste Management includes funding for handling storage and transfer of high-level and transuranic waste forms, continuation of design work for the Waste Isolation Pilot Plant (WIPP), operation of Waste Calcining Facilities, transportation R&D and related studies, which are all activities geared toward optimum long-term disposition of spent fuel.

Commercial waste management, with proposed funding of \$199 million, will continue work on a deep geologic nuclear waste repository for commercially generated waste, with expanded efforts in the evaluation of various geological environments, including non-salt media.

The decontamination and decommissioning program will shift its emphasis from planning, engineering studies, and cleanup of DOE-owned facilities to cleanup operations for remedial action at several former Manhattan Engineer District/Atomic Energy Commission facilities.

DOE NUCLEAR WASTE MANAGEMENT PROGRAMS

(\$ in Millions)

	FY 1979		FY 1980	
	<u>BA</u>	<u>BO</u>	<u>BA</u>	<u>BO</u>
Defense Waste Management	\$257.0	\$277.9	\$371.9	\$406.2
Commercial Waste Management	190.7	166.9	199.4	193.6
Spent Fuel Storage	11.4	7.4	320.5	27.3
Decontamination & Decommissioning	<u>25.4</u>	<u>23.9</u>	<u>32.6</u>	<u>28.4</u>
TOTAL NUCLEAR WASTE	\$484.5	\$476.1	\$924.4	\$655.5

ENERGY IMPACT ASSISTANCE

The budget includes a request (which is shown in community and economic development rather than energy totals) for \$150 million for FY 1980 for the Economic Development Administration (EDA) to make grants to states and Indian tribes to aid communities facing the adverse impacts of rapid energy development. For each of five years beginning in 1980 the program would provide \$15 million for planning grants and \$135 million for implementation grants, primarily to capitalize state revolving funds that would make grants and loans to local areas for infrastructure improvements. Matching contributions of state and tribal funds for the implementation of impact mitigation strategies would be required. The basic principles of this proposed program were presented to Congress last session and were contained in the Inland Energy Impact Assistance proposal (S1493) introduced by Senators Hart and Randolph.

The administration did not request any funding for the new Section 601 energy impact assistance program, which was authorized last year in the National Energy Act. However, should the administration's new energy impact bill encounter resistance in the Congress, it is understood that the administration might support funding through Section 601 rather than the new bill.

The Coastal Energy Impact Program is proposed for no funding in FY 1980 for the loan program because an estimated \$130 million will be available in that fiscal year from prior year appropriations. Outlays in the program are expected to rise from \$11 million in FY 1979 to \$54 million in FY 1980.

OVERVIEW OF THE ENERGY BUDGET

The energy budget reflects continuing increases in support of solar energy and conservation, and, overall, attempts to constrain the growth of the budget.

BUDGET AUTHORITY FOR THE DEPARTMENT OF ENERGY

(\$ millions)

<u>Activity</u>	<u>FY 1979</u>	<u>FY 1980</u>
Energy Supply	3,010	2,999
Solar Research and Technology Development	(522	589)
Fossil Research and Technology Development	(723	772)
Nuclear Fission Research and Technology	(1,100	937)
Other Energy Supply Activities	(1,614	1,882)
Offsetting Energy Supply Receipts	(- 959	-1,181)
Energy Conservation	659	555
Energy Information, Policy and Regulation	980	1,003
Offsetting Receipts	- 96	- 84
Total Regular Activities	4,553	4,473
Special Appropriation for TVA Capital Outlays	0	15,000
Emergency Energy Preparedness (stockpile)	3,007	8
Grand Total	7,560	19,482

Budget authority fluctuates sharply between FY 1979 and FY 1980 for two major reasons. The FY 1980 budget includes \$15 billion in authority for the Tennessee Valley Authority to borrow funds to support power plant construction. Also, much of the authority provided for purchases of petroleum for the stockpile has not yet been used, so substantial added authority is not needed in FY 1980 to support the stockpile program.

Emergency Management

The creation of the Federal Emergency Management Agency (FEMA), to be formally activated on March 25, 1979, consolidates in one agency the activities formerly carried out by numerous federal agencies and offices. The most prominent agencies to be consolidated are: the Defense Civil Preparedness Agency, the Federal Preparedness Agency, the United States Fire Administration, the Federal Insurance Administration, and the Federal Disaster Assistance Administration. In addition, FEMA will administer activities of the National Insurance Development Fund and the National Flood Insurance Fund.

The budget calls for an FY 1980 spending level of \$259 million, down slightly from the \$263 million estimated outlays for FY 1979. The decrease represents expected savings derived from the consolidation into one agency of the activities of numerous programs formerly administered by several departments and independent agencies. The budget figure for the new agency essentially represents level funding for the component parts of FEMA.

The new agency will continue to carry out a number of state-related activities. These fall into three areas:

- **Civil Defense:** matching grants to state and local governments to develop and operate civil defense programs and to design, construct, equip, and operate state emergency operations centers;
- **Disaster Mitigation:** funds to support hazard mitigation programs and activities, such as flood insurance, flood studies and surveys, planning assistance to states for natural disaster preparedness and mitigation programs, and training and education programs to upgrade fire service personnel; and
- **Disaster Relief:** grants to states for preparedness planning for natural and man-made disasters, and a wide range of disaster relief aid and assistance.

Agriculture

The FY 1980 budget for agriculture proposes a major reduction from FY 1979 levels. Total budget authority drops from \$8.3 billion in FY 1979 to \$4.9 billion in FY 1980.

This reduction is caused primarily by assumptions of substantially lower costs for agricultural price supports and export credits. Whether these reductions will be realized in practice will depend on world market conditions and prices. The administration's budget is based on the assumption of strong international demand and lower domestic production of such commodities as feed grains.

Outlays for the agricultural research and service functions of the Department of Agriculture are expected to decline from \$1.3 billion in FY 1979 to \$1.2 billion in FY 1980. Within the research program, funds are being redirected from other areas of research to permit increases in research for food safety, human nutrition, conservation and natural resources, pest management, and basic plant research activities.

The budget calls for a reduction of personnel in the Department of Agriculture from an estimated 85,000 in FY 1979 to 82,700 in FY 1980, with major reductions in the Soil Conservation Service, Forest Service, and in-house research capabilities.

Food safety and marketing systems programs would remain at the FY 1979 level of \$411 million with a \$1.6 million decrease in grants to state marketing agencies, under the administration's proposal.

Some key programs of the Department of Agriculture are discussed in other portions of this analysis. Following the format of the budget, food stamps are discussed in connection with income maintenance programs, and rural development and housing are considered with economic and community development programs of other agencies.

OTHER PROGRAMSSTATE ARTS PROGRAMSNational Endowment for the Arts

While there is a \$5 million increase in the total proposed budget for the National Endowment for the Arts for FY 1980, the increase is in matching funds which are more readily available to institutions than to states and communities. The proposed budget for program and administration decreases slightly from the FY 1979 level. State grants are earmarked at 20 percent of the program budget.

Arts Funding
(\$ millions)

	<u>FY 1979</u>	<u>FY 1980</u>
Salaries and Expenses	111.9	107.5
Administration	9.8	10.5
Program	102.2	97.0
Matching Grants		
Treasury Funds	7.5	20.0
Challenge Grants	30.0	26.9

Livable Cities

The proposed budget contains \$5 million for the livable cities program passed by the 95th Congress as one of the urban policy initiatives. The program has an FY 1980 authorization of \$10 million, to be expended in grants made by HUD to states and communities for artistic or cultural projects aimed at revitalizing communities and neighborhoods. This is a new program which had no FY 1979 appropriation but may receive a \$5 million supplemental appropriation for FY 1979.

International Trade and Foreign Relations

The president proposes to commit \$14 million to the export development initiatives recommended in his National Export Policy. The bulk of these funds will come from savings realized as the result of closing six tourism development centers abroad and five trade promotion facilities in foreign locations.

The administration's program calls for comprehensive trade promotion, including the collection of international tourism data to provide policy recommendations, technical assistance, and coordination of governmental organizations.

The Agency for International Development programs for basic needs in poor countries to aid in the promotion of economic growth are estimated to rise from \$1.2 billion in 1979 to \$1.3 billion in 1980. P.L. 480, food aid for humanitarian relief, is proposed for FY 1980 outlays of \$1 billion, which would permit shipment of 6.7 million tons of food. This level meets two-thirds of the worldwide food aid target of 10 million needed tons.

VI. GLOSSARY

- APPROPRIATION**--The spending limit set by Congress for each federal program.
- AUTHORIZATION**--Basic legislation enacted by Congress that sets up or continues the legal operation of a federal program or agency. Such legislation is normally a prerequisite for subsequent appropriations, but does not usually provide budget authority (see below).
- BUDGET AUTHORITY (BA)**--Authority provided by law which permits federal agencies to spend or to make loans.
- BUDGET RECEIPTS**--Money collected from the public by the federal government through taxes, premiums paid by voluntary participants in federal social insurance programs and gifts and contributions.
- BUDGET SURPLUS (+) OR DEFICIT (-)**--The difference between budget receipts and outlays for any given period.
- CONCURRENT RESOLUTION ON THE BUDGET**--A resolution passed by both houses of Congress, but not requiring the signature of the president, setting forth, reaffirming, or revising specified congressional budget totals for the federal government for a fiscal year.
- CONTINUING RESOLUTION**--Legislation enacted by Congress to provide budget authority for specific ongoing activities when a regular appropriation for such activities has not been enacted by the beginning of the fiscal year.
- CONTROLLABILITY**--In the president's budget this refers to the ability of the president to control budget authority or outlays during a fiscal year without changing existing substantive law. The concept "relatively uncontrollable" includes outlays for open-ended programs and fixed costs, such as interest on the public debt, and social security and veterans benefits, as well as outlays to liquidate prior-year obligations.
- CURRENT SERVICES ESTIMATES**--Projections of the amount it would cost during the coming fiscal year to continue programs at the same level as during the fiscal year in progress. The Congressional Budget and Impoundment Control Act of 1974 requires that the president transmit current-services estimates to Congress.
- DEFERRAL**--Any action or inaction by a federal agency to temporarily withhold or delay expenditure of funds. Deferrals may not extend beyond the end of the fiscal year and may be overturned at any time by either house of Congress.

FISCAL YEAR--The yearly accounting period for the federal government which begins on October 1 and ends on September 30. The fiscal year is designated by the calendar year in which it ends. e.g., fiscal year 1980 is the fiscal year ending September 30, 1980. (Prior to fiscal year 1977 the fiscal year began on July 1 and ended on June 30.)

OBLIGATIONS--Commitments made by federal agencies during a given period or that will require outlays during the same or some future period.

OFF-BUDGET FEDERAL ENTITIES--Organizational entities, federally owned in whole or in part, whose transactions belong in the budget under current budget accounting concepts but which have been excluded from the budget totals under provisions of law. While these transactions are not included in the budget totals, information on these entities is presented in various places in the budget documents.

OFFSETTING RECEIPTS--Collections deposited in receipt accounts that are offset against budget authority and outlays rather than counted as budget receipts. These are collections from other government accounts or from transactions with the public that are of a business-type or market-oriented nature (such as sales, interest, or loans).

OUTLAYS--Checks issued, interest accrued on the public debt, or other payments made, net of refunds and reimbursements.

RESCISSION--Enacted legislation canceling budget authority previously provided by Congress.

SUPPLEMENTAL APPROPRIATION--An appropriation enacted as an addition to a regular annual appropriation act. Supplemental appropriation acts provide additional budget authority beyond original estimates for programs or activities (including new programs authorized after the date of the original appropriation act) for which the need for funds is too urgent to be postponed until the next regular appropriation.

TAX EXPENDITURES--Losses of tax revenue attributable to provisions of the federal tax law that allow a special exclusion, exemption, or deduction from gross income or provide a special credit, preferential rate of tax, or a deferral of tax liability.

NOTE: The sources for this glossary are "Budgetary Definitions" published by the General Accounting Office in July 1977 and the Budget of the United States Government, 1979.

VII. APPENDIX

Congressional Budget Process

Congressional consideration of the President's budget has, since 1975, been governed by the procedural requirements of the Congressional Budget Act.

The initial step in the process is the submission of the president's budget in mid-January. Shortly after the budget is submitted, the budget committees in the House and Senate hold hearings on the budget and the economic assumptions on which it is based.

A number of separate actions then take place in preparation for budget committee action. The standing committees advise the budget committees on likely programs and outlays to be authorized during the year. The Joint Economic Committee advises on the economic outlook and appropriate fiscal policy. The Congressional Budget Office reviews the budget, makes economic projections, and then files a report dealing with national economic policy, alternative total budget levels and national budget priorities.

Based on these materials and the results of its own hearings, the budget committees recommend a first concurrent resolution on the budget to their respective houses by April 15. This resolution covers the recommended levels of budget authority and outlays in total and for each of the major functions in the budget (but not for individual programs), the deficit, the total levels of revenues and expenditures, and the changes in federal debt implied by the other decisions. The first budget resolution establishes targets for budget authority and outlays. These budget targets, which represent a congressional determination of appropriate fiscal policy and national budget priorities, guide Congress in its subsequent spending and revenue decisions. However, the allocations for each function are not binding on Congress at this stage. Using the normal procedures for enacting a resolution, including a conference committee to reconcile differences between the two houses, Congress approves the first resolution by May 15.

The May 15 date is also important because it is the deadline for reporting legislation authorizing new budget authority. Authorizing bills reported after that date, with a few exceptions, are subject to a point of order unless an emergency waiver is granted.

In a statement which accompanies the first budget resolution, the totals for functions (e.g., community and economic development) are divided up among the committees of the House and Senate, so that each committee is working against a known, but non-binding, ceiling.

Under the budget process, Congress completes action on bills and resolutions providing new budget authority and new spending authority by one week after Labor Day. Exceptions are made for appropriation bills that cannot proceed until authorizing bills are passed. Exceptions also arise when Congress is unable to agree on particular bills, as when an issue such as abortion holds up appropriation bills.

The Congress is scheduled to pass a second budget resolution by September 15. This resolution covers the same subjects as the first one, but is binding. It reflects updating estimates of both expenditures and revenues as well as any program decisions that have changed since the first resolution. Based on this resolution, the schedule calls for the Congress to complete action on "reconciliation" bills and resolutions by September 25. These measures are used to alter previously passed appropriations legislation to conform to the totals of the second resolution. Reconciliation action must be completed by October 1, when the federal government begins its new fiscal year.

For information on how the budget process worked last year, see the chart on page 71.

NOTES ON THE TABLE

In considering what Congress might do to the president's FY 1980 recommendations, it is interesting to examine what changes Congress made in the FY 1979 recommendations. This is shown in the table on the next page.

The table clearly indicates that Congress followed the president's recommendations on total revenues (although the president's tax package was changed substantially in its details) and made major reductions in outlays, concentrating on defense and energy while providing for significant increases in veterans programs and agriculture. However, not all of the reductions made by Congress necessarily reduce final outlays, though increases usually do increase outlays. When reductions are made in programs whose costs are determined by uncontrollable factors (e.g., price supports and interest), outlays may rise above original estimates through the supplemental appropriations process. For example, the total outlays shown for FY 1979 (the current fiscal year) in the "Congress" column of the table are \$487.5 billion. The president's FY 1980 budget suggests that this figure will be \$493.4 billion, a number much closer to what is shown as the presidential recommendation than to what is shown as the congressional figure.

COMPARISON OF PRESIDENTIAL BUDGET ¹
AND CONGRESSIONAL ACTION ² FOR FISCAL YEAR 1979

OUTLAYS

(in billions of dollars)

	<u>President</u>	<u>Congress</u>	<u>\$ Change</u>
Outlays	496.6	487.5	- 9.1
Revenues	448.2	448.7	+ 0.5
Deficit	48.5	38.8	- 9.7
<u>Function</u>			
National Defense	114.6	112.4	- 2.2
International Affairs	7.4	7.1	- 0.3
General Science, Space, and Technology	5.1	5.0	- 0.1
Energy	10.4	8.1	- 2.3
Natural Resources and Environment	11.8	11.5	- 0.3
Agriculture	5.6	7.5	+ 1.9
Commerce & Housing Credit	3.0	2.8	- 0.2
Transportation	17.3	17.3	0
Community & Regional Development	9.4	9.6	+ 0.2
Education, Training, Employment, and Social Services	31.4	30.3	- 1.1
Health	49.8	48.1	- 1.7
Income Security	159.6	159.3	- 0.3
Veterans Benefits & Services	19.8	20.7	+ 0.9
Administration of Justice	4.4	4.2	- 0.2
General Government	4.2	4.0	- 0.2
General Purpose Fiscal Assistance	9.5	8.8	- 0.7
Interest	49.0	48.0	- 1.0
Allowances	1.1	.8	- 0.3
<u>Undistributed Offsetting Receipts</u>	<u>-16.6</u>	<u>-18.0</u>	<u>+ 1.4</u>
Total Budget Outlays	496.6	487.5	- 9.1

Footnotes

1. Midsession Review of the FY 1979 Budget, July 6, 1978
2. Second Concurrent Resolution for FY 1979

Senator BENTSEN. Governor Snelling, please proceed.

STATEMENT OF HON. RICHARD A. SNELLING, GOVERNOR,
STATE OF VERMONT

Governor SNELLING. With your indulgence, Mr. Chairman, I will not read the prepared statement I brought with me today. It is, of course, available to you and to your staff, and it does represent the point of view which I bring here as a representative and as authorized spokesman of the National Governors' Association. My decision not to read it is simply in the interest of time.

I would like to address, very specifically, your opening statement. I am sure they must deal with the hard philosophic concerns that undoubtedly you and the other members of the committee have.

Your concern is, as I understand it, that the States are in good financial position, that they are coming to the Congress—

Senator BENTSEN. In comparison.

Governor SNELLING [continuing]. In comparison, through resolutions of their State legislatures, and are giving people back home to believe that Congress should deal with the problem of excessive Government spending.

At the same time, they are failing to show the Congress just how specific savings can be made.

I would like to respond to that philosophy in the vein in which you spoke, by saying that I think that historic circumstances that have led to these circumstances absolutely must be considered.

Prior to 1916, the Federal Government took the position that its task was to render only those services which could not be effectively rendered in the States. It has become almost a joke in this part of the century to talk about the days in which the role of the Federal Government was perceived as being national defense and the post office, but prior to 1916, the vast majority of the funds collected in the States for the support of the Federal Government were used for solely Federal purposes.

For 60 years now, there has been a massive change in attitude which I don't think the Congress can now ignore. For more than 60 years, the Federal Government has taken the position that its task, in large part, was to tell the folks in the States what they ought to be doing for the people in the States, telling the people what was not being done adequately in the judgment of the Federal Congress by programs implemented at the State or local level. So, over a period of time, a very substantial number of programs have been enacted by the Congress, some of them fully paid for by taxes taken to the Federal level, but a substantial number of other programs have been partially paid for by Federal funds. In principle and philosophy, I hope you will agree that the Congress, for many years, has pointed the way toward the expansion of service at the local level to give incentive to local and State governments to render services which they had not initiated, and many, many programs have started out by providing full funding or 80-percent funding or 50-percent funding in order to encourage spending, to encourage the expansion of programs.

Now, the financial circumstances to which you refer are that the States and the local governments have heeded the advice, instructions, and the prodding of the Congress, and have built up a huge

establishment for providing services. They have accomplished that in large part by increasing their tax rates, and I might say, by doing so with greater rate of acceleration than that of the Federal Government.

Now, at exactly the same time when the public has decided that expenditures are too great at the Federal level, the States and local governments have come to the point where they have built up very, very high tax rates, very high burdens. The figures you cited earlier do show, in addition to the relative liquidity of the States, that the tax rates have been increasing more rapidly at the local level, that the adjusted per capita increase is more rapid in tax revenues at the State level than at the Federal level. I would just ask you, sir, not to mistake liquidity for burden. Your argument, as I understand it, is that we are more liquid than the Federal Government, because we show a surplus. Well, it was destined to be so, since we don't print money, since we had an absolute obligation to pay for every burden thrust upon us by our own legislators or the U.S. Congress over a period of years.

If there were two families living side by side and both of them had the same income, both of them belonged to some neighborhood association, and one of them ended the year with a balanced budget and the other overspent and ended with a deficit, I don't think it would be equitable to say that the dues to the association paid by the family which had ended the fiscal year in balance should be increased, or that the dues of the family which had overspent and, therefore, was not liquid, should be reduced.

Senator BENTSEN. I think the family that overspent would be a fool to spend the money that they had collected from the taxpayers for that family that happened to have a balanced budget.

Governor SNELLING. Maybe the people I am talking about have been foolish for a period of time, and maybe they are about to rectify that failure.

Nevertheless, the statement that the States are liquid and that the Federal Government has a deficit, I would hope, sir, would be considered in the light of what programs are being implemented at the State level, and at whose instigation those programs were implemented.

What I am really arguing for, and what I think the Governors are arguing for, is that deceleration take place cautiously and that if now the thrust of Federal policy has changed and the Federal Government is no longer intent on telling the States what they should do, and encouraging them to add new programs, perhaps will come the recognition of how painful it is when programs undertaken at the Federal initiative and tax rates to support those programs at the local level have been built up as high as they have are suddenly and dramatically turned around.

Now the position of the States, I believe, is not at all that the Federal Government should accept the responsibility for all of this depression. I believe we have been specific. If one makes a statement that an automobile with a low horsepower that is not designed for rapid acceleration will provide more mileage to the gallon, I would say that is not a generality. That is a specificity. What we have said is that there are savings to be had in increasing the administrative flexibility of the programs for the States.

We are saying the categorical grants are expensive, and that, in the last few years, the number of categorical grants increased from 472 to 492. For the same period, 1972, we don't know of new block grants. We are saying we can take less money from the Federal Government and perform the services which we have mandated and you have mandated, if, indeed, we are allowed to do so with less regulation.

We are saying that the Federal mandates that have come down from the Congress for which no money has been provided are eating up our capacity at the local level, and that the Congress, at the same time as it addresses the concerns for reducing the Federal Government's expenditures, can put us in a position to pick up more of the slack and do more of these programs, if it will remove from us the burden of mandated programs for which it has provided no money.

We have offered to the President and to the Congress a bargain. What we have said is that we will accept less money in exchange for grant reform. It seems that at the moment there are some who will pick up the part that says less money, but the pace of picking up the part that provides for grant reform is not in the environment.

Senator BENTSEN. Governor, I am in concurrence with that statement and in fact have mandated the first major study on the effect of State spending of federally mandated programs, because I am in concurrence with that statement. I think we ought to understand what we are mandating, and that study will be conducted by this committee to try to find the full extent of what we are mandating. I totally agree with that part of your statement, but I still need specifics from you. When you talk about categorical grants and the ones you want cut, I want to know which ones. I really want your counsel and advice. I am going to be supporting a lot of those cuts, and did last time. If there are some programs that are not working, tell us about it, but don't, on the one hand, tell us to have a balanced budget and that you want your revenue sharing, and not tell us where we are going to make the cuts.

Governor SNELLING. I appreciate that, and the National Governors' Association is now deep into a program which, if it is to have value and the kind of specificity that you are talking about, will require a little time to complete. The Governors have all been asked to write to the National Governors' Association and outline priorities of Federal programs and show specifically which categorical grants we think are less valuable than others, and which can be brought together.

We have already provided to Mr. McIntye a list of 100 or more categorical grants which we think can operate more effectively if they are consolidated. I believe that within 4 or 5 months we will be able to be considerably more specific than we have been in the past, and that is the direction that you are requiring.

Let me just finish, Mr. Chairman, by a reference to something which I know is a sore point. There are those who are coming to the Congress from the States and saying, "Well, States balance their budgets and why can't the Congress balance the budget?"

There are those within Congress who are saying really almost the same thing. They are just putting it a little differently. What

they are saying is, "Since you are in balance back home, the first step in achieving Federal balance or, at least, the thrust of the steps at the Federal level should be to reduce the funds which go to the local level."

I ask you to recognize, Mr. Chairman, that there is really not a perfect analogy between the financial balance in the States and that of the Federal Government. State governments do have deficits quite frequently, in that they spend more money than they take in in a particular year. For example, our own fiscal surveys indicate that in fiscal 1979, State governments will, in their general revenue funds alone, spend about \$5 billion more than their revenue.

Most of this is attributable to a single State—California—for fiscal 1979 spending will exceed receipts in that year by almost \$3 billion. Additionally, many States differ, and significantly, from the Federal Government in the way that they handle capital expenditures. Federal budget outlays for capital expenditures are found in the operating budget. In many State budgets, we treat some capital expenditures as off budget item to be financed by bonds, including only debt service in our operating budgets. If one were to reform the Federal budget to do this, which I would hope would not happen, the Federal budget would disappear or be reduced, depending on the capital. Forty-eight States have legal restraints against deficit spending. However, what we mean when we say States are required to have balanced budgets is not that revenues always equal spending expenditures, but that the combination of the balances brought into the year will exceed expenditures, because State budgets must be balanced in this sense rather than the Federal sense. States normally maintain balances that will be built up or drawn down in any given year, depending upon both conscious choice of State policymakers and the fluctuation in revenue over which those policymakers have no control.

Mr. Chariman, your position on general revenue sharing is well known, and the position of the National Governors' Association in this matter has been stated so clearly and so repetitively that I will not restate it, except in the context that we believe that the one least restrictive categorical grant offers the States a very necessary opportunity to flex some of these multitudinous changes that are in the 1980 and prospective 1981 budgets, where categorical grant funds are going to be reduced.

We subscribe to the concept of a balanced budget. We subscribe to a trend in which Federal and local expenditures are going to be reduced. What we want to do is work with the Congress to accomplish that change over a reasonable period of time in which decompression takes place logically, and in which we try to get the savings which are to be had. With these consolidations of grants, simplification of grants, and the simplification and reduction of mandates, we must recognize that for a period of time we are going to need some flexibility to accommodate the changed Federal attitude about the role of the Federal Government in causing expenditures at the local and State levels.

Thank you, Mr. Chairman.

Senator BENTSEN. Thank you, Governor.

When we are finished, I have some questions for you, and I know Senator Javits will.

[The prepared statement of Governor Snelling follows:]

PREPARED STATEMENT OF HON. RICHARD A. SNELLING

Mr. Chairman and members of the committee, I am pleased to appear here today on behalf of the National Governors' Association; I am currently serving as the Chairman of the NGA Committee on Executive Management and Fiscal Affairs. The testimony I will give this morning reflects the consensus of the Governors as developed through my committee and the policy-making machinery of the National Governors' Association.

In dealing with budgets, Members of Congress and Governors have some important experiences in common. Both of us are under considerable pressure to hold down or reduce taxes. We are also under considerable pressure from various sincere groups, including local governments, to increase spending or, at least, to continue existing programs. Sometimes we get the pressure to reduce taxes and increase spending from the very same people.

Governors are like Members of Congress in another way also. When we look at specific policy problems, we reach one set of conclusions. When we look at aggregate budgetary impacts we begin to doubt our conclusions about the specifics. This happens in Congress when, for instance, you ask your own authorizing committees about budgetary recommendations and then total those recommendations and consider the implications. This also happens to Governors collectively. If you ask us, for example, whether we think the national interest would be served by a particular proposed new expenditure, we normally answer in terms of the benefits we see or fail to see associated with that particular expenditure, without trying to relate that particular position to impacts on overall spending and revenues.

The importance of a process that relates particular decisions with financial implications to overall economic policy and budget posture was recognized by the Congress in the Congressional Budget Act. My impression as an outsider is that the Act has increased the ability of Congress to deal more rationally, and perhaps more frugally, with federal spending issues. Within the National Governors' Association, we too have tried to approach fiscal issues within a framework that is responsible overall. For example:

(1) We have been more careful in developing policy positions that call for increases in the federal budget. A comparison of our new positions with those of three years ago show that we are asking for less.

(2) We support the concept of a balanced federal budget.

(3) We recognize that one implication of moving to a balanced budget is that some grant programs may not be maintained at current service levels. Accordingly, we have worked with the Administration on the fiscal year 1980 budget, and we are organizing a more intensive, detailed effort for fiscal year 1981.

BALANCING THE FEDERAL BUDGET

I think practically every Governor, and for that matter, practically every Member of Congress, supports the concept of a balanced federal budget. The problem is not reaching agreement on the principle but determining how that principle can best be implemented.

It is our responsibility as state officials and expert witness on this point to criticize those who make simple analogies between balancing state budgets and balancing the federal budget. Those who come to Congress to say that states balance their budgets and to ask why the Congress cannot balance the federal budget are not recognizing some basic differences in both the economic roles and the accounting procedures of the two levels of government. One of our policy resolutions adopted last February called for a study of these differences.

State governments do have deficits quite frequently, in the sense that they spend more than revenues in particular years. For example, our own fiscal survey estimates that in fiscal year 1979 state governments will, in their general revenue funds alone, spend about \$5 billion more than revenues. Most of this is attributable to a single state, California, where fiscal year 1979 spending will exceed receipts in that year by nearly \$3 billion. Many states also differ from the federal government in the way they handle capital expenditures. In the federal budget, outlays for construction are found in the operating budget. In many state budgets, we treat some capital expenditures as "off budget" to be financed by bonds and put only the debt service in our operating budgets. If one were to reformat the federal budget to

do this, the federal deficit would either be reduced or would disappear entirely, depending on what one counts as capital.

Forty-eight states have legal restraints against deficit spending. However, what we mean when we say that states are required to have balanced budgets is not that revenues always equal or exceed expenditures, but that the combination of revenues and the balances brought into the year will exceed expenditures. Because state budgets must be balanced in this sense, rather than in the federal sense, states normally maintain balances that will be built up or drawn down in any given year depending both upon conscious choice of state policy-makers and fluctuations in revenues over which those policy-makers have no control.

In general, using the federal concept of balance, our budgets tend to be in deficit during recessions and in surplus in boom times. This is because our revenues and expenditures are adversely affected by recession, just as are those of the federal government. However, our balanced budget requirements do achieve one thing. While not necessarily in balance each year, state budgets are in balance over the business cycle.

Every Governor I know believes that there are at least some years in which the federal budget should be in balance. Thus, we are in support of eliminating the deficit when the economy is growing and have formally endorsed having a balanced federal budget in 1981.

THE GOVERNORS' POSITION ON THE FISCAL YEAR 1980 BUDGET

Last fall we met with various Administration officials about the budget. Our basic point, then and now, is that if there are going to be cuts in real spending levels, we are willing to work with the Administration and the Congress to make sure those cuts cause the least possible damage.

Our main approach is to try to concentrate reductions in areas of high administrative costs and lower priority smaller programs, while using a number of program reforms to try to do a better job with available funds. We continue to advocate the position we took this fall and continue to seek out federal policymakers who recognize that we are willing to take action that is considerably different from coming to Washington every year and asking for money. Our basic points are these:

1. Budget savings in intergovernmental programs should be accompanied by increased administrative flexibility for state and local governments. Program reductions should be accompanied by major administrative reforms, such as program consolidation, reducing mandates on state and local governments and streamlining procedures and paperwork. Between 1975 and 1978, the number of separate federal categorical programs increased from 442 to 492, and the last major block grants program was enacted in 1974.

Congress should recognize that program consolidation, reduced mandates, and other administrative reforms are responsive to the public's concerns about inflation and government inefficiency, duplication and waste. The reforms we are advocating would permit improved integration of state and federal funds, resulting in better service delivery and better targeting of funds to areas of state and local priority.

The President's budget is disappointing in the area of program reform. Some changes are proposed in relatively minor programs (energy management, environmental regulatory and planning activities and certain mental health programs) and the possibility of further proposals is mentioned in the case of economic and community development. We would like to see much more than this. For example, we have our own grant consolidation proposal in the economic development area.

The problem, of course, is that each small program has its own constituency in the federal bureaucracy, in interest groups, in congressional subcommittees and, indeed, in state bureaucracies. Thus, we must look to committees in the Congress, such as the Joint Economic Committee and the Budget Committees, which have a broad perspective and which recognize that program design is directly related to the feasibility of holding the budget to reasonable totals.

I will come to the specifics of general revenue sharing in a moment. As a general observation, let me note that it appears that in both the Administration and the Congress, the programs most under attack are those that have the greatest flexibility and lowest administrative costs and the programs where sympathy for budget increases is greatest appear to be some of the narrower categorical programs.

2. Funding decisions should result in real savings to taxpayers: Cut-backs in programs administered by state and local governments cannot be equated with cuts in other sectors of the budget. A reduction by the federal government in a program area of exclusive federal responsibility is virtually certain to result in reduced government spending. A cut by the federal government in an area of joint federal-state-local responsibility—such as welfare or education—may simply result in the

transfer of costs from the federal government to state and local governments. The effect may not be a reduction in the overall level of government spending but a transfer of the burden from the federal income tax to a state sales or income tax or even to the local property tax.

3. The Administration should use budget-making techniques which preserve the fiscal choices of the states. In general, we oppose federal cutbacks which are made by shifting funding responsibilities to state and local government through reduced federal matching rates.

4. Fiscal constraints should not delay the development of authorizing legislation for high priority programs which will have a limited impact on fiscal year 1980 budget projections. A welfare reform proposal and a stand-by program of economic assistance to state and local governments are key examples here.

5. Intergovernmental assistance should not bear a disproportionate share of funding reductions below current services.

6. The impact of federal policies on state and local government should be determined before those policies are adopted.

The federal government has been criticized for placing unfunded mandates on state and local governments. Requirements for specific tests for safe drinking water, for specific state actions to ensure air quality, and for special education are recent examples of mandates promulgated without adequate assessment of cost.

Unfunded mandates placed on state and local governments are a current point of intergovernmental conflict, but they are not the only issues of major concern between states and the federal government. The relationship of federal programs to existing state and local efforts is another important recurring question, and so is the amount of paperwork which the federal government requires of its grantees.

Congress, in considering new legislation and appropriations, should be as conscious of the financial impacts on state and local governments as of the financial impact on the federal government. Representative Elizabeth Holtzman is preparing legislation to be considered by the House of Representatives which would meet our concerns on this point, and I hope that the Senate will take up a similar proposal.

7. Prescriptive federal regulations should be revised to permit increased flexibility for states and improved targeting according to state and locally defined needs. State officials and others who have studied federal program administration have found that detailed regulations add significantly to the cost of running federally funded programs and hamper the targeting of funds to local needs. In general, we support the President's strategy to reduce prescriptive regulations through executive reorganization, improvement in federal planning requirements, and reforms in the joint funding simplification program. In many cases, these efforts will require the cooperation of the Congress and, in some cases, congressional leadership may be necessary to get the Administration to act. There are several examples of what can be done, including the HEW planning grants demonstration in five states, a coordinated investment strategy demonstration involving North Carolina and the Farmers Home Administration and HUD's work with two states on rural housing and community development cooperation. Governor Hunt will cover these points in more detail in his testimony.

THE PRESIDENT'S RESPONSE TO THE BUDGET RECOMMENDATIONS OF THE GOVERNORS

The fiscal year 1980 budget proposals that are pending before you reflect some of our views, but not all of them.

The fiscal year 1980 budget is submitted by the President permits grant outlays to increase by about 1 percent, which, of course, is a reduction in real (inflation-adjusted) spending of 6 to 8 percent depending on which inflation assumption one uses. If real spending is to be maintained in the federally-assisted domestic programs and the federal government will not fund inflation-driven cost increases for its share of the costs, then state and local governments can either cut back the programs or fund the cost increases for the federal, as well as the state and local share.

In general, grants felt the ax in the budget process more than practically any other category of federal spending. Partially offsetting this are a few program consolidations (including one for energy management and one for environmental regulatory and planning activities.) However, the Administration has not made any major grant consolidation proposals, although serious consideration is being given to one in the economic and community development area.

In addition, the budget reflects greater reliance on categorical grants rather than broad-based ones. Broad-based and general purpose grants (basically block grants and revenue sharing), which are much more flexible and less expensive to administer, have declined as a proportion of federal grants to state and local governments

since President Carter took office. They were about 26 percent of total grants in fiscal year 1977 and are about 22 percent of the grants proposed in the fiscal year 1980 budget.

By failing to include substantial program consolidations, the Administration has not pursued an opportunity to ensure that substantial portions of the reductions in federal spending come out of administrative overhead costs, as the Governors recommended. Because the level of service provided by the proposed budget would decrease while only limited efforts are being made to reduce administrative costs through consolidation, the budget may actually raise the costs of delivering services on a per-unit basis.

Some of the administration's budget reductions are clearly designed to decrease actual spending of both the federal government and state and local governments that share costs with the federal government. The health cost containment proposal is an example of this approach. In other cases, however, the effect of the federal decision to cut spending or to cut purchasing power by holding the fiscal year 1980 spending to prior year levels, would be to inflict costs on state and local governments. For example, the Administration recommendations would prevent the scheduled increase in the federal share of costs for education of the handicapped that federal legislation mandates for state and local government. Other federal savings, such as having the FBI leave investigation of bank robberies to state and local government, represents a transfer of costs, not savings.

The budget fails to discuss the impact of federal spending and legislative proposals on state and local government. For the Medicaid program, for example, new coverage is proposed for up to 2 million people. The impact of this major expansion on state and local governments is not discussed in the budget recommendations. No explanation is provided in the budget to suggest that the Administration will do more to gauge the impact of its proposals on state and local governments than it has in the past, although the urban impact statement procedure started by the President last year could be helpful if applied in the context of the budget. The budget document contains no proposals to review or revise mandates that have been imposed on state governments in the past.

The Administration's recommendations were also not responsive to the Governor's general desire for advance appropriations as a means to produce more certainty about future federal program levels. Such appropriations are continued for a few transportation programs, but were not requested by the Administration for other programs, despite a major recommendation from the Governors that wastewater treatment grants be advance funded and despite legislative authority for such appropriations for a number of nutrition and education programs.

In general, we were pleased that the Administration and the Congress are at least willing to listen to our recommendations for better management of grant programs, but not pleased at how little action has been taken.

In some areas, such as economic development, it may be that leadership on program consolidation and simplification will have to come from the Congress. We would think that the Budget Committees particularly would be interested in this, because our ability as Governors to live with declining real federal support could be improved by such actions.

PARTICULAR GRANT PROGRAMS

From a state perspective, our highest budget priority is the General Revenue Sharing program. The President's budget includes funds for revenue sharing, as it should. However, changes in the authorizing legislation for the program have been proposed for consideration by the Congress this year.

The popularity of general revenue sharing with elected officials at the state and local level should surprise no one. With revenue sharing, you can always do what you could do with a particular categorical grant, merely by devoting the money to whatever that grant would have been used for. The reverse is not true. With a categorical grant, you must use the federal money, and often some matching money of your own, on the particular category of activities covered by the grant—no matter how low the priority of that program may be. In addition, the administrative costs associated with general revenue sharing are negligible at both the federal level and at the recipient level.

We are concerned, for a variety of reasons, with legislation that has been proposed which would take states out of the General Revenue Sharing program. First of all, we regret that such proposals appear to be in the form of retaliation for the concern of many state legislatures with a balanced budget at the federal level. One way we can guarantee never having a balanced budget is to develop a general attitude in the Congress that everyone who wants one should be the first in line to

have programs cut. Hopefully, those kinds of judgments can be made on program merits.

Second, such proposals are often made in the context of a situation in which the federal government is presumed to be in poor shape financially and state governments are presumed to be in particularly good shape. There are a variety of ways that one could examine the relative positions of the two levels of government. Clearly one is to examine deficits for the latest year on which we have comparable data. According to our fiscal survey of the states, with 48 states reporting, state expenditures in fiscal year 1979 (the current fiscal year) will exceed revenues by \$4.9 billion. When that deficit is compared to total revenues (and minor adjustments) of \$113.8, the deficit is 4.3 percent of revenues. This is larger than the comparable federal figure for fiscal year 1979.

One thing we all recognize about the federal budget, which is not necessarily true about state and local budgets, is that the federal government's revenue and expenditure structures are such that, except for social insurance, federal revenues will be sufficient so that tax cuts at the federal level can be expected periodically. There have been tax cuts at the federal level in 1978, 1977, 1976, and 1975. The Administration's projections show the federal budget having such large surpluses of revenues over expenditures through 1984 that tax cuts clearly would be possible.

The state situation is not similar, and certainly that of the state and local sectors together is not. State government generally do not have revenue structures that respond as quickly or completely to inflation as the federal income tax. In addition, many state governments are financing increasing shares of expenditures that used to be local, particularly in education, as state decision-makers respond to crises in cities and to increased citizen dislike for property taxes.

Thus, states are not in a particularly good position to experience a major shift in funding responsibilities which repeal of General Revenue Sharing would entail. More important, if there is to be some sort of a shift of costs from the federal government to the states, it would seem more logical to make that shift by dropping certain categorical programs rather than revenue sharing. If the states had to choose where to take a cut of the magnitude that would be involved if General Revenue Sharing were to be eliminated, preference would be in programs at the federal level that involve high administrative costs and little flexibility. Revenue sharing has none of these characteristics.

Revenue sharing should be attractive at the federal level for another reason. The program has proven to be one of the steadiest in the history of federal programs. There have not been major pressures to increase it above the levels of current authorization. Assuming that some indicator of cost increases such as the consumer price index or federal revenues, the program should operate on the same basis in the future.

Failure to renew general revenue sharing for the states will have significant consequences for local governments. That such consequences exist is suggested by the support of local government officials for revenue sharing for states. Behind this support lies the fact that state and local finances interact significantly. In some cases, revenue sharing programs are used directly to finance a variety of local initiatives, such as education, juvenile justice and retirement programs and county court costs. Treasury figures indicate that 40 percent of all state revenue sharing funds were passed through to local governments.

In other cases, the revenue sharing money is part of the overall fiscal posture of state governments and all state activities, including local government assistance and school aid, would likely suffer if it were cut off. The result would simply be more fiscal pressure on local governments. This pressure should be substantial. Census figures show that state aid to many local governments (the 74 largest SMSA's) is four times the federal aid they receive.

One impact that revenue sharing continues to have is on the tax structure of the United States. There is still much to be said for raising the funds used for revenue sharing for states from the taxes to which the federal government has access rather than sales and state income taxes. Use of the federal revenue source is equalizing nationally, and the formula automatically responds to increases in local tax effort in the different states and to changes in personal income (which are reflected in relative federal tax payments that support the program).

Welfare reform is also of particular interest to Governors. We have long advocated comprehensive reform of the welfare system, both because we administer the program and know how badly the reform is needed and because we see the need for a greater federal role in income maintenance programs. We asked the President to address welfare reform in the budget, which was done, but we believe that implementation should occur on a faster schedule than contemplated by the President.

As you know, we share with the federal government the ever-increasing costs of Medicaid. We have supported hospital cost-containment legislation in the past and continue to do so. We are willing to work with this Committee, and other committee of the Congress and the Administration, in trying to find ways to contain medical costs.

We have another proposal, also part of the President's program, that we believe should be adopted. Hopefully, it will have no fiscal year 1980 cost implications. That is some form of stand-by counter-cyclical assistance. Such a program should avoid the problem everyone found with counter-cyclical assistance when last enacted. That problem was that the enactment came too late—the money couldn't be used by state and local governments when their spending was most needed to stimulate the economy and when they were most pressed for revenues because the program was not enacted and funded until later.

While we do have these recommendations for spending in excess of the President's budget, we would point out that they could be implemented in the context of outlays that do not rise faster than the rate of inflation. Receipts are scheduled to rise 11 percent between fiscal year 1979 and fiscal year 1980. If inter-governmental programs were to rise by, say, 5-7 percent in fiscal year 1980 these recommendations could be accomplished easily within the context of a slight decline in real federal assistance to state and local governments. While not equipped to address spending priorities in such areas as defense, we do believe that not even asking for a continuation of all current grant programs with increases to match inflation puts us in a reasonable position vis-a-vis moving toward a balanced budget.

CONCLUSION

Mr. Chariman, the pressure on state and local governments to reduce expenditures has the potential for causing major shifts in current federal spending practices. It is up to the Congress to direct this pressure into constructive channels.

The federal grant-in-aid system which has developed over the last two decades is badly in need of reform. Too many restrictions inhibit targeting funds to state and local priorities. Too many separate programs make it difficult to link federal and state funds effectively. Too much paperwork absorbs federal resources and diverts the money from supporting services.

As members of the Joint Economic Committee, you have a unique opportunity to take a broad view of the grant-in-aid system. We urge you to work with us to devise reforms that forge an effective partnership between the federal and state governments.

Mr. Chairman, this concludes my statement. I will be happy to answer questions from the committee.

Senator BENTSEN. Governor Hunt, please proceed.

STATEMENT OF HON. JAMES B. HUNT, JR., GOVERNOR, STATE OF NORTH CAROLINA

Governor HUNT. Thank you, Mr. Chairman. Let me first of all express my appreciation for the opportunity of discussing the Federal budget and its impact upon us with this very important committee of Congress. I have often been impressed with the kind of economic analysis and findings, that this committee has brought about. I want to thank you for that.

I would like to make three points in my testimony, Mr. Chairman.

First of all, I want to express my willingness, and I think it is the willingness of most of the Governors, to work with this Congress and with the President, to balance the budget and to accept our fair share of any reductions that are necessary.

Senator BENTSEN. That would include revenue sharing to the States.

Governor HUNT. Whatever it would take to balance the budget, Mr. Chairman. I want to see the job done one way or another.

Second, I believe it is imperative that we take strong steps—

Senator BENTSEN. I might say that cutting out revenue sharing to the States is my starting position.

Governor HUNT. I will tell you the end result of what it takes to get there. I think it is imperative that we take strong Federal steps to control spending—both to protect our economy and to maintain the faith and confidence of our people in their Government.

The third thing I want to show is how the President's proposed budget affects assistance for State and local governments generally, and problems related to our major initiatives specifically.

With regard to the matter of faith and confidence, I want to state to you, and I want to state to the members of this Congress, I think that is a critically important thing today. I am not sure the people here in this city are aware the extent to which that has been diminished. Yet, I think that is perhaps the most crucial thing facing us.

In the last 10 years, inflation in this country has increased $2\frac{1}{2}$ times faster than the 25 years after World War II. Sixty-five percent of the Federal debt was created in the last 10 years. We have been on an unprecedented spending spree. I recognize fiscal policy and budget deficits can be a tool for progress. Certainly that was proved with the leadership of Franklin D. Roosevelt. Many times during our history, and even in this decade, economic conditions dictated fiscal stimuli to reduce unemployment.

I am afraid—and I think the people feel this way—we can't seem to wean ourselves off of deficits. Massive deficits have continued, even into strong recovery periods such as 1976 through 1979, and they have fed the fires of inflation.

I know that has not been the only cause, but I think that it has been one of the causes, a significant one that we can do something about. I think the people are beginning to understand. I don't think for a long time they did, but I think they do now, and are willing to take the consequences of doing something about it. To retain economic stability and retain the world market we just now have a more responsible Federal fiscal policy.

It has to do with all of these other things throughout the world, which you know far better than I do. To do that, we must have this more responsible Federal fiscal policy. We have to have better management in all government, and a stronger partnership between the Federal, State, and local governments. I think we all need to remember, all of us in government at every level, that the American taxpayer is the one who pays the bill. I don't have to tell you the cost of taxes to inflation.

We recently did a study in my State of North Carolina, and learned that a North Carolina taxpayer who earns \$15,000 a year, if he got a cost-of-living pay raise in 1968, was 1.6 percent worse off in terms of actual buying power than at the beginning of the year. That comes about because of progressive income taxes, and the way other taxes are levied.

But the taxpayer was actually worse off. That has contributed to a kind of desperate, panicked feeling among so many of our people.

What is the result? It is that the taxpayers pay more, while they see Government grow more and go deeper and deeper into debt. At the same time, he believes too much money is wasted by redundant programs, and I think we can literally describe the situation today

as one in which our people feel that at a lot of different levels, but primarily at the Federal level, that government is literally out of control.

I know a lot of things can be said about that, a lot of explanations can be given. I am simply saying to you, Mr. Chairman, that that is the feeling among the people throughout the country. That is why we in North Carolina, and a lot of responsible legislators, feel that we may need to take dramatic steps to restore fiscal responsibility. That is why 28 State legislators, including my own in North Carolina, have called for a constitutional convention and a balanced budget amendment. The strength of this support is why the National Governors' Association last year approved my resolution calling for a balanced Federal budget by 1981. That is the position of the National Governors' Association.

I want to reiterate that this sentiment for a balanced budget is, of course, concerned with getting it in balance, but it runs deeper than that. That is why it would be so disastrous to mistake it. It is really a sign of an alienation. I think the term "estrangement" is appropriate here. Many people in this country feel today the lack of confidence in the ability of their Government to manage their Nation's affairs responsibly. I don't think we can afford to ignore those deep feelings.

I know the risk of a constitutional convention. I think those risks have been exaggerated. It would be made up of men and women chosen from the various States of this country, including, perhaps, a lot of the Members of Congress. I think those fears are exaggerated, particularly by people who don't have much faith in America, particularly those outside Washington. I do have faith in them. I think we need to be careful to provide adequate safeguards, and I want to point out that the North Carolina General Assembly, in its resolution, did provide carefully developed safeguards in their resolution.

Let me enumerate some of them. First of all, our resolution would allow 4 years from the date of ratification by the various States for the balanced budget requirement to take effect. Second, it recognizes the need for a safety valve to allow deficit financing in a national or economic crisis. Third, it stipulates the convention would be restricted to this one issue, and our call would be rescinded, if that were not the case. Finally, our resolution would no longer be in effect, if Congress proposed a constitutional amendment on its own by January 1, 1980.

The ultimate safeguard, of course, is the fact that any amendment proposed by convention would still have to be ratified by 38 States of this Nation.

I believe that a constitutional convention should be a last resort. I don't want one. I just want the budget balanced, and I want it put into the laws or the Constitution in such a way that it will continue to be done unless in cases of emergency. I want the President's economists to balance the budget. I think the President, with the support of you and many Members of Congress, is making excellent progress toward that goal. He promised to do that when he ran for President. He is doing that, and we are making progress.

But Congress must recognize, and I say this with all the earnestness that I can muster, that if this is not done, the people of this

country are going to take whatever steps are necessary to bring about a balanced budget in normal times. It would not be responsible for me to speak of a balanced budget without being willing to accept the consequences of reductions in the moneys States receive from the Federal Government. My State is willing to do that. The Executive Committee of the National Governors' Association reaffirmed earlier this week that it is willing to do that, consistent, of course, with a number of things that have already been set out.

Let me say to you, Mr. Chairman, that in the budget I talked to my legislature about several weeks ago, there were two things in there that indicated a very strong emphasis. One, in terms of taking whatever medicine it requires on our own part, and that had to do with cutting down the increases in personnel, and that is where so much of the money goes at the State level.

We had a spree during fiscal period 1972 to 1976 in which personnel growth in our State per year averaged 4.8 percent—a lot went to public schools, but every year we averaged 4.8 percent.

When I became Governor in 1976, we cut it first to 3.2, and then to 3.1. I proposed for the next 2 years to cut it to 2 percent in the first year and 0.9 the second year. That is the kind of step we are prepared to take in terms of our own budget.

In terms of general revenue sharing, although I will say in a moment I don't think we ought to totally cut it out, we did not count on that being renewed. The budget that I took to my legislature does not have those funds from October 1980 on included.

So I say to you, Mr. Chairman, we are prepared to take the medicine in order to get the budget balanced. I say that to indicate that we are serious about it and we understand there are going to be costs. We are prepared to take our share.

I do want to say this, and this has been said by my fellow Governors here. It would not be responsible for the Congress to cut Federal spending in a punitive way, cutting off money to the States or the people throughout the States.

I can think of nothing that would do more to exacerbate the alienation that our people feel. You spoke of that this morning.

I want to say to you that it is coming through that way to an awful lot of people throughout this country. We have to work together to eliminate waste in spending. We have begun to do this in our State in a lot of different ways. We are working together with some of the Federal agencies, and I might just say to you for your information—because I think you would be interested—we have developed the first plan in the country where the State is working with the Farmers Home Administration to jointly decide how funds ought to be used, putting together State and Federal funds.

Again, I say the States are willing to accept their fair share of cuts, but only if the cuts are accompanied—and I am sure the Congress will do this, but we need to urge it—by an objective and even-handed assesment of how we can better structure programs. We are making a lot of progress. The Governors are very pleased with how the Government is working with us, and the legislative branch, in giving us input as to how we restructure these, but we need to continue.

I am convinced, personally, that there are many cases where we can cut spending without cutting services. I want to urge, Mr. Chairman, that the Federal Government get serious about looking at how many people are on the payroll. That is not easy to do. You don't do it by saying, "Is there anybody who you can get along without?"

When I became Governor of North Carolina, within the month that I took office, knowing that there was a lot of waste, a lot of people we could get along without, we could do a better job, we could combine things, and so I just simply gave an order to my cabinet secretaries that we were going to cut out 2 percent of the personnel involved in State government. Of course, they hollered a lot when I first did it. They said, "That is not the way to do it, and we can't do it" but we worked on it very hard, we worked with them, and in the course of 2 months, we cut out 2.3 percent across the board. That many people were taken off the payroll, and I don't think services were hurt one bit in my State because we did it.

I think the Federal Government can do it and, gracious knows how many tens of thousands can be found. Again, it would not be something that would be popular.

Senator BENTSEN. Governor, I think we are trying very hard to do this very thing. This committee—and I just became the new chairman—presented a budget estimate to the Appropriations Committees the other day that substantially cut the amount of money that had been estimated in the President's budget for this committee. This committee has not had any increase in its personnel for 3 years.

Governor HUNT. Thank you, sir. I commend you for that, and I suggest it be done not only in this committee, but throughout the Congress and the entire Federal Government.

Over \$80 billion of the proposed budget of \$493.4 billion goes directly or indirectly to State and local governments. That is some \$30 billion more than in fiscal 1975, with sizable increases coming in medicaid, employment and training programs, temporary employment assistance, and health care costs. The States have little discretion with regard to an awful lot of that money, as you know.

Frequently, the Federal budget dictates increases and shifting priorities in State and local governments. It frequently requires more State and matching money in programs mandated by the Federal Government. That money comes from other State and local programs. In essence, the Federal budget mechanism undermines the decisions and priorities that have been determined by the State and local government.

I would want to join here with the suggestion of Governor Thompson and many others, that the Federal Government really make a firm move, by whatever means would be best, toward a truth in funding principle, or whatever it might be called. I have done this in the State of North Carolina. I have pledged to local governments that we will not again mandate a program that they have to carry out without providing the funds to do it with.

I can't tell you how much that has done to build relationships, the trusts between us at those two levels.

I would strongly urge that the Federal Government do the same kind of thing.

I mentioned this to one of the Senators over in our conference a couple of days ago. He mentioned areas such as eliminating discrimination in civil rights. That is a tough one, and that is something we must move to do.

I know there are going to be some of those areas where, perhaps, work cannot absolutely be begun, but there would be greater restraints in terms of funding. This should do a great deal for the relationship between the State and Federal Governments.

Senator BENTSEN. Governor, I certainly don't want to cut you off, but I promised one of the other Governors I would get him out fairly early, and I do have some questions.

Governor HUNT. Mr. Chairman, I believe the great advantage of a balanced budget is that it would force us—at whatever level it is done, and we experience this all the time at the State and local levels—to take the steps of getting things back in hand. It will require tough scrutiny and harder decisions. It will require accountability and honesty in government. It will force us to find ways to develop new approaches and be more productive with what we have and, in particular, here in our Capital City, it would be a counterweight to the insatiable demands of the special interest groups.

I can certainly appreciate how they come here, because I know what it is like in the State capital.

I would conclude by praising the President again for his leadership in working us toward a balanced budget and for all of those who are supporting him and working with him.

I want to say again to you, Mr. Chairman, and to this committee and to this Congress, the people of this country are serious about fiscal responsibility in a way now that is perhaps as deep and as strongly felt as they have been about any issue in this country in a long, long time.

If we don't get a balanced budget, I think the people of this country are going to take whatever action is necessary and is provided for in that Constitution that was so well written, to assure it comes about. Thank you, Mr. Chairman.

Senator BENTSEN. Thank you very much, Governor. The people have spoken time and time again on that specific issue, and more so in the last few years than in a long time. I concur with that. They do it at each election and each of us is elected by the same constituencies.

[The prepared statement of Governor Hunt follows:]

PREPARED STATEMENT OF HON. JAMES B. HUNT, JR.

Mr. Chairman, I am deeply grateful for this opportunity to discuss the issue of the federal budget with this committee.

I want to make three points in my testimony:

First, I want to express my willingness—and, I believe, the willingness of all governors—to work with this Congress and with the President to balance the budget and to accept our fair share of any reductions that are necessary.

Second, I believe it is imperative that we take strong steps to control federal spending—both to protect our economy and to maintain the faith and confidence of our people in their government.

Third, I want to show how the President's proposed 1980 budget will affect assistance for state and local governments generally and programs related to our major initiatives specifically.

This matter of faith and confidence is vitally important. In the last 10 years, inflation in this country has increased two and a half times faster than in the 25 years after World War II. Sixty-five per cent of the federal debt was created during the last 10 years. We have been on an unprecedented spending spree.

I recognize that fiscal policy—and budget deficits—can be a tool for progress. Franklin Roosevelt proved that. Many times during our history—even in this decade—economic conditions dictated fiscal stimuli to strengthen the economy and reduce unemployment. But we can't seem to wean ourselves from deficits. Massive deficits have continued even into strong recovery periods, such as 1976-79, they have fed the fires of inflation.

To regain economic stability and strength in the world market, we must have a more responsible federal fiscal policy, better management in all government and a stronger partnership among federal, state and local governments.

We must remember that the American taxpayer is the one who pays the bill. I don't have to tell you the cost of taxes and inflation to the average person. I was astonished to learn recently that a North Carolina taxpayer who earns \$15,000 a year, if he got a cost-of-living pay raise in 1978, actually was 1.6 per cent worse off in terms of actual buying power. This is because of the combined effects of inflation and a progressive income tax.

So the taxpayer has paid more and more while he sees government grow more and more and go deeper and deeper in debt. At the same time, he believes that too much money is wasted by inefficient and redundant programs. He feels that his government is literally out of control.

That is why we in North Carolina and responsible governors and legislators in many other states feel that we may need to take dramatic steps to restore fiscal responsibility. This is why 28 state legislatures, including North Carolina's, have called for a constitutional convention and a balanced budget amendment. The strength of this support is why the National Governors' Association last year approved my resolution calling for a balanced federal budget by 1981.

We must recognize that the sentiment for a balanced budget is a sign of the alienation that many people feel in this country today, the lack of confidence they have in the ability of their government to manage this nation's affairs responsibly. We cannot ignore those deep feelings.

Now I realize there are risks in the constitutional convention. I think those risks are exaggerated by critics who don't seem to have any faith in the American people. That is why North Carolina's General Assembly provided carefully developed safeguards in the resolution it passed on January 29, 1979 for a convention. Let me enumerate some of those safeguards.

First, it would allow four years from the date of ratification by the various states for the balanced budget requirement to take effect.

Second, it recognizes the need for a "safety valve" to allow deficit financing in a national emergency or economic crisis.

Third, it stipulates that the convention would be restricted to this one issue. North Carolina's call would be rescinded if the convention is not so limited.

Finally, the North Carolina resolution would no longer be in effect if Congress proposed a constitutional amendment on its own by January 1, 1980.

The ultimate safeguard, of course, is that any amendment proposed by a constitutional convention would still have to be ratified by 38 of the states.

I believe, though, that a constitutional convention should be a last resort. I want the President and the Congress to balance the budget. I think this President is making excellent progress toward that goal, as he promised the American people he would do. I hope Congress will support him.

But Congress must recognize that, if it doesn't do it, the people of this country are going to do it.

It would not be responsible for me to speak so strongly for a balanced budget without being willing to accept the consequences of reductions in the money states receive from the federal government. My state is willing to do that. The executive committee of the National Governors' Association reaffirmed earlier this week that it is willing to do that.

It would not be responsible, on the other hand, for Congress to cut federal spending in a punitive way—cutting off money to the states simply because the states are calling for a balanced budget. I can think of nothing that would do more to exacerbate the alienation that our people feel.

What we must do is work together to eliminate waste in spending. We have begun to do this in North Carolina. We have signed an agreement with the Farmers Home Administration to better coordinate what the state and federal governments are doing. Several of our major state departments are preparing a joint funding application system that will cover the most important federally assisted policy-planning programs. This means less paperwork, fewer overhead dollars and better coordination of planning. We have begun a centralized review of federal funding programs in our state. These management efforts are already reducing inefficiency and waste. The state and federal governments need to join together in more such efforts.

Again, the states are willing to accept their fair share of cuts. But only if those cuts are accompanied by an objective, even-handed assessment of how we can better structure these programs. I am convinced that there are many cases where we can cut spending without reducing services.

Over \$80 billion of the proposed budget of \$493.4 billion goes directly or indirectly to state and local governments. That is some \$30 billion more than in fiscal 1975, with sizeable increases coming in Medicaid, employment and training programs, temporary employment assistance and health care costs. The states have little discretion over most of this money.

Frequently, the federal budget dictates increases and shifting priorities in state and local budgets. It frequently requires more state and local matching money in programs mandated by the federal government. That money comes from other state and local programs. In essence, the federal budget mechanism undermines the decisions and priorities that have been determined by the state and local governments.

In addition, much of the spending is wasteful, inefficient and inflationary. We now have over 300 separate programs, over 50 so-called comprehensive plans and thousands of reports to meet bureaucratically mandated requirements. Too often, they substitute the judgments and priorities of federal bureaucrats for the judgments and priorities of elected representatives in the states.

I want to caution you that elimination of general revenue-sharing to state and local governments would be a serious mistake. It is the most responsible and least inflationary form of federal-state spending. It avoids the waste and inefficiency of complex, multiple planning and reporting systems. The states have used this money to meet pressing needs—such as education and health care. Categorical spending, by contrast, often takes place regardless of need. Eliminating revenue-sharing would undermine the careful balancing of needs and resources that state and local governments must guarantee—in the context of a balanced budget.

I also want to urge you to maintain equity between rural and urban areas and between the different regions of this country.

Assistance to state and local governments appears to bear a disproportionate burden of the President's austerity program. These programs fall from a 14.8 percent share of the total budget in 1979 to 13.8 percent in 1980. The decline is even more dramatic when state and local assistance is compared with the budget authority for domestic spending. Further, the budget authority for state and local programs is projected to grow by only 1 percent, far less than the projected rate of inflation (7.4 percent).

To some extent, this decline in relative share for state and local programs, reflects the phase-out of economic stimulus assistance programs. However, the relative decline is also apparent to a lesser degree in the program relating to North Carolina's major policy initiatives. None of the economic stimulus programs were included in the three state policy initiatives (See Attached Tables A, B, and C at conclusion of my remarks.)

With the exception of the Crime Control policy area, the state's policy initiatives show a relative decline and a slower rate of growth than the total budget or proposed domestic spending. The Balanced Growth area is the most seriously affected falling from a 4.8 percent to a 4.1 percent share of the budget. The impact is even more severe upon programs aimed at small cities and rural areas (see attached Table A). All of the actual dollar increase in this policy area can be traced to Presidential proposals that will mostly benefit large distressed cities.

We need more discretion and authority at the state level, not less. Program managers should be rewarded for holding down costs and for being responsive to needs. States should have greater latitude in defining needs, combining programs and eliminating unnecessary red tape.

The great advantage of a balanced budget is that it will force us to take those steps. It will require tough scrutiny and hard decisions. It will require accountability and honesty in government. It will force us to find waste and develop new

approaches and be more productive with what we already have. It will be a counterweight to the insatiable demands of the special-interest groups.

I want to conclude by praising President Carter for the progress he is making toward the goal of a balanced budget. I hope Congress will support him. The people of this country are looking for a sign that we are serious about fiscal responsibility. If they don't see it, they are ready to send the loudest and clearest message they can to Washington—in the form of a constitutional convention. I believe that we should let them know that we have gotten the message.

TABLE A

State Policy Initiative: Balanced Growth

Program Areas	Budget Authority (millions)		% of Budget Area	
	1979	1980	1979	1980
Urban/Metro -				
National Dev. Banks *	-	550.0		
Urban Parks	33.0	145.0		
C.D. Block Grants (80%)	3,000.0	3,120.0		
Urban Dev. Action Grants (75%)	300.0	300.0		
Urban Mass Transit	2,653.0	2,653.8		
Neighborhood Dev. Corp.	-	15.0		
Liveable Cities	-	5.0		
Sub-Total	5,986.0	6,788.8	24.2	27.0
Small Cities/Rural Areas				
CDBG (20%)	750.0	780.0		
FmHA Water/Sewer	282.5	265.0		
Business Dev.	13.0	10.5		
Dev. Loans	2,250.0	1,950.0		
UDAG (25%)	100.0	100.0		
Rural Mass. Trans.	76.5	75.0		
Sub-Total	3,472.0	3,180.5	14.1	12.6
General				
ARC	368.6	358.6		
Title V Commissions	64.0	71.0		
EDA - PW	228.5	225.3		
Business Dev.	170.4	176.4		
Sec. 304	20.0	20.0		
Title IX	88.5	77.2		
EPA '201'	4,200.0	3,800.0		
Land/Water Cons. Fund	738.0	610.0		2.4
Highway Trust	7,994.1	8,599.5		34.2
Airport Trust	1,373.0	1,238.1		4.9
Sub-Total	15,245.1	15,176.1	61.7	60.4
Grand Total	24,703.1	25,145.4	100.0	100.0
New Programs				
National Development Bank*		2,800.0		
	24,703.1	27,945.4		

*Note: This amount reflects proposed loans, subsidies and guarantees authority the bank would use to directly assist private organizations rather than channeling through states and local governments.

TABLE B

Policy Initiative: Raising A New Generation

Program Areas	Budget Authority (millions)		% of Budget Area	
	1979	1980	1979	1980
Health -				
Maternal & Child Health	380.5	375.0		
Family Planning	135.0	145.0		
CDC Project Grants	84.7	88.8		
Child Health/Human Dev.	190.1	204.4		
Child Nutrition	2,697.1	3,161.3		
WIC	569.5	771.5		
Special Milk	142.0	32.0		
Sub-Total	4,198.9	4,746.0	15.1	16.6
Education -				
ESEA	3,521.3	3,952.9		
Indian Ed.	71.7	76.9		
Handicapped Ed.	967.6	1,027.8		
Student Assistance	3,922.7	3,687.0		
Voc./Adult Ed.	781.6	772.4		
School Libraries	202.4	157.6		
National Inst. of Ed.	92.5	98.3		
Special Projects	134.5	117.6		
Federal Impact Aid	816.0	528.0		
Sub-Total	10,510.3	10,418.5	37.7	36.5
Welfare and Jobs -				
Assistance Payments	6,664.1	7,079.2		
Child Welfare	2,776.4	2,632.3		
Human Development	777.2	849.8		
WIN	385.0	385.0		
Youth Conservation Corps.	60.0	0.0		
Summer Youth	17.0	0.0		
Youth Sports	6.0	0.0		
CETA - Youth	1,967.0	1,925.0		
Child Support	400.0	438.0		
Sub-Total	13,052.7	13,309.3	46.8	46.6
Justice -				
Formula Grants	64.1	60.5		
Juvenile Justice Programs	35.0	38.5		
Sub-Total	99.1	99.0	0.4	0.4
Grand Total	27,861.0	28,572.8	100.0	100.0

TABLE C

Policy Initiative: Crime and Public Safety

<u>Program Areas</u>	<u>Budget Authority (millions)</u>		<u>% of Budget Area</u>	
	<u>1979</u>	<u>1980</u>	<u>1979</u>	<u>1980</u>
<u>Law Enforcement</u>				
Drug Enforce Assistance	21.6	21.4		
Nat. Inst. Corrections	9.9	9.9		
Criminal Justice Planning	61.3	10.0		
Corrections - Form. Grants	45.0	30.0		
Juvenile Justice - "	64.1	60.5		
Criminal Justice - "	409.3	185.3		
Training/Manpower	42.4	19.3		
Correctional Programs	45.0	30.0		
Crime Prevention	16.0	28.0		
Juvenile Justice Programs	35.0	38.5		
Data/Statistics	20.4	19.4		
*Proposed - OJARS	---	497.9		
Sub-Total	770.0	950.2	75.3	78.6
<u>Disasters/Fire Prevention</u>				
Disaster Preparedness	129.7	139.1		
Hazard Mitigation/Assistance	133.1	119.6		
Sub-Total	252.8	258.7	24.7	21.4
Grand Total	1,022.8	1,208.9	100.0	100.0

*Note: The President intends to transfer many of the functions now performed by LEAA and the National Institute of Corrections to proposed Office of Justice Assistance, Research and Statistics (OJARS) as part of the 1979 Justice Systems Improvement bill. OJARS will include several new programs, totaling \$365.6 million and additional authority of \$132.3 million for existing LEAA programs.

Senator BENTSEN. Governor Thompson, you repeatedly indicate that Federal funds should be funneled through States rather than going directly to local governments. You also state that Congress is subject to too much lobbying by too many interest groups. It seems to me that the National Governors' Association is no less a lobbyist than is the Conference of Mayors, who would probably be strenuously opposed to such a proposal. How would you counter the mayors' arguments that they need the latitude to decide what is best for their jurisdictions and that, in the past, most States have not had aggressive urban policies?

I run into this also as chairman of the Transportation Subcommittee of the Environment and Public Works Committee, when it comes to highways. I hear that fight all the time.

Governor THOMPSON. I appreciate the dilemmas and the concerns put upon Members of Congress by the people back home. I think that is something which, if approached by the Governors and the mayors and the appropriate congressional committees, can be accommodated. I think there is a reasonable likelihood that those competing interests could be balanced in trying to devise a mechanism which gives back to the States a little more authority to reconcile competing municipal interests within their own borders, not necessarily funneling all the moneys that now go directly to communities back through the States as they once flowed.

I don't think we are asking for that. I don't think we are asking that all of the dollars come back to our folks to be doled out. We want to reconcile programs within our borders that are often in disharmony in cities which are side by side.

I think we can set up a structure that would do that.

I might also say, if my reading of the press is correct, that the Governors come and say, "Either let us keep what we have, or let us have more latitude to use the funds we receive in more productive ways." That has been suggested this morning: a reform of program structure. I don't think the Governors have come, as have the mayors, for more funds—and I don't mean to put down the mayors.

At this time, we are willing to help the Federal Government to get the deficit under control. But I think the mayors can be accommodated, and we will work at it.

Senator BENTSEN. There has been a lot of talk of cutting categorical grants, but the response I have had this morning is for consolidation, and cutting waste, but not any specific categorical grants. If I understood, Governor Snelling, you say you are going to be coming up with that, but I did not get it this morning, and that is what I had hoped to be able to hear.

Governor SNELLING. We are invited here, as I understood it, to represent our association, and our association has only recently undertaken the task—the obviously sensitive task—of asking its members to identify categorical grants which they would be willing to do without. I do respectfully suggest that cutting total expenditures can be accomplished two different ways, and will probably require both ways.

One way is to find out how to do the things which the public has ordered us to do, either directly, in our States, or through the congressional representatives, and find ways to do those things

with less expense. Additionally, we must decide not to do as many things. At this juncture, we do believe that consolidation of grants, and less restrictive grants will give a greater opportunity for us to address quite differing circumstances in our State. They do differ enormously.

Some of us work on programs largely through counties. Some States—Hawaii, for example—perform almost all of their public services at the State level—welfare and almost all others. So, we are saying that if we are given some flexibility in our States, that an identical and, in some cases, a lesser amount of money available for those same categorical grants will enable us to do the job, and that is square one.

It takes a longer period of time to get the public sentiment and some uniformity of public sentiment to entirely stop doing something. A year, or 5, or a relatively short period of time ago, we in our States, or you in the Congress, were telling the people there were services that absolutely had to be performed. We would like to approach this in what we think is a uniform way.

Governor HUNT. The practical problem you run into in saying what can be cut out, is that one assumes that you can just cut it all out and that none of it is any good. Sometimes that is the case, but more often the case is that this could be reduced some.

There are changes we could make, and this can take some reduction. I don't think it is going to be very realistic to expect Governors to identify a lot of programs that can be totally cut out.

Senator BENTSEN. Right now, I would settle for one.

Governor HUNT. Governor Snelling is getting responses from the Governors, but I would just suggest they are more apt to say, "Yes, we can make reductions." As far as I am concerned, an awful lot of them can be cut across the board.

Senator BENTSEN. Let me make another point. State expenditures have been going up dramatically in recent years, and reliance on Federal dollars has increased substantially. Some Governors have been able to bring about tax cuts. Part of that seems to me to be financed with Federal dollars. We have this incredible problem with the dollar and the debts. I can't help but believe that every time we collect a note, that money loses a little weight before it gets back down to the Governors. I had just assumed you fellows collect those taxes on your own—that that is what the State is doing—and not sending it back to Washington.

I can't help but remember the old story Senator Long tells—he tells it much better—about the old gentleman who addressed a note to God and asked him to send him \$100. He was in desperate need. For some reason, they sent it to the President, and someone in the White House said, "Let's humor the old fellow. He ought to get by with \$50. Send him the \$50." He wrote another note back to God and said, "God, I sure appreciate the \$50, but the next time, I would really appreciate it if you didn't send it through Washington. It seems to lose a little coming through Washington."

Governor SNELLING. Then there is an old story about Jeb, up in Vermont. Jeb wasn't feeling too well, so he went to see his doctor. The doctor said, "Jeb, if you don't stop your drinking, you are going to lose your hearing. Why don't you stop this drinking?"

Jeb replied, "I like the taste of what I am drinking a lot better than what I am hearing."

There is a sense in which this dialog, based on the question of who is going to give up what first, is a little bit like Jeb, because it seems to me that the States, given the tremendous number of mandated programs and programs which have been initiated by the Federal Government and partially funded by the Federal Government as an incentive, as an encouragement and as an instruction, literally undertake our own programs, and this gives considerable pause for the problem. Is it unfair for the States to say back to the Federal Government, "Which of the things you instruct us to do are you prepared to stop instructing us to do?"

In Vermont, we thought we had too many unemployed fathers on welfare. Bear in mind that that particular program, welfare assistance to unemployed fathers, is a voluntary program. It is not required by the Federal mandate, but it is a system, and it is largely paid for by general fund dollars at the State level.

We designed a program which really required little else. It meant those people tried to find employment first, and that we assist them.

The Department of Labor, under regulations set up and sanctioned by the U.S. Congress, told us we could not do that. We had to modify that program. We run into many, many examples of things that you have told us to do, for example, 94-142—and I am not speaking from a state which has any reluctance to discharge responsibilities for the handicapped, because Vermont had completed 6 years of such plans before Congress passed 94-142.

When the Congress passes programs of that kind and gives a year or so for compliance, and does not provide the funds to do it, the Congress has absorbed some of the capacity of the States to use funds raised at the local level to meet the obligations of programs at the local level.

We, sir, are literally a catch-22.

Senator BENTSEN. Let's talk about that. I assume you are a member of the Coalition of Northeastern Governors.

Governor SNELLING. Yes.

Senator BENTSEN. In their analysis of the President's budget, nowhere is there a request for restraint or curtailment. They indicate several of the programs are underfunded. In addition, they advise their members that "there are new opportunities for the States of the region to begin to meet pressing problems through the infusion of new Federal funds."

It appears they are talking restraints on the one side, but still clamoring for new Federal dollars.

Governor SNELLING. I am not a spokesman for the Coalition of Northeastern Governors. In fact, until recently, I had the interesting but disturbing status of being the only Republican member, so I seldom speak for that group.

However, I will speak for the National Governors' Association and our position is that we favor restraint in spending, and we encourage reduction in Federal appropriations; we wish to provide some assistance as to how they may be accomplished, and, as a matter of fact, we have recently adopted a policy that we are going to, as a result of action taken by the executive committee, require

fiscal notes on all policy statements of the National Governors' Association so that we will not fall into the trap that you just referred to with respect to that other organization.

Governor THOMPSON. May I make two brief points?

First, I think it would be very useful for both this committee and the National Governors' Association to undertake a definitive study of how much of the increase in State spending, or State tax reductions, which are another form of spending, are fueled by Federal dollars, and how much are fueled by surpluses accumulated due to progressive taxes.

Senator BENTSEN. You are absolutely right on that.

I am interested in knowing exactly how much is caused by our mandating.

I have called for a study of this by this committee. The responsibility of this committee is a very substantial one. We analyze the impact of the President's budget and project what we see for the economy and indicate some of the things we think are important and that need to be done. In addition, the effect on States by mandated programs is a very important issue. I could not agree with you more. I really do.

Governor THOMPSON. You asked for some examples of how you can save money. Let me give you two illustrations of how we could save Federal dollars, for that is what they are, or Federal and State dollars, in two programmatic areas, by moving toward the block grant concept.

When I was in the process of preparing my budget to be released next week, the man who administers the Governor's office for manpower and development, in charge of our CETA program, came to me and said, "You are not going to like this"—and I share Governor Hunt's concern about head count and employees. I would like to keep that down. I have had to add 300 case workers for abused children, and 700 prison guards. I had no choice.

I am looking for other ways in the Government to keep that count down. He said, "I am going to have to ask you to authorize the addition of 100 and 200 new employees." I said, "For what?" He said, "To monitor our CETA program."

I asked, "Are they needed to run a good program?"

He said:

No, I don't think all of them are needed to run a good program, but all of them are required to comply with Federal mandates. If we don't comply with these Federal mandates, we will have government auditors in here, and they will be saying the State of Illinois was maladministering this program.

We pay and you pay for approximately 1,000 employees in the State of Illinois, a total of \$20 million to do nothing but draw 100 separate State plans to be submitted to the Federal Government by 11 State agencies to receive funding from 171 separate Federal sources, just for programs for children and family services.

If we move away from the categorical to the block grant, we could dispense with most, if not all, of those 1,000 employees.

Senator BENTSEN. The trouble we see with general revenue sharing is that when it was originally proposed, it was proposed as a substitute for some of the categorical grants. That is not the way it worked out. Revenue sharing went beyond that.

Since we have a time limit, I will now recognize my colleague in the House, Congressman Brown.

Representative BROWN. Thank you very much, Mr. Chairman.

I have to say this is an area in which the Senator and I have a relatively slight disagreement on how things should be dealt with, but it comes from our experience level, perhaps, and also from the global view one gets from a Senate constituency as large as Texas. My constituency is somewhat smaller than Texas, geographically and in numbers, but it is a little bit more like Vermont, Governor Snelling.

We have no major metropolitan areas in my constituency, and I find that I have a bias for revenue sharing, and against some of the categorical programs, because somehow, they have never been able to come up with a category that helps the folks in my district. Mostly, what we do is pay for programs, and revenue sharing is one of the first opportunities we really have on a per capita basis to get some money back out from Uncle Sam.

Our folks generally don't like the idea of getting any money out of Uncle Sam under any circumstances, because they have the feeling they have to pay for it.

A comment was made in one of your testimonies here and I have read them all, and they all kind of run together in my mind, because all Governors look alike. The question I am asking is that a comment was made about the efficiency of revenue sharing, collections, and distributions. Do you have a statistical figure on that? What percentage of revenue sharing, collection and distribution goes for the administrative handling of revenue-sharing funds?

Governor SNELLING. No, sir, I don't have a statistical summary with me today, but I will say that it varies from State to State, from darned close to zero, to perhaps some considerable sums. There are some States that use it, I think, quite properly, as sort of a not otherwise classified fund to make up for shortfalls in Federal programs when a program is designed and has certain standards of operation. Then the funding does not come through quite in that way.

A number of States use their State shares of the general-revenue fund for that purpose. It is an elastic fund, and that obviously takes a considerably lower cost, but I am afraid I can't answer your question.

Representative BROWN. Far be it from me to tell you administrators how to get your act together, but I think you should get those statistics at the Federal level. I serve on the subcommittee dealing with revenue sharing on the House side of the Government Operations Committee. It runs in my mind the statistic in terms of the Federal cost, in terms of checks and distributions, is only one-tenth of 1 percent of the cost of the funds distributed, the lowest administrative cost of any Federal program. A record with reference to Government programs and the subcommittee dealing with revenue sharing has that statistic.

Let me give you one other reason for my bias with regard to categorical programs, rather in opposition to categorical programs.

The largest city in my district has 85,000 people—that is a chamber of commerce figure—it is probably closer to 80,000—but in any event, it is one of the few cities of that size in the United States

that has ever, by initiative referendum, denied to the city officials the right of eminent domain. The reason they did, and I don't know whether it would stand up in a constitutional sense, was that for about 3 or 4 years running, they had back in the late 1950's and early 1960's, or perhaps it was mid-1960's, urban renewal issues to resolve, and they came up with the plans and then found out that their plan was not drawn according to current Federal requirements. The next year, they drew them according to the Federal requirements, submitted the plan and found out that the money had been expended and was not available for them at that time.

The next year, they made plans and applied for the money quite early, and found out that the program had been altered and the whole thing had to be scrubbed. They had to start over with a new approach to the Federal requirements in this area, and the fourth year, something similar in nature happened again, and the people of the community gave the instructions to the city fathers:

You stop messing around with those people down there, and wasting our money on all these plans and submissions. In order to assure that it will not in the future get involved with them on renewal, we are denying you the right of eminent domain to participate in the program.

It later took the combined efforts of the chamber of commerce, the labor union central committee, and the city, several civic and social groups in the city, and consumer groups and civil rights groups, and so forth, to pass a repealer of that eminent domain denial.

We now are back to the Federal program business, but it left a very bad taste in the mouths of the people in that community. I thought it was a rather unusual response to control the city fathers in that way.

That is one of the concerns that I have about categorical grant programs.

I would suggest to you that there may be a couple of issues here with reference to categorical grant programs. One is the disproportionate concern, and I mention that principally in my opening remarks, over the disproportional Federal distribution of funds. It seems to me that here in Washington we tend to target those funds to certain kinds of programs, leaving other national issues unaddressed, which perhaps, at the State and local levels, particularly with records of different States, there may be a different concern for some things.

One, I would submit, involves potholes. A bill was distributed on a State-by-State basis last year to resolve—

Senator BENTSEN. We killed that bill in the Senate.

Representative BROWN. The House did not kill it. I voted against it. We were unsuccessful in killing it in the House, but the State funds distribution included funds for States like Florida to cure potholes in that State. I had some difficulty with that. I have been to Florida several times, but don't remember being cold enough for potholes.

The concept of that bill was that we were going to go after a specific problem. We had other bills of that nature that did get passed. Maybe the rat control bill is a classic example, when we were worried about social problems of that nature, and you got your money or you did not get your money, depending on whether

or not you used it for the specific purpose that the bill was designed for.

So, I am concerned about that kind of distributional disproportionateness, if I can use that term.

I would like to ask one other question. You may comment on that concern of mine, if you wish, but I would like to ask one other question, which is the number of Federal mandated programs that require the State to make comparable or proportional spending in a particular area. Do you have any statistics on whether the States all use the federally mandated funds that must be matched by the States, or is there an inability on the part of some States to respond to that kind of Federal assistance?

I have in mind pipeline safety legislation, the meat inspection requirements of the Federal Government, and several others which you say you get the money if you provide certain services or change your laws to meet these requirements, so that you will do it the way the Federal Government wants you to do it.

Governor SNELLING. Mr. Congressman, the States are beginning, more and more, not to take up, soak up all the dollars that are made available on Federal matching programs, because you really don't raise a critical issue when you talk about a mandate.

Let's talk about a drinking water bill, for example. The States have to determine theoretically by voluntary sources whether they will accept primacy, or whether primacy will continue to reside with the Federal Government, but Congress has mandated certain accomplishments with respect to all the States by certain years.

There are certain substantial expenditures. When you sit down with the representatives of the Federal Government to discuss the pros and cons of primacy, what they tell you, very disarmingly, is that if you don't accept primacy, that you cease to get Federal funds for projects which are absolutely necessary, and would otherwise have been available to you.

So if there is really any judgment to be made about primacy, the States will accept primacy, and they will fulfill the mandates on the Federal Government's time schedule for pure drinking water, or they will lose even the capacity that they now have to address those needs.

I don't know how it would work out economically in all other States, but I believe that my legislature would approve, in record time, a deal whereby we do away with all general revenue sharing, if the Federal Government agrees to stop mandating performances in our State for which they don't compensate us.

We would have that argument over, and we could talk about how further savings could be made by packaging the remaining categorical grants, but I have no doubt in my mind that the cost of mandated Federal programs not addressed by Federal funding is enormously more than Vermont's share of general revenue sharing.

Governor HUNT. Congressman, if I follow up on what Governor Snelling just said, I would strongly urge this committee—and this is a long-range view of things, and has pushed toward improvements in how we manage our financing—to look toward getting State and local governments to work together to utilize funds and,

furthermore, to work together with Federal agencies that have a responsibility in this particular field.

For example, the question of housing. We generally have State housing finance agencies or development agencies. Local people, of course, are involved. We have the Farmers Home Administration and HUD and all these other programs. There are various ways in which we should have the Federal, State, and local employees working together to combine funds in the best kind of ways, so that we meet our needs.

We are doing that in my State. We have what we call our balanced group policy. We don't have the problems between the mayors and the State level, because we are working together. They are having a voice in determining where funds are going and how we are using them, both State and local funds.

If we develop that kind of mechanism, that kind of procedure, you can put the money into a pot and then you can know that both State officials, which have a broader view, and local officials, who want to have their own voice in things, are being involved in making those decisions.

That is the way I think we ultimately ought to go with regard to categorical versus revenue sharing.

Representative BROWN. My time is up, but I hope I will have an opportunity to come and differ with some of your testimony.

Senator BENTSEN. Congressman, why don't you do that now? I will give up my time in the interest of saving the Governors' time.

Representative BROWN. Thank you, Mr. Chairman.

Governor Snelling, I am a little bit concerned about your comments about budget appropriations. I operate a business in real life, and we have to do our accounting procedures, allowing for depreciation of machinery and buildings, and so on.

You suggest that if the Federal Government would approach its budgeting processes in the same way States do; that is, on capital improvements, funding them as a debt and paying them off as part of the budgetary process, then rather than including an expenditure for that item all in the budget for that 1 year, we might be closer to a balanced budget than now shows up in the way we handle those things in accounting procedures.

The thing that worries me is that State governments, it seems to me, do not allow for the depreciation of the capital expenditures that they make, and really are not keeping a good business record, either at the State or Federal level on that basis. Would you want to react to that comment?

Governor SNELLING. I, too, in real life am a manufacturer. I would just have to say that any relationship between accounting practices in the private sector and the public sector, whether it is Federal, State, or local, is purely coincidental.

They don't even start from the same premise, so neither Federal nor State governments capitalize from the standpoint of a capital asset and liability of the original or remaining asset.

The concept is not known. That is why more and more States are going to long-term capital plans so they can take into consideration at what point they will have to consider replacement capital.

I am not saying that the Federal Government should adopt the practice of the States' selling bonds for capital construction. The

argument was only comparison between the liquidity, because that is really the argument being made by some Members of the Congress, that the States are more liquid in that they show a match between revenues and expenditures, whereas the Federal Government does not.

I think, as a matter of fact, that the States' method of handling it represents some equity for current taxpayers in that the alternative to capital bonding would be current taxpayers would have to pay for the cost of projects that last 20 or 30 years.

On the other hand, the Federal Government's method of handling things is more conservative, in that it demonstrates at once exactly what the cost of projects is, and bonding in turn really tends to encourage greater expenditures at a moment in time.

My statement did not suggest, nor do I think it would be a good idea, for the Federal Government to start bonding for long-term projects. It is merely to suggest the inequality in the comparison made between ingo and outgo of the States and the Federal Government.

Representative BROWN. Let me turn, on that point, to the question of the States' surpluses, and the balanced budget question.

First, could you tell me how many States have constitutional prohibitions against a deficit in current operations?

Governor SNELLING. Forty States have barriers. They are not all constitutional. I would like to leave two booklets with you. One is a fiscal survey of State, 1978-79, published by the National Association of State Budget Officers and the MCA, concerning fiscal conditions of the States. The questions you are asking are covered more specifically there. Forty-eight States have restrictions or barriers against unbalanced budgets.

Representative BROWN. It occurs to me, as a watcher of the Federal budget process, that one of the things that happens to us from time to time—and, of course, we are discussing it in this hearing—is that the Federal Government, from time to time, misjudges the receipts and expenditures that it has to make and, not having the prohibitions against deficit financing, of course, frequently the budget deficit comes out much lower or much higher than the prediction. This is because we have additional receipts that come in on a rising economy, or a loss in receipts that come in on a falling economy, which frequently require expenditures, or that Congress responds to in that way.

It occurs to me that one of the responses is that there is a lot of surplus in State budgets these days, because we have had a rising economy throughout the country, and the prohibition against deficit spending requires the Governors to prepare relatively conservative budgets to present to the States. Then suddenly, there is a surge of receipts, and you are a little better off than you anticipated being, and, therefore, show a larger receipts balance than otherwise; is that true?

Governor SNELLING. It is very true, and it is also very important to one of the basic points of discussion as regarding general revenue sharing or the economic conditions of the States.

When the States fell into recession in 1974 and 1975, many States had no choice but to raise taxes, because their constitutions or other limitations called upon them to plan balanced budgets.

The increased costs of many social programs—unemployment-type related programs, welfare programs—caused the States to be looking at very clear deficits, and they had to raise the taxes.

When the economy recovered, the increased tax rates, together with the buoyancy of the economy, obviously produced surpluses. The philosophic point I want to make, and the point of justice, is to the extent those surpluses were because of our having undertaken the burden of taxation in bad times, the States should not be considered overly liquid when that came as a result of having to raise taxes in a prior bad time. The result has been that taxes have now been reduced and that has been cited as an indication of liquidity, but it merely restores it to the level prior to the last recession.

Governor HUNT. Not only do we have to plan for a balanced budget, but we have to keep it throughout the year.

In my State—and, I assume, in other States—if revenues are not coming in at an adequate level, we just have to cut back as needed. There is great reason for being conservative and properly so, and this is what is needed at the Federal Government.

Representative BROWN. Let me press on, unless you want to make any other comments on that issue. If not, I will go on to another issue.

There has been a lot of talk by economists in this committee, and elsewhere, about the prospects of a recession in the next couple of months. The question was, what do you anticipate in your States will happen to the surpluses? Would you anticipate you will have enough balance to make it through without making major adjustments in the budget, or not?

I won't press that.

Governor HUNT. We are reducing the amount of growth in our budgets, and we are anticipating that.

Governor SNELLING. These books would show you these trend lines. If they were on a chart, they would be square, but because the surpluses that existed in 1977 have been halved, and because of the estimate for 1979 in my prepared statement, frankly we are predicting a small deficit for fiscal 1980. That is allowable in our State only because we operate on a biennial basis, but I would anticipate the States will not have surpluses in fiscal 1980 and 1981.

Representative BROWN. Do all of you favor a balanced budget amendment, or do you have different views?

I would say, Governor Hunt, I have read your prepared statement. North Carolina is one of the States represented here that sat in on the first Constitutional Convention. I am not so sure it is a good idea to have a State constitutional convention, but Ohio has a background, too.

Governor HUNT. I would much rather the Congress do it. Earlier, there was a cry for direct elections of Senators. The people wanted it for a long time, and the Congress did not respond. Now, almost enough States called a convention, and the United States submitted an amendment, and it passed.

Governor SNELLING. I oppose having that, and I feel we need fiscal restraint measured by the thoughtful actions of the Congress.

Governor THOMPSON. I do oppose the constitutional convention, and I have not quite been persuaded that a constitutional amend-

ment can be drawn with sufficient care or safety or, as a matter of discipline, needs to be drawn, or should be drawn.

I tried to make the point at the National Governors' Association meeting the other day that if the Congress does not now have the internal discipline to balance the budget, passing a constitutional amendment requiring a balanced budget will not help the problem, because all it will do is make the pie smaller and increase the pressures on you.

Internal discipline is needed to tell the mayors and everybody else who comes down here what is important and what is not.

Representative BROWN. You may want to take the fifth on this. I want to go back to ask you if you know of specific examples, obviously, in some other State than that which you represent, where Federal funds were supplied for a specific purpose, and have been accepted, and then used to accomplish what the local government felt had a priority other than for that specific purpose.

As I understand the first general revenue-sharing money distribution requirements, they prohibited the use of general revenue-sharing funds to match other Federal funds but, of course, they go into an aggregated budget and, therefore, they can be used for something that you might have planned to use local funds for otherwise, and the locally generated funds can be used to match. It seems to me that that is not illegal, but a fairly clever accounting method of meeting that requirement of the general revenue-sharing law. There are other examples, at least more of the levels than I am aware of in my district, where good school superintendents have taken money for distributional educational programs and used it for repairing a gym floor or something else.

They tell me how they do that, and still feel they can live within the law and face the taxpayers with integrity.

I think it would be helpful for those of us who feel some concern about category assistance programs—I don't have to give them now, I know you want to hurry along—that I cite as one of the examples in this area and, perhaps Governor Thompson can tell us, whether any planning funds are ignored in any way. There may be other examples more appropriate. If you want to supply them for the record, I would be happy to know about them.

Governor THOMPSON. I have heard it happening in other States, as you suggest.

Governor SNELLING. Congressmen and Governors do not have the right to take the fifth amendment. That is not a privilege accorded to the chief executive officers of States.

I would say to you, I don't know of any specific example of abuse of the law, but I would say that the allocated process is susceptible to imaginative use.

I believe people do find the most appropriate source for the funds required, so the end-use of the Federal funds may sometimes be in terms of the increment or the marginal performance, and may not do what is intended, but I think that there will always be accomplishable, regardless of how strictly one would write or follow up on special categorical grants.

Governor HUNT. I would say it is logical, if the State and local people have a voice in the way the funds will be used, to assume that they are more apt to be used more properly.

Representative BROWN. I think there is always the feeling on both sides of the table, that there is a better idea of what should be done with public money, and I am sure you feel that way, as Governors. I am sure the third level of government officials may think that neither the States nor the Federal Government know what should be done with the money. If they could handle it, they could handle it better, they think. I understand that psychologically, but I also think there is one other thing that happens.

That is that we think we control from the Federal level how it is spent, and you may think, as Governor, you are controlling it when it goes local, with reference to its expenditures, but I think the people who ultimately make the expenditure have more to do with how it is spent than any of us.

Senator BENTSEN. Let me add my little bit on that. I think if we left it to the taxpayer, he would feel he could best control it.

Thank you, gentlemen, very much, for your comments. We appreciate having them, and your point of view.

[Whereupon, at 11:57 a.m., the committee recessed, to reconvene at 10 a.m., Friday, March 2, 1979.]

THE 1979 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, MARCH 2, 1979

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

The committee met, pursuant to recess, at 10 a.m., in room 2253, Rayburn House Office Building, Hon. Richard Bolling (vice chairman of the committee) presiding.

Present: Representatives Bolling, Reuss, and Rousselot.

OPENING STATEMENT OF REPRESENTATIVE BOLLING, VICE CHAIRMAN

Representative BOLLING. The committee will be in order.

We are very pleased to have as our witnesses this morning two very distinguished leaders of the American labor movement. Mr. Howard Young is special consultant to the president. He is replacing the president of the United Auto Workers, because my very good personal friend has a bad cold, and I am glad—although I regret he is not here—he is taking care of it, because not taking care of a cold can be very unpleasant.

And Mr. Rudolph Oswald, research director of the AFL-CIO, who is accompanied by Ken Young. This, at least in my experience, is the first time I have seen him officially since he has been head of the legislative department of the AFL-CIO. We are delighted to welcome you both.

The Joint Economic Committee has been considering a number of issues during its annual hearings that are of major concern to American workers and the American labor movement.

The first is jobs. During 1978, the employment situation improved dramatically. Between January 1978 and January 1979, 3.3 million new jobs were created. In January of this year, a record 59.3 percent of all adult Americans held jobs. Since the fall of 1977, we have cut 1 full percentage point from the unemployment rate.

But jobs are still an important issue. Although we are rid of the extraordinarily large unemployment caused by the 1974-1975 recession, there are still many people who are unemployed for structural reasons.

Structural unemployment is a great tragedy for this country. It means people who have poor educations, people with inadequate job skills, and people who have suffered from discrimination are the people who will have a difficult time finding jobs even in better times.

If we fail to attack structural unemployment with effective job training and placement programs, we will be shunting these Americans aside, and wasting one of our most valid resources.

Before I read on to the second and third points in this statement, I'd like to mention that one of the concerns that many of us have had is the whole question of productivity and capital formation. Mr. Oswald told me some very interesting things just a few minutes ago that I hope he will work into his statement, or in answers to questions somewhere along the line, because there is some information that is of great importance to this committee and to the country.

The second is inflation. Despite the fact that the average worker's weekly income rose 8.7 percent during 1978, inflation actually made many worse off with real gross weekly earnings falling 0.3 percent over the year. The Labor Department reports that the spendable income of a worker with three dependents actually fell 3.4 percent in real terms last year. This inflation is simply eating away at the livelihood of the American worker. It has an affect that is not a healthy one in terms of our ability to function in this country as a responsible participant in the world and affairs outside our borders, as well as causing difficulties within our borders.

President Carter has an anti-inflation program which includes fiscal and monetary restraint, wage and price guidelines, and control of regulatory costs. We would like to have your thoughts on how well this program is working, and whether there is anything more we can do to improve the plight of the average worker.

The third problem is foreign trade. We are all for free trade as long as our partners play by fair rules. But if we open the floodgates for foreign imports while other countries, such as Japan, slam the door on our goods through complex regulations, artificial standards, and administrative delays, then the game isn't being played fairly.

For the past 30 years, our vast markets have helped to build strong economies abroad, often to the detriment of American workers who have lost jobs to imports. If foreign countries don't reduce some of the artificial barriers to our goods, we may have to reexamine our own trade policy.

Now, this opening statement was prepared for Senator Bentsen, who has been very much involved in this particular issue. But since it happens to express my own views very well, I decided to include it.

I think we are in a very difficult situation, which is now becoming clearer and clearer and clearer. We are dealing with a variety of countries which are described usually as free enterprise countries, but which are really led by governments. The position, the power of government, in making the foreign trade policy of a variety of our allies, is, I think, very much underestimated, and I think we will have to look at our hold card, if I can put it in that crude way, if we are going to be successful in competing. That represents not a new discovery by me, but a realization that the situation has become more acute, at least in my opinion, over the last few years.

We look forward to your testimony.

Please proceed, Mr. Oswald.

**STATEMENT OF RUDOLPH OSWALD, RESEARCH DIRECTOR,
AMERICAN FEDERATION OF LABOR AND CONGRESS OF IN-
DUSTRIAL ORGANIZATIONS, ACCOMPANIED BY KENNETH
YOUNG, DIRECTOR, LEGISLATIVE DEPARTMENT**

Mr. OSWALD. Thank you, Mr. Vice Chairman. Mr. Lane Kirkland had hoped to be with the committee, but he expresses his regret that he is not able to be here this morning. Mr. Young, our director of legislation, is accompanying me this morning.

I would like to address, first of all, the question of productivity that you mentioned, Mr. Vice Chairman, before I get into the formal remarks.

Representative BOLLING. Thank you.

Mr. OSWALD. I know this has been a major concern of yours, and I think some of the headlines of the productivity gains in the past year have failed to provide adequate emphasis on some of the real improvements in productivity that have taken place in the productivity sector.

Over the past year, the numbers that are reported is 0.3 percent gain in productivity for the total private economy.

The figures just released this week indicate a 1.1 percent gain in productivity for nonfinancial institutions in the private sector, non-farm sector. But I think the important figure is the growth in productivity in the manufacturing sector over the last year, fourth quarter to fourth quarter, which is 3.7 percent.

Now, that is a very healthy gain, and, if we look at the gain in manufacturing for the whole period of the 1970's, the rate of growth in productivity in manufacturing was 2.4 percent, the same rate we had in the 1950's. The only reason that it was not substantially better in the 1970's, as good as the 3 percent rate that we had in the 1960's, was because of the two severe recessions that occurred in the 1970's, and, particularly, the severe recession in 1975 when you had negative productivity growth.

The summary of the details of the other industry sectors are attached in the background statement that is a part of the appendix to my prepared statement, and it is a background to the executive council's national economy statement. The discussion of productivity is at the end of that background statement.

Representative BOLLING. Your presentation will appear in full in the record.

Mr. OSWALD. Mr. Vice Chairman, I would like to read a part of my prepared statement, because I believe it highlights some of our major concerns.

Representative BOLLING. Proceed as you wish.

Mr. OSWALD. The AFL-CIO is deeply concerned about today's inflation unemployment levels and dismal outlook for the rest of this year. Present economic policies are not curtailing inflation, but are pushing the economy toward a recession. A new recession would start from a higher level of unemployment than the last recession. Unemployment is 1 full percentage point, or 1 million workers, higher than 5 years ago.

To control inflation, to move the Nation faster toward full employment, decisive, effective, and prompt Government action is essential.

Unfortunately, the administration's anti-inflation program is simply not working. It cannot be successful in holding down inflation because it does nothing effectively about controlling prices while it relies wholly upon a rigid wage control mechanism. The program fails to address adequately the inflation pressures on the food, housing, energy and medical care sectors—the major problem areas.

The current prospects are that inflation may well get worse in 1979. The wholesale or producer price indexes for January portend greater consumer price increases over the new few months, and continued high interest rates are driving up housing costs.

The administration's predictions on inflation did not include the recent events in Iran, which are leading to shortages and higher oil prices. The already weak dollar cannot withstand further speculation or higher trade deficits, as reflected in the January figures.

Furthermore, the administration's restrictive budget proposals will not reduce inflation. Cutting essential programs to meet an arbitrary \$29 billion budget deficit will have only a one-tenth of 1 percent impact on the rate of inflation, according to the Congressional Budget Office figures. However, that budget will severely cripple a number of important Federal programs and, worst of all, would cut job programs at a time when the administration's own projections indicate the unemployment will go up.

In fact, the Congressional Budget Office predicts an unemployment rate for December 1979 which may be up to 1 full percentage point higher than administration estimates. That would mean 1 million more jobless workers at the very time the administration is cutting back on programs to create jobs.

Despite the impressive increase in the number of jobs over the past year, little or no dent was made in the official unemployment rate which continues to hover around 6 percent.

Black unemployment, particularly depressed, has unemployment levels remaining over 11 percent. This is nearly double the 6 percent black unemployment levels of the late 1960's.

Unfortunately, the economic policies of the administration—as outlined in the President's Economic Report to the Congress and in the administration's budget proposals—fail to meet the goals set by the Humphrey-Hawkins Full Employment and Balanced Economic Growth Act of 1978.

The administration expects the unemployment level to climb to 6.2 percent in the fourth quarter of 1979 and remain at that level through 1980. The administration assumes that the unemployment rate will start dropping in 1981 and will get down to the required 4 percent in 1984, but sets forth no programs over the next 2 years to reduce unemployment. Rather, its policies do just the reverse. They aggravate the already high unemployment levels.

Unless there is substantially more stimulus to the economy than currently projected by the administration, the Humphrey-Hawkins goal will not be met, and, according to the CBO, the unemployment rate will still be at the high level of 5.5 percent in 1984.

The Joint Economic Committee has major responsibilities under the Humphrey-Hawkins legislation. This committee has the responsibility to report to the Senate and House Budget Committees on the short-term and medium-term goals set forth in the Economic

Report of the President. And this committee has the opportunity and the responsibility to present to the Senate and House Budget Committees policies and programs to achieve the Humphrey-Hawkins full employment goals.

We urge this committee to make in its report and recommendations a clear statement that the administration's economic goals and policies are not adequate nor appropriate to fulfill the full employment mandate of the Humphrey-Hawkins law nor to control effectively continuing high inflation.

Many of the policies and programs proposed by the administration either ignore or are contrary to the nine distinct countercyclical employment policies proposed in section 202(a) of the Humphrey-Hawkins Act, and I cite these parts, and I will touch on a few of them and leave the rest of them for the record.

The first of those countercyclical programs proposed in section 202 is accelerated public works, including development of standby public works projects.

The previous accelerated public works program has expired and last year Congress failed to act on the so-called "soft" public works program proposed by the administration. This latter program, of course, is still needed and should be enacted promptly. A new standby public works program should be established as an essential part of an antirecession program, which could get started quickly, if a new recession were to occur.

With regard to public service employment, contrary to the budget proposal, the level of funding for CETA title VI anticyclical public service jobs should be restored to the levels already approved by Congress, and the \$1 billion proposed cut in title VI funds rejected.

Item three, State and local grant programs. A targeted, countercyclical relief program to aid areas of high unemployment should be adopted.

Item four, the levels and duration of unemployment insurance. The unemployment compensation law needs to be immediately improved to provide adequate protection against the threatening recession. Specifically, the law should establish a Federal minimum benefit standard of two-thirds of the worker's wage up to a maximum of three-fourths of the statewide average weekly wage, extend the present maximum 39-week duration to 65 weeks, provide Federal financing from general revenue for benefits paid to workers after they are unemployed 39 weeks and reimburse States for disbursements they made beyond basic payments for the period January 1975 to January 1978, and extend coverage to all workers now excluded.

Item five, skill training in both the private and public sectors, both as a general remedy and as a supplement to unemployment insurance.

Contrary to the budget proposals, skilled training under national training and outreach programs should be continued at current or expanded levels. The proposed \$50 million cut in title III funds should be restored.

Item six, youth employment programs. Proposed budget cuts in the funds for the summer youth programs which reduce employment opportunities from 1 million to 750,000 should be rejected.

Item seven, community development programs to provide employment in activities of value to the States, local communities—including rural areas—and the Nation. The administration's proposed National Development Bank would facilitate such community development, and should be approved by Congress.

The President's budget proposal would cut that funding by over \$1 billion from that which would be necessary to provide the jobs that are in the bill passed by Congress last year. We feel that needs to be remedied in terms of the job needs:

I develop in detail the total of nine items that are in that section, and I would like to point out one part of the section 202(b), the following language in the Humphrey-Hawkins bill, which makes reference—and I would like to quote—"In any countercyclical efforts undertaken, the President shall consider a triggering mechanism which will implement the program during a period of rising unemployment and phase out the program when unemployment is appropriately reduced."

The President did not recommend a triggering mechanism, and we would hope that the Joint Economic Committee would consult with the Budget Committees both in the Senate and in the House to provide a type of triggering mechanism so that when the conditions worsen, as they may well do later on this year, that there may be an automatic measure under which countercyclical programs and public works can be gotten underway without going through the process of the third budget resolution.

There can be a contingency situation, if unemployment worsens substantially, so that the Appropriations Committees could just act to provide the funds for new programs under those conditions, without going through the specific waiver provisions or a third budget resolution.

In addition to the specific employment policy proposals of Humphrey-Hawkins, the AFL-CIO is also deeply concerned about inflation, and at its recent executive council meeting, set forth the following program to curtail inflation. I would like to quote from that council statement:

We do not like controls. We do not welcome Government operation of the marketplace. But recession is worse; runaway inflation is worse; the discriminatory application of wage controls is worse, the distorting of laws for purposes other than those intended is worse; public scapegoating without due process is worse.

Therefore, we urge the President to draft a legislative program of full economic controls, covering every source of income—profits, dividends, rents, interest rates, executive compensation, professional fees, as well as wages and prices.

Supplemental policies must be designed to deal with specific price problems in the necessities. These should curb commodity speculation that drives up the prices of wheat and other agricultural products, regulate exports of foodstuffs and other raw materials to prevent domestic shortages, revise restrictive agricultural policies that contribute to shortages and insure that the benefits of price support programs be restricted to family farmers, and expand energy supplies to relieve the OPEC stranglehold on domestic prices.

It should also continue to regulate gasoline and petroleum prices, contain hospital costs and control professional fees for health care, control and allocate credit toward productive public and industrial

investment, expansion of housing and assistance to the family farmer and away from nonproductive areas such as corporate acquisitions and dollar speculation.

In addition, it should expand housing programs for low- and middle-income families to expand the housing supply and reduce the price and rent inflation.

An excess profit tax should be instituted to insure that businesses maintain fair prices, as well as revisions in the real wage insurance proposal to correct inequities.

The AFL-CIO, of course, is very much concerned about the need for effective economic stimulus and more rapid economic growth, so that the U.S. economy will be creating enough jobs for the Nation's growing labor force and so that high unemployment will be reduced instead of going higher.

The AFL-CIO called for five specific programs to maintain this commitment, and they are as follows:

The Federal budget must provide stimulus to expand the economy and to shrink unemployment.

Employment and training programs need to be expanded to provide jobs and training.

Unemployment compensation needs to be improved and expanded to protect workers and the economy.

A National Development Bank must be established to bring employment opportunities to depressed areas.

Standby programs of expanded public works should be adopted so that they will be in place to meet worsening unemployment.

As you indicated in your opening remarks, Mr. Vice Chairman, the international economic area is also a major concern of ours, and we are concerned that some of these international factors fuel inflation in the United States, as well as weakening the U.S. position in the world economy.

You indicated the very big deficits over the past 2 years. We are very concerned that the administration itself predicts very little decline in that trade deficit for 1980.

We would like to point out that the big change in 1978 in terms of imports, was the jump in manufactured imports, which jumped from \$77 billion to \$100 billion in 1978, while oil imports actually declined slightly from \$44 billion to \$42 billion.

The AFL-CIO welcomes the President's state of the Union pledge to "protect American jobs threatened by unfair trade." This pledge and this goal should be in the forefront of U.S. policy in the multilateral trade negotiations. When the codes and the implementing legislation are completed, their impact must be fully evaluated as to whether they do actually protect American workers and industries against unfair trade competition and assure the maintenance of a diversified, healthy U.S. economy.

Mr. Vice Chairman, I appreciate this opportunity to present the views of the AFL-CIO on this range of economic issues. I have attached, as supplements to my prepared statement, a number of the statements recently adopted by the executive council on a number of these issues. I think these documents demonstrate that there is the ability to meet the goals of Humphrey-Hawkins and to meet inflation as well as to promote additional employment opportunities.

Representative BOLLING. Thank you very much, Mr. Oswald, for a very clear statement of the position of the AFL-CIO. As I said earlier, all the materials in your prepared statement, including the supplementary ones, will be included in the record, without objection.

[The prepared statement of Mr. Oswald, together with appendix material, follows:]

PREPARED STATEMENT OF RUDOLPH OSWALD

Mr. Chairman, I appreciate this opportunity to present the views of the AFL-CIO on the current economic situation and current economic policies.

Let me state at the outset that we are deeply concerned about today's inflation and unemployment levels and the dismal outlook for the rest of this year. Present economic policies are not curtailing inflation but are pushing the economy towards a recession. A new recession would start from a higher level of unemployment than the last recession. Unemployment is a full percentage point or 1 million workers higher than five years ago.

To control inflation, to move the nation faster toward full employment, decisive, effective, and prompt government action is essential.

Unfortunately, the Administration's anti-inflation program is simply not working. It cannot be successful in holding down inflation because it does nothing effectively about controlling prices while it relies wholly upon a rigid wage control mechanism. The program fails to address adequately the inflation pressures on the food, housing, energy and medical care sectors -- the major problem areas.

The current prospects are that inflation may well get worse in 1979. The wholesale or producer price indexes for January portend greater consumer price increases over the next few months, and continued high interest rates are driving up housing costs.

The Administration's predictions on inflation did not include the recent events in Iran, which are leading to shortages and higher oil prices. The already weak dollar cannot withstand further speculation or higher trade deficits, as reflected in the January figures.

Furthermore, the Administration's restrictive budget proposals will not reduce inflation. Cutting essential programs to meet an arbitrary \$29 billion budget deficit will have only a one-tenth of one percent impact on the rate of inflation, according to the Congressional Budget Office figures. However, that budget will severely cripple a number of important federal programs and, worst of all, would cut job programs at a time when even the Administration's own projections indicate that unemployment will go up. In fact, the Congressional Budget Office predicts an unemployment rate for December 1979 which may be up to one full percentage point higher than Administration estimates. That would mean one million more jobless workers at the very time the Administration is cutting back on programs to create jobs.

Despite the impressive increase in the number of jobs over the past year, little or no dent was made in the official unemployment rate which continues to hover around 6 percent.

Black unemployment remains particularly depressed, with unemployment levels remaining over 11 percent. This is nearly double the 6 percent black unemployment levels of the late 1960's.

Unfortunately, the economic policies of this Administration -- as outlined in the President's Economic Report to the Congress and in the Administration's Budget proposals -- fail to meet the goals set by the Humphrey-Hawkins Full Employment and Balanced Economic Growth Act of 1978.

The Administration expects the unemployment rate to climb to 6.2 percent in the fourth quarter of 1979 and remain at that level through 1980. The Administration assumes that the unemployment rate will start dropping in 1981 and will get down to the required 4 percent in 1984, but sets forth no programs over the next two years to reduce unemployment. Rather, its policies do just the reverse. They aggravate the already high unemployment levels. Unless there is substantially more stimulus to the economy than currently projected by the Administration, the Humphrey-Hawkins goal will not be met, and, according to the CBO, the unemployment rate will still be at the high level of 5.5 percent in 1984.

The Joint Economic Committee has major responsibilities under the Humphrey-Hawkins legislation. This Committee has the responsibility to report to the Senate and House Budget Committees on the short-term and medium-term goals and policies set forth in the Economic Report of the President. And this Committee has the opportunity and the responsibility to present to the Senate and House Budget Committees policies and programs to achieve the Humphrey-Hawkins full employment goals.

We urge this Committee to make in its report and recommendations a clear statement that the Administration's economic goals and policies are not adequate nor appropriate to fulfill the full employment mandate of the Humphrey-Hawkins law nor to control effectively continuing high inflation.

Many of the policies and programs proposed by the Administration either ignore or are contrary to the nine distinct countercyclical employment policies proposed in Section 202(a) of the Humphrey-Hawkins Act. These are as follows:

1. "Accelerate public works, including the development of standby public works projects."

The previous accelerated public works program has expired and last year Congress failed to act on the so-called "soft" public works program proposed by the Administration. This latter program is urgently needed and should be enacted promptly. A new standby public works program should be established as an essential part of an anti-recession program.

2. "Public service employment."

Contrary to the budget proposal, the level of funding for CETA Title VI anti-cyclical public service jobs should be restored to the levels already approved by Congress, and the \$1 billion proposed cut in Title VI funds rejected.

3. "State and local grant programs."

A targeted, countercyclical relief program to aid areas of high unemployment should be adopted.

4. "The levels and duration of unemployment insurance."

The unemployment compensation law needs to be immediately improved to provide adequate protection against the threatening recession.

Specifically the law should: (a) establish a federal minimum benefit standard of two-thirds of the worker's wage up to a maximum of three-fourths

of the statewide average weekly wage, (b) extend the present maximum 39-week duration to 65 weeks, (c) provide federal financing from general revenue for benefits paid to workers after they are unemployed 39 weeks and reimburse states for disbursements they made beyond basic payments for the period January 1975 - January 1978, and (d) extend coverage to all workers now excluded.

5. "Skill training in both the private and public sectors, both as a general remedy and as a supplement to unemployment insurance."

Contrary to the Budget proposals, skilled training under national training and outreach programs should be continued at current or expanded levels. The proposed \$50 million cut in Title III funds should be restored.

6. "Youth employment programs."

Proposed budget cuts in the funds for the Summer Youth Programs which reduce employment opportunities from 1 million to 750,000 should be rejected.

7. "Community development programs to provide employment in activities of value to the States, local communities (including rural areas), and the Nation."

The Administration's proposed National Development Bank would facilitate such community development, and should be approved by Congress.

8. "Federal procurement programs which are targeted on labor surplus areas."

In this regard, Congress should review the impact of the Multilateral Trade Negotiation's code on "government procurement." This new code may interfere with government procurement policies that give preference to procurement to high-unemployment areas. The Congress, should examine the MTN agreements very carefully and make sure that procurement preference for high-unemployment areas is not weakened.

9. "Augmentation of other employment and training programs which would help to reduce high levels of unemployment arising from cyclical causes," and 202(b) "In any countercyclical efforts undertaken, the President shall consider a triggering mechanism which will implement the program during a period of rising unemployment and phase out the program when unemployment is appropriately reduced..."

Since the President did not recommend a triggering mechanism, the Joint Economic Committee should consult with the Senate and House Budget Committees to provide a triggering mechanism. Advanced budget authority for supplemental appropriations may well be needed later this year to fund countercyclical programs at higher levels as the economy moves into recession and higher levels of unemployment. Such budget authority could provide for countercyclical contingency funds and emergency public works. This would simplify and shorten the procedures necessary to offset the recession which looms later this year.

In addition to the specific employment policy proposals of Humphrey Hawkins, the AFL-CIO is also deeply concerned about inflation, and at its recent Executive Council meeting set forth the following program to curtail inflation. The Council stated:

"We do not like controls. We do not welcome government operation of the market place. But recession is worse; runaway inflation is worse; the discriminatory application of wage controls is worse, the distorting of laws for purposes other than those intended is worse; public scapegoating without due process is worse.

"Therefore, we urge the President to draft a legislative program of full economic controls, covering every source of income -- profits, dividends, rents, interest rates, executive compensation, professional fees, as well as wages and prices."

The AFL-CIO Executive Council went on to lay out a comprehensive set of anti-inflation policies as follows:

1. The mandatory, across-the-board control program, which this Executive Council found necessary to advocate last October and which we reiterate today must control the cost of everything and the income of everybody.

2. Supplemental policies must be designed to deal with specific price problems in the necessities. These should:

- a. Curb commodity speculation that drives up the prices of wheat and other agricultural products.

- b. Regulate exports of foodstuffs and other raw materials to prevent domestic shortages.

c. Revise restrictive agricultural policies that contribute to shortages and insure that the benefits of price support programs be restricted to family farmers.

d. Expand energy supplies to relieve the OPEC stranglehold on domestic prices.

e. Continue to regulate gasoline and petroleum prices.

f. Contain hospital costs and control professional fees for health care.

g. Control and allocate credit toward productive public and industrial investment, expansion of housing and assistance to the family farmer and away from non-productive areas such as corporate acquisitions and dollar speculation.

h. Expand housing programs for low- and middle-income families to expand the housing supply and reduce the price and rent inflation.

3. An excess profit tax to insure that businesses maintain fair prices, as well as revisions in the real wage insurance proposal to correct inequities.

The AFL-CIO, of course, is very much concerned about the need for effective economic stimulus and more rapid economic growth so that the U.S. economy will be creating enough jobs for the nation's growing labor force and so that high unemployment will be reduced instead of going still higher.

Therefore, we believe this Committee and the Congress must reject the notion that inflation must be fought through recession and rising unemployment. We believe this Committee and the Congress must continue this nation's commitment to full employment, to the eradication of poverty, and to the kind of investment in public programs and public services that are essential to economic progress.

The AFL-CIO Executive Council set forth the following employment policies to maintain this commitment and we ask this Committee to support these policies:

1. "The federal budget must provide stimulus to expand the economy and to shrink unemployment.
2. "Employment and training programs need to be expanded to provide jobs and training.
3. "Unemployment compensation needs to be improved and expanded to protect workers and the economy.
4. "A National Development Bank must be established to bring employment opportunities to depressed areas.
5. "Stand-by programs of expanded public works should be adopted so that they will be in place to meet worsening unemployment."

Another important area of economic concern is the international economic arena, with its high trade deficits and declining value of the dollar. These factors fuel inflation in the U.S. and weaken the U.S. position in the world economy.

The U.S. trade balance dropped into sharp deficit during the last two years. Imports exceeded exports by \$29 billion in 1977 and by \$31 billion in 1978. Imports of manufactured goods rose from \$77 billion in 1977 to \$100 billion in 1978, while oil imports actually declined from \$44 billion to \$42 billion.

The dollar declined sharply against the currencies of major industrial countries. The decline stemmed not only from the trade deficit, but also from speculation against the dollar.

The AFL-CIO welcomes the President's State of the Union pledge to "protect American jobs threatened by unfair trade." This pledge and this goal should be in the forefront of U.S. policy in the Multilateral Trade Negotiations. When the codes and the implementing legislation are completed, their impact must be fully evaluated as to whether they protect American workers and industries against unfair trade competition and assure the maintenance of a diversified, healthy U.S. economy.

Mr. Chairman, I appreciate this opportunity to present the views of the AFL-CIO on a range of economic issues. I respectfully request that the record include the appendix to my prepared testimony which contains recent AFL-CIO statements on economic policy. These statements demonstrate the AFL-CIO's conviction that inflation can be attacked by programs consistent with the full employment goals of the Humphrey-Hawkins Full Employment and Balanced Economic Growth Act of 1978.

APPENDIX TO STATEMENT OF DR. RUDOLPH OSWALD,
DIRECTOR, AFL-CIO DEPARTMENT OF RESEARCH,
BEFORE THE JOINT ECONOMIC COMMITTEE

MARCH 2, 1979

AFL-CIO Executive Council statements on economic policy issues
(February 1979):

The National Economy and background paper

The Federal Budget

Unemployment Compensation

Family Farmers

Housing

Energy Prices and Supplies

Hospital Cost Containment

AFL-CIO American Federationist article (February 1979):

Controls: An Unfair Program Gets Worse

Statement by the AFL-CIO Executive Council

on

The National Economy

Bal Harbour, Fla.

February 19, 1979

America's economy is heading toward a recession. Only swift, effective government action, controlling inflation without increasing already-high unemployment, can prevent it.

The current prospects are that inflation will get worse in 1979. The 9 percent increase in the consumer price index during 1978 further eroded the consumer buying power essential to economic growth. Yet the wholesale or producer price indexes for January portend even greater consumer price increases.

The Administration's predictions on inflation did not include the recent events in Iran, which are leading to shortages and higher oil prices. The already weak dollar cannot withstand further speculation or higher trade deficits.

The employment outlook is equally dismal. Despite the impressive increase in the number of jobs over the past year, little or no dent was made in the official unemployment rate which continues to hover around 6 percent. The economic slowdown certain to result from record interest rates will lead to higher joblessness, particularly in the home building industry and the manufacturing industries dependent upon it.

At the same time, the Administration's restrictive budget proposals would deny the economy needed stimulus and cut jobs programs. In fact, the Congressional Budget Office predicts an unemployment rate for December 1979 of up to one percentage point higher than Administration estimates. That would mean a million more jobless workers at the very time the Administration is cutting back on programs to create jobs.

The Administration's anti-inflation program will not be successful in holding down inflation because it does not have a comprehensible, effective, enforceable system of controlling prices. Wage controls without price controls are not only inequitable but compound the problem of declining consumer buying power.

We repeat what we said last October:

"We do not like controls. We do not welcome government operation of the market place. But recession is worse; runaway inflation is worse; the discriminatory application of wage controls is worse, the distorting of laws for purposes other than those intended is worse; public scapegoating without due process is worse.

"Therefore, we urge the President to draft a legislative program of full economic controls, covering every source of income -- profits, dividends, rents, interest rates, executive compensation, professional fees, as well as wages and prices."

While the AFL-CIO believes that inflation is now the nation's most serious economic problem and must be effectively controlled as soon as possible, we believe the U.S. would be making a serious mistake if it failed to adopt programs to meet each of the nation's economic problems.

Therefore, the AFL-CIO Executive Council urges the following programs:

Anti-Inflation Policies

1. The mandatory, across-the-board control program, which this Executive Council found necessary to advocate last October and which we reiterate today must control the cost of everything and the income of everybody.
2. Supplemental policies must be designed to deal with specific price problems in the necessities. These should:
 - a. Curb commodity speculation that drives up the prices of wheat and other agricultural products.
 - b. Regulate exports of foodstuffs and other raw materials to prevent domestic shortages and price rises.
 - c. Revise restrictive agricultural policies that contribute to shortages and insure that the benefits of price support programs be restricted to family farmers.
 - d. Expand energy supplies to relieve the OPEC stranglehold on domestic prices.
 - e. Continue to regulate gasoline and petroleum prices.

f. Contain hospital costs and control professional fees for health care.

g. Control and allocate credit toward productive public and industrial investment, expansion of housing and assistance to the family farmer and away from non-productive areas such as corporate acquisitions and dollar speculation.

h. Expand housing programs for low- and middle-income families, to expand the housing supply and reduce the price and rent inflation.

3. An excess profit tax to insure that businesses maintain fair prices, as well as revisions in the real wage insurance proposal to correct inequities.

Employment Policies

1. The federal budget must provide stimulus to expand the economy and to shrink unemployment.

2. Employment and training programs need to be expanded to provide jobs and training.

3. Unemployment compensation needs to be improved and expanded to protect workers and the economy.

4. A National Development Bank must be established to bring employment opportunities to depressed areas.

5. Stand-by programs of expanded public works should be adopted so that they will be in place to meet worsening unemployment.

Trade Policies

1. Fair trade policies must be adopted and enforced to assure realistic protection of U.S. industries and jobs.

2. Speculation against the dollar by banks and multinational corporations must be curtailed.

3. Countervailing duties must be assessed against imports receiving foreign subsidies, and the already expired waiver of such duties should not be extended.

4. Trade adjustment assistance must be improved to help alleviate the immediate hardships of job loss due to imports.

* * *

We hope our prediction of a recession is wrong, but a healthy economy must be built on stronger foundations than "hopes." There can be no substitute for effective, fair government actions to control inflation through a program that draws the support of the people because it is equitable, visible and enforceable. At the same time, government must not abandon its responsibility to provide opportunities for workers, the poor, the unemployed and the disadvantaged through necessary social programs.

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Background Statement on The National Economy

Accelerating inflation, sky-high interest rates, trade deficits, restrictive budget policies and the erosion of consumer buying power are pushing the economy toward another recession. This would mean increasing unemployment starting from the highest base rate since World War II.

In spite of impressive profits for corporations and banks in the fourth quarter of 1978, and a 6.1 percent rate of real growth in the national economy during this period, consumer and business caution and pessimism about the future have worsened. This portends a serious slowdown in spending in 1979 that will cut sales and production and thus bring lay-offs and increased unemployment.

Slow growth in consumer buying power as a result of the so-called voluntary wage restraints enforced by employers will contribute to the economic slowdown in 1979.

High interest rates adversely affect housing construction and home-buying, state and local government operations, small business investment and consumer spending for durable goods. The administration's tight budget policy reduces the government spending stimulus needed to keep the U.S. economy expanding.

Employment and Unemployment

The civilian labor force in January 1979 included 102.2 million workers -- 96.3 million with jobs and 5.9 million without jobs. The official unemployment rate was 5.8 percent. But when discouraged workers and those forced to work part-time because full-time work is unavailable are counted, the true unemployment rate is 8.1 percent.

Although the number of workers with jobs has risen by 3.4 million over the past 12 months, unemployment has continued to hover around the 6 percent level. In other words, there was no improvement in the unemployment picture in 1978.

These are the unemployed: One out of every nine black workers, one out of every seven teenagers, one out of every three black teenagers, one out of every 11 Hispanic-origin workers, one out of every seven male veterans aged 20 to 24 years, and one out of 10 construction workers.

The administration expects the unemployment rate to climb to 6.2 percent in the fourth quarter of 1979 and remain at that level through 1980. To meet the requirements of the Humphrey-Hawkins Full Employment and Balanced Growth Act, the administration is assuming that the unemployment rate will start dropping in 1981 and will get down to the required 4 percent in 1984.

A more realistic view is held by the Congressional Budget Office which suggests that the unemployment rate may be as high as 7.2 percent by the end of 1979 and still be there by the end of 1980. CBO also predicts the unemployment rate will start dropping in 1981, but states that unless there is substantially more stimulus to the economy than currently projected by the administration, the unemployment rate will still be at the high level of 5.5 percent in 1984.

Inflation

The Consumer Price Index went up by 9 percent from December 1977 to December 1978. Food costs went up 11.7 percent, housing costs 11.5 percent, medical care 8.9 percent, and energy costs 6 percent -- or a total inflation rate for necessities of 10.7 percent.

The outlook for inflation in 1979, on the basis of wholesale or producer price indexes, is gloomy.

For example, unprocessed foods and feedstuffs were up 20.1 percent over the 12-month period ending January 1979; intermediate materials for food manufacturing 15 percent, and finished consumer foods 12.9 percent.

For the general category of crude materials for further processing, the January-to-January price rise was 18.5 percent; for intermediate materials, supplies, and components 8.9 percent; for finished goods, 9.8 percent.

The price of necessities are likely to escalate substantially in 1979. Food prices, particularly beef prices, are expected to increase sharply. Oil price increases, resulting from OPEC determinations and the Iranian cutoff, will affect not only the gasoline pump price, but the price of all items related to petroleum and energy, including food. Continued high interest rates will push all costs even higher.

So the economy is heading towards another recession without ever fully recovering from the 1973 recession. Overall unemployment rates are a full percentage point -- or 1 million workers higher -- and for blacks the situation is even worse -- an unemployment rate 3 percentage points greater, up to 11.2 percent.

The Administration's Wage-Price Control Program

The administration's wage and price program is one-sided wage control. It pretends that wages are the cause of the current inflation. It fails to deal with many of the major factors influencing inflation, particularly price inflation in the necessities of life -- food, energy, medical care and housing.

The administration's program exempts many types of price changes. While it sets a precise measure for wage changes, the standard for prices is vague. Profits, dividends, rents and interest rates are basically ignored.

Price guidelines do not cover all items and do not even pretend to control the major causes of inflation. Additionally, they allow those who raised prices the most in the past two years to profit further from that conduct.

For wages there is a single number -- 7 percent -- easily remembered, widely publicized, applicable across-the-board, enforced by every employer in the country, from multi-billion dollar corporations to the individual firm employing only a single worker.

The 7 percent is a maximum applicable to every employee unit, but not every unit will receive the full 7 percent. Wage controls are enforced by employers eager to cooperate with the government in holding down their employees' pay.

Wage controls are particularly discriminatory against federal employees. The law requires that federal salaries be comparable to those paid in the private sector. The President in 1978 arbitrarily placed a 5.5 percent limit on federal salary increases, and the Congress acquiesced. In 1978, that comparability would have required an 8.4 percent increase. That same 5.5 percent increase is projected in the budget for 1979 without regard for what the comparability figure would be. This wage control figure for federal workers is 1.5 percent below the 7 percent allowed all other workers, is clearly unfair.

In contrast to wage guidelines, there is no single number for prices. Coverage is not universal. There is no enforcement, except for the government's ability to dispense or withhold favors through regulatory and procurement contract mechanisms.

This entire program has no basis in law and, in fact, constitutes mandatory wage controls by indirection in the face of explicit congressional action denying the Executive this authority.

The general public has no way of knowing whether particular price increases -- no matter how large -- are in compliance or not. Because allowable rates of price increase are computed on the basis of individual company price histories, never before compiled and not on the public record, the individual citizen will have no means of making an independent check on compliance. Wide latitude is allowed for price increases on particular product lines and particular products, and there are alternative methods of testing compliance other than through price deceleration.

There are actually several price guidelines in addition to the originally announced "price deceleration" guideline, and there are a number of important exclusions. Additionally, companies are allowed considerable flexibility in the choice of their accounting methods and in whether to report as a single company or as separate units within a single company.

Finally, and perhaps most importantly, there are certain situations in which no restraint applies. Essentially excluded, for all practical purposes, are the four basic necessities of life for the average family -- food, housing, energy and medical costs. Thus there is little or no attempt to hold down prices on the items no family can do without.

Inflation Problems -- The Necessities

The success of price abatement may hinge on the elements excluded from price deceleration requirements -- raw materials, commodity exchange items, interest rates, imports and exports.

Over the last two years the compound effects of inflation on the cost of necessities have been particularly severe. Specifically, food went up 20.6 percent, shelter 21 percent, fuel and utilities 14.6 percent and medical care 18.5 percent.

These four categories make up 57 percent of the C.P.I. and during the 1977-78 surge in prices accounted for two-thirds of the increase. Put another way, had the cost of necessities stayed constant from December 1976 to December 1978, the C.P.I. would have risen by only 5 percent over the two-year period compared with the 16.4 percent actual increase. The annual average rate of increase during the two years would have been only 2.5 percent -- 68 percent lower than the actual annual average rate of 7.9 percent.

Inflation Problems -- Interest Rates

In 1978 interest rates on borrowed money rocketed upward and by the end of the year were approaching or had surpassed the all-time highs reached in the credit crunch of 1974.

The cost of money enters into every price in the economy -- those paid by consumers, farmers, business and government. Rising interest costs in themselves help fuel inflation. Not only do they increase the costs of short-term loans used by business in the course of normal operations but they burden the costs of long-term capital investment in plant and equipment. And they make up a large part of the cost of housing both in the form of construction loan rates and in mortgage loan charges to home buyers. Eventually, if money becomes very tight and very expensive, borrowers cut back, economic activity slows down, production is reduced, sales drop and a recession develops. The recessions of 1970-71 and 1974-75 were both preceded by rapid and severe escalations of interest rates.

Federal Reserve Discount Rates

The Federal Reserve Board, which directly influences interest rates through its role as "banker for the banks," jacked up its discount rate seven times during 1978, starting with its January 9 increase to 6.5 percent (from 6 percent). By October 16, the rate had reached an all-time record of 8.5 percent -- 42 percent higher than the 6 percent rate at the beginning of the year. This record was again shattered with the 9.5 percent rate announced on November 1.

Commercial Bank Prime Rates

The lending rates of commercial banks rose in similar fashion. At the beginning of 1978, the big bank "prime rate," which is the minimum lending rate to large businesses, was 7.75 percent. This rate has been successively increased 15 times during the year until on December 26 it reached 11.75 percent, just short of the record 12 percent of July 1974.

Home Mortgage Rates

As of December 1978, the effective mortgage rate on loans closed for purchasing newly-built single family homes was 10.02 percent, up from a year earlier figure of 9.09 percent. This was an increase of over 12 percent. For existing homes, the effective mortgage rate was 10.06 percent at the end of the year, more than 10 percent above the December 1977 rate of 9.12 percent.

Financing charges for mortgage interest, property taxes, and insurance, taken together, rose 15.2 percent in the Consumer Price Index for Wage Earners and Clerical Workers. Combined with rising home prices, they contributed importantly to the overall rise of 12.5 percent in all home ownership costs in 1978.

Credit Allocation

Credit crunches are hurting housing, and other needed investment activities. The Congress granted the President and Federal Reserve Board this authority to allocate credit under the 1969 Credit Control Act. Allocation would alleviate somewhat credit problems in such essential sectors of the economy as housing, family farming, small business and state and local public investment.

Inflation Problems -- Trade

Much of the U.S. inflation results from international economic policies. The devaluation of the dollar and huge deficits in trade and international payments fuel inflation at home and economic weakness abroad. The administration's anti-inflation program fails to address these problems directly.

In the past two years, the dollar has dropped 16 percent on a trade-weighted average. The currencies of key trading partners like Japan and West Germany have risen 50.4 percent and 26.8 percent respectively in relation to the dollar. The U.S. imports manufactured products of all types from these countries -- from textiles and cars to computers and parts. These imports are consequently more expensive and add to U.S. inflation.

The U.S. imported \$29 billion more than it exported in 1977. In 1978, this deficit increased to \$32 billion. While oil imports are an important element in the U.S. trade deficit, the fact is that manufactured imports into the U.S. accounted for the increase in the trade deficit in 1978. The trade surplus of \$3.6 billion in manufactured goods in 1977 changed to roughly a \$6 billion deficit in 1978. These excessive imports cost American consumers dearly -- in higher priced foreign currencies and in taxes to pay for the social and economic costs of lost jobs.

But exports of food and live animals -- bought by foreigners at a bargain with cheaper, devalued dollars -- rose almost 30 percent in 1978. These export sales contribute to food price inflation in the U.S. The attempt to spur exports of products without curbing imports at all will merely create more shortages and put added inflationary pressures on the U.S. economy. The result is worse problems at home and a weaker stance for the dollar abroad.

Trade deficits lead to inflationary speculation against the dollar. Rather than curbing dollar speculation directly or limiting imports, the domestic Federal Reserve Board discount rate was raised to the unprecedented levels of 9.5 percent, creating added inflation pressures as interest costs are pushed up.

Wages

No single statistic can be used to show what is happening to wages because overall percentage wage increases reflect the wage changes of many different people and many different groups.

Employees in private non-farm industry have averaged increases in hourly compensation of 8.3 percent in 1976, 7.6 percent in 1977, and 9.7 percent in 1978, according to the Bureau of Labor Statistics. This average includes executives, professionals and all private blue-collar and white-collar employees. BLS wage studies show that different groups of workers have had substantial variations in wage changes.

When executive and supervisory employees are excluded, the rates of wage increases are substantially lower as are the wages paid such workers. Average hourly earnings were \$5.90 in December 1978 -- 8.2 percent above those of a year earlier. The 1977 increase was 7.3 percent, identical to the 1976 increase. However, after allowing for inflation and taxes, real earnings are actually lower than they were in 1972.

Chief executive officers received total compensation increases of 12.2 percent in 1977, according to Forbes magazine. These are chief executives of the top 800 firms and their compensation averaged \$300,000 -- so a 12 percent increase was about \$36,000 for the year.

Unions negotiating in 1978 generally settled for lower wage increases than in the two previous years. In 1976 first-year increases averaged 8.4 percent; in 1977 7.8 percent, and in 1978 7.7 percent.

For building trades unions wage and benefit increases amounted to 7.1 percent in 1976, 6.6 percent in 1977, and 6.2 percent in 1978, according to a special Labor Department survey.

Union contracts with deferred wage increases in 1979 average 5.1 percent. A number of these contracts, however, also provide increases resulting from cost-of-living escalator clauses.

The Squeeze on the Worker

In spite of dollar gains in the paycheck, the American worker has lost real buying power. Between 1967 and 1972, the buying power of the average non-supervisory worker's weekly pay, after deduction of federal income and social security taxes, rose 6.4 percent. But in 1978, the average worker's buying power was down 4.9 percent from 1972.

Productivity

Although overall productivity measures show a slowdown this is not true of the basic manufacturing sector. In fact, since manufactured goods make up a declining share of total output, there is a serious question about the validity of productivity measurement for the total private economy which also includes construction, finance insurance, real estate and personal and business services.

Productivity growth has not slowed in the manufacturing sector. In terms of output per worker hour it increased 3.5 percent in 1978. For the 1970s, manufacturing productivity growth averaged 2.4 percent per year -- less than the 3 percent average of the 1960s, but the same as the 2.4 percent average yearly growth of the 1950s.

The respectable rate for the 1970s of manufacturing productivity growth came despite two back-to-back recessions and an underutilization of plant and equipment during most of the 1970s. The 1974 recession was so severe that it caused a 5.2 percent drop in productivity, the largest for any year since World War II. The recession of 1970 also caused a decline in productivity.

The decade of the 1950s also had two recessions, but neither was as severe as the 1974 recession. The decade of the 1960s was a long period of continuous expansion of output with only a slight slowing of growth in 1967.

Plant, equipment, and manpower was seriously underutilized during the 1970s which lessened the need for expansion and thereby slowed productivity growth. Plant and equipment utilization averaged only 81 percent in the 1970s compared with 85 percent in the 1960s and 84 percent in the 1950s.

Despite the severe recessions of the 1970s and the low utilization of plant, equipment and labor, productivity growth in manufacturing in the 1970s fared as well as that of the 1950s. And considering the marked difference in economic climate, the 1970s productivity growth compared very well to that of the 1960s.

Productivity in manufacturing is not slowing down -- but manufactured goods are a declining share of total output and manufacturing now accounts for only 29 percent of total hours of work in the private business economy.

The slowdown in measured productivity for the total private business economy results primarily from non-manufacturing data which do not have the reliability of manufacturing data. The data are so poor for construction, finance, insurance and real estate services, and other sectors that the slowdown in productivity may be entirely a measurement problem rather than an actual slowdown. In fact, the government's productivity figures in these sectors are based largely on the flow of money rather than the number of goods and services actually produced.

Construction, finance, insurance, real estate and services account for about 23 percent of all hours used for measuring productivity in the total private business economy. The growth of these sectors and relative decline of manufacturing adds a downward bias to measurement of productivity in the total private economy.

The inadequacies of measurement of productivity in these sectors and the probability that productivity is vastly understated in these sectors means that the downturn in productivity in the 1970s may be a problem of measurement and not reality. The lack of any decrease in the more reliably measured manufacturing productivity despite the poor economic climate of the 1970s strengthens this conclusion.

Concentration on doubtful statistics concerning productivity growth and unit labor costs for the total private economy may seriously distort an understanding of inflationary pressures in the economy. Productivity has been robust in manufacturing and continues to contribute substantial real gains to the economy. In the non-manufacturing sectors, the true extent of productivity growth may have been seriously understated.

Productivity Growth by Industry^{/1}
(Percent Change Per Year)

	<u>1949-59</u>	<u>1959-69</u>	<u>1969-77</u>
Manufacturing	2.4%	3.0%	2.4% (Includes 1978)
Transportation	2.9	3.6	2.3
Communicaton	4.8	5.0	6.2
Agriculture	6.2	5.5	4.9
Electric Gas and Sanitary Services	6.6	4.7	1.7
Services	1.3	1.9	1.2*
Finance Insurance and Real Estate	1.6	1.2	1.2*
Retail Trade	1.8	3.0	1.3
Construction	3.0	1.9	-1.9*
Mining	4.1	4.3	-3.2

/1 Data for manufacturing and agriculture are from yearly indexes.
All others are from least squares trend lines.

*BLS does not consider these data to be of sufficient quality to be published separately. The data are released only as a means to aid in understanding the movements in productivity measures.

Source: Bureau of Labor Statistics

CPI Increase 1976-1978
(December-December)

	<u>1976-77</u>	<u>1977-78</u>	<u>Total</u> <u>1976-1978</u>
Necessities	8.4%	10.7%	20.0%
Food	8.0	11.7	20.6
Shelter	8.7	11.5	21.2
Fuel & Utilities	8.1	6.0	14.6
Medical Care	8.8	8.9	18.5
Other	4.7	6.7	11.7
All Items	6.8	9.0	16.4

CPI is Consumer Price Index for Wage Earners and Clerical Workers.

- NOTE: 1. "Necessities" make up 57 percent of all items in the index. In 1977 and 1978, they accounted for over two-thirds of the increase in the index.
2. Had the cost of necessities stayed constant from December 1976 to December 1978, the CPI would have risen by 5.0 percent over the 2-year period compared to the 16.4 percent actual increase. The annual average rate of increase during the period would have been only 2.5 percent -- 68 percent lower -- than the actual annual average rate of 7.9 percent.

Source: Bureau of Labor Statistics. "Necessities" index computed by AFL-CIO.

Statement by the AFL-CIO Executive Council

on

The Federal Budget

Bal Harbour, Fla.

February 19, 1979

The Administration's proposed cuts, made at the expense of vital social programs, are too great a price for the nation to pay in order to achieve a miniscule reduction in inflation. In fact, the cuts increase the risk of recession.

The proposed budget is \$12.6 billion less than is necessary simply to maintain current services. This will result in a decline in governmental services which will mean a reduction in the standard of living.

The cuts are concentrated in programs designed to help retirees, the working poor, students, the unemployed and urban residents. In human terms, the proposed budget is a disaster; in economic terms, it is illogical.

According to Congressional Budget Office estimates, each \$10 billion in budget cuts will reduce inflation by only one-tenth of one percent. Thus, in order to reach an arbitrary goal of bringing the deficit down to \$29 billion, the Administration has proposed a budget which could well prove counterproductive.

Indeed, if the last Congress had not given the wealthy and corporations an unnecessary tax cut, more revenue would be available.

If a recession develops, these proposed budget cuts will actually lead to a larger budget deficit as a result of declining tax revenues and increased social costs.

In many programs, the budget would freeze or reduce spending -- especially for domestic human services and aid to state and local governments -- at a time when inflation is accelerating. This means that the government's buying power -- like the buying power of workers -- will be reduced.

Federal Budget

We are especially troubled by the adverse impact the proposed budget would have on programs which directly affect people, such as those examples included in the addendum to this statement.

Cutbacks in education weaken America's commitment to the future; cutbacks in Social Security break the government's word to retirees, widows, orphans and the disabled; cutbacks in jobs programs, particularly CETA, deny the unavoidable federal responsibility to make the unemployed taxpayers rather than taxusers.

Additionally, the budget proposes to continue the blatantly discriminatory practice of denying federal workers pay raises they have earned and are due under law. There can be no justification for demanding a greater sacrifice in the fight against inflation from the government's own employees than from any other group.

The AFL-CIO believes that the federal budget must embody more than tables of statistics, because it is through the budget process that the nation provides opportunity to those who have none, assistance to those in need, and services which enrich the quality of life for all. We believe the budget should be a commitment to the future of this country, not a testament to antiquated economic theories.

The Executive Council calls upon the Congress to adopt a budget which adequately and appropriately reflects the nation's needs. Those needs can not be calculated on a mathematical formula based on a declining percentage of the nation's GNP or by any other mechanical approach.

Congress must also reject the notion that inflation must be fought through recession and rising unemployment and it must continue this nation's commitment to full employment, the eradication of poverty, and investment in public programs and services essential to progress.

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ADDENDUM TO THE STATEMENT ON THE FEDERAL BUDGET

In arriving at its "austerity" budget, the Administration has proposed severe cutbacks in numerous programs benefitting working people, minorities, and the poor and providing jobs for the unemployed.

Some examples are:

*CETA -- The budget calls for a \$1.5 billion decrease from Fiscal Year 1979, a cut that is magnified by the increased costs of inflation. Title VI, counter-cyclical public service employment, job slots would be reduced by 240,000 by the end of 1980. Title VI, fully funded and using the Administration's unemployment estimate, would provide 440,000 job slots.

The summer youth program would be reduced by 250,000 slots.

National outreach and training programs would be emasculated. Such programs include the on-the-job and apprentice programs of the AFL-CIO and many of its affiliates, and other special programs servicing the nation's black and Hispanic communities.

*Education -- While the Administration has proposed increases for the educationally-disadvantaged youth attending elementary and secondary schools, it calls for the elimination of impact aid funds for children of federal employees who do not live on federal property. Other elementary and secondary education programs are maintained at 1979 levels, or, in the case of handicapped students, funded at levels below previous commitments. The result is a cut in services because of the impact of inflation.

In the area of higher education, while the Administration calls for full funding of such programs as Middle Income Student Assistance, according to the Congressional Budget Office, it underestimates the number of eligible students and, thus, provides insufficient funds.

*Health -- The Administration's training cuts imply a shift from using the Federal government as a means to help increase the supply of health professionals. Aid to nursing and medical students is sharply cut back. No funds are proposed for the start of any national health insurance program.

Addendum-Federal Budget

*Social Security -- Proposed cuts in Social Security either eliminate or reduce existing benefits. These cuts include:

-Abolition of benefits to deceased workers, dependent children between the ages of 18 and 22 who are fulltime students.

-Elimination of the \$255 lump-sum death benefits which help pay funeral costs.

-Elimination of the minimum benefit of \$122 a month for persons with low earnings under covered employment.

-The cut off of benefits to widows and widowers when the youngest child reaches 16 instead of the present 18-year cutoff.

-Reduction in Social Security benefits for persons receiving civil service pensions.

-Denial of disability benefits to many now eligible.

*Housing -- The Administration proposes reducing Section 8 and public housing units by 60,000. This is insufficient funding for other housing programs.

*Child Nutrition -- Administration cuts include: reducing subsidies to middle income students for school lunches, eliminating the special milk program in schools operating lunch or breakfast programs, and tightening eligibility requirements for free and reduced-price school meals.

*Food Stamps -- the Administration has called for a reduction in funds below the 1979 level. Given the sharply rising cost of food, such a reduction means a substantial cut in benefits.

*Worker Protection -- While funds are provided for the OSHA enforcement positions added last year by Congress, the Administration has suggested no additional funds for positions necessary to provide adequate health and safety job protection.

*Public Works -- The Administration's budget includes no additional funds for public works -- not even the so-called "soft" program it advocated last year or stand-by authority for regular public works triggered to increasing unemployment.

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Statement by the AFL-CIO Executive Council

on

Unemployment CompensationBal Harbour, Fla.
February 26, 1979

For more than 40 years unemployment compensation has been the nation's first line of defense against hunger and suffering for millions of jobless workers and their families, particularly in times of recession.

Unfortunately, the unemployment compensation system has become less and less capable of doing its essential job of forestalling poverty for the unemployed and their dependents, because it is based on an ill-matched federal-state sharing of responsibility for a national problem. The system is inadequately financed and provides benefits that are far too low to meet the basic needs of the millions of Americans who must look to it for protection.

The AFL-CIO has long urged major improvements in unemployment insurance aimed at shoring up the system. Such action could have been taken during the recent period of declining unemployment, but except for a much needed extension of coverage to nearly all workers, the need for strengthening the program was neglected in favor of creating yet another study commission to examine the program.

This commission is not scheduled to issue its final report until March 1980. Clearly that will be too late for millions of Americans who will be forced to rely on unemployment insurance in the intervening months.

Therefore, we call for the following immediate changes in the unemployment compensation law:

1. Establish a federal minimum benefit standard of two-thirds of the worker's wage up to a maximum of three-fourths of the state-wide average weekly wage. This is absolutely essential to prevent severe reductions in the incomes and living standards of workers who lose their jobs through no fault of their own.

2. Extend the present maximum 39-week duration to 65 weeks. For the long-term, we call for consideration of an extended benefit program which in good times and bad would offer jobless workers income support and employment and training services appropriately geared to the duration of their unemployment and labor market conditions. But with the prospect in the coming months of a large increase in unemployment and many more workers jobless for long periods, such long-term action would be too little and too late.

3. Extend coverage to all workers now excluded. It is unconscionable to deny unemployment compensation protection to any worker including those farm and domestic employees now excluded.

4. Provide federal financing from general revenue for benefits paid to workers after they are unemployed 39 weeks and reimburse states for disbursements they made beyond basic payments for the period January 1975 - January 1978. Taken as a whole, the unemployment insurance system is still in debt resulting from the tremendous financial pressures placed on it during the last recession. It is certainly ill-equipped to take on an additional financial burden now. Massive unemployment during an economic recession is a national problem, and it must be met with the financial resources of the federal government.

The emergency actions we are calling for are no substitute for the long-term improvements we continue to recommend. These would include not only an effective program to meet the needs of the long-term jobless but also federal standards which would:

- * Require removal of harsh state eligibility and disqualification provisions.
- * Establish minimum solvency standards for state funds.
- * Eliminate the worst abuses of the so-called experience rating system.
- * Provide for improvements in the administration of the program.

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Statement by the AFL-CIO Executive Council

on

Family FarmersBal Harbour, Fla.
February 26, 1979

The issues being raised by America's family farmers, through the American Agricultural Movement and other traditional family farm organizations, go to the heart of America's economic problems and deserve more serious consideration and action by the government than is evident thus far.

* The growth of corporate farming, which is driving many farm families from agriculture, raises questions about food monopolies and concentrations of corporate power dominating the nation's vital food supply.

* The role of commodity speculators, who add to inflation in food prices through paper profits, must be regulated to increase the farmer's share of the food dollar without driving up consumer prices.

* U.S. farm land is being purchased at alarming rates by foreign corporations and individuals, especially from the OPEC states. Control of productive farm land in the hands of foreign interests could seriously injure the nation's economic health.

* Family farmers also face serious international trade problems. Other nations subsidize their agricultural exports heavily. Since they do not require the health and safety standards the U.S. imposes on domestic agriculture, we believe the same standards should be applied to imports, and agricultural imports labeled as to country of origin.

* Exports of agricultural commodities are presently conducted by corporations who act in their own self interest and usually to the detriment of family farmers. We believe a mechanism, similar to the Canadian Wheat Board, should be established to promote and handle foreign sales of U.S. grain.

* High interest rate policies adversely affect family farmers, who must borrow money each year for planting and other expenses. Since credit is not allocated to such vital needs as agriculture, farmers are forced to compete for loans against speculators and corporations. This further drives up the farmer's interest payments, increasing the cost of food.

We believe that agricultural policy should be based on the principle of a fair return to family farmers for their labor. Price supports and other programs should be strictly limited to family farmers and denied to corporate farms and other absentee owners.

If policies to help the family farmer are not quickly adopted, consumers could be left at the mercy of corporate monopolies, and the nation could lose the rich heritage family farmers have provided.

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Statement by the AFL-CIO Executive Council

on

HousingBal Harbour, Fla
February , 1979

The drastic January decline in housing starts marks the beginning of the expected housing slump. It will aggravate the already existing, major national housing crunch.

Not enough homes are being built to meet demand, forcing up housing prices and rents. Interest rates continue to climb, making housing unaffordable for millions of families. The net result of a decline in residential construction will be increases in unemployment, starting in the construction trades and rippling throughout the economy in industries which produce and distribute housing materials.

Each year the nation needs 1.55 million housing units just to accommodate new households. In addition, more units must be built to provide for mobility through higher vacancy rates and to replace units lost due to demolition, fire, flood and other disasters. Thus, there is a total annual need for 2.4 million units, without any allowance for replacement of substandard units which are presently occupied.

An estimated five million occupied housing units have serious physical deficiencies and should be replaced or rehabilitated within a reasonable time period. Thus, the annual housing requirement is three million new or rehabilitated units.

Since 1973, the average annual total of new housing unit starts was less than 2 million per year, including 330,000 mobile home shipments. The result of this shortfall of one million housing units a year is inflationary. It is also socially unacceptable because it forces millions of low and moderate-income families, the elderly and minorities to endure inadequate and often substandard housing conditions.

Because a recession in the housing industry always precedes general economic declines, the AFL-CIO urges strong actions to boost housing production and maintain it at a high enough level to meet current and future needs. Specifically, we support:

* Releasing the \$1 billion in standby authority for emergency assistance for the Government National Mortgage Association for single-family homes as soon as a depressed housing market threatens.

* Reducing the 7½ percent ceiling on mortgage interest rates under tandem plan financing to 6 percent. The law -- Title III of the National Housing Act, Section 313 -- only stipulates that a mortgage interest rate of 7½ percent is the most that can be charged. Therefore, legally, there is no reason why the interest rate could not be lowered.

* Lowering the interest rate for HUD Section 235 homebuyers from the current 4 percent to the 1 percent statutory minimum. Such an action would enable low-income families to buy homes, thus, stimulating the production of tens of thousands of additional assisted homeownership units.

* Authorization by the President for the Federal Reserve Board to implement the Credit Control Act of 1969. Under that Act, the FRB could exercise selective credit regulation measures for the purpose of preventing housing from bearing the brunt of tight money policies.

Currently, the homebuilding industry is beginning to decline as money tightens and mortgage interest rates rise. At the same time, large amounts of credit are extended for corporate takeovers of companies, for foreign industries, and for international money market speculation and other non-essential purposes. Selective credit regulation would make many of these housing support programs less necessary because lower interest rates would enable more people to obtain housing without subsidy.

* Institution of mortgage revenue bond programs by municipalities. These tax-exempt revenue bonds would be used to finance low-interest mortgages, but the benefits should be restricted to families who cannot afford to pay private market rates.

* Establishing a Federal Housing Bank. Such a bank would assure that loans will be available at 5 to 6 percent interest -- and under special circumstances at lower rates -- for families below a given income level.

* Increasing the authorization for the debt service and operating subsidy programs in the Housing and Urban Development and Farmers Home Administration. Such programs assist low- and moderate-income families in acquiring homes and meeting monthly payments.

* Increasing the authorization for the Public Housing program, which provides rental housing for low-income families and elderly individuals in projects owned by local public housing authorities.

* Increasing the authorization for Section 8 Rental Housing Assistance to support additional units. This program provides low- and moderate-income families with leased standard rental housing units in privately-owned structures, employing a flexible subsidy, so that increasing utility and other operating costs can be met without raising costs of low-income tenants.

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Statement by the AFL-CIO Executive Council

on

Energy Prices and Supplies

Bal Harbour, Fla.
February 20 , 1979

At a time when inflationary fires are burning full blast, it would be ill-advised and untimely for the Administration to initiate measures to remove ceilings from gasoline retail prices and to decontrol crude oil prices. Both of these steps, now under consideration by the Administration, would increase inflation and dampen economic activity.

By the Administration's own estimates, gasoline prices would rise about 4 cents per gallon if controls are lifted. Others estimate the increase resulting from decontrol at a higher level. Each one-cent increase in the price of a gallon of gasoline would cost American consumers about \$1 billion a year.

Certainly, if the Iranian cutoff of oil continues and shortages develop, decontrolled gasoline retail prices would rise even more dramatically. Gasoline makes up about 46 percent of domestic oil products. Motor vehicles consume 90 percent of the gasoline.

Mandatory controls on crude oil prices expire on May 31, 1979. However, the President has the authority to continue controls until September 1981.

Decontrol of crude oil prices would have an even more devastating inflationary impact. If domestic crude oil prices were to rise to world levels, the direct cost to American consumers would be about \$14.5 billion per year.

In addition, there would be a ripple effect throughout the economy, the cost of which is difficult to calculate. In the past, the Library of Congress has estimated the ripple effect at $1\frac{1}{2}$ to 2 times the primary effect. In truth, decontrol of domestic crude oil prices is a submission to the OPEC cartel and establishes its prices as the U.S. price.

Obviously, the economy would suffer from such an action, and consumers would bear the burden of the effects of decontrol. Only the oil companies would benefit.

We therefore urge the President not to decontrol gasoline and crude oil prices.

At the same time, the Administration should immediately proceed with programs for both developing domestic energy supplies and conserving existing supplies. Recent developments in Iran demonstrate that America is still too dependent for a critical portion of its energy supplies on insecure foreign sources.

So long as there is the current unequal relationship between the Organization of Petroleum Exporting Countries, and the consuming nations, we can expect continuing oil price increases and resultant inflationary effects. For the U.S. this is compounded by the willingness of U.S. oil companies to cooperate in these price increase schemes. The only solution is for the U.S. to develop an import-purchasing mechanism at the governmental level which can deal as an equal with OPEC nations. We, therefore, call upon the government to establish an Energy Import Board, with sole authority to determine the level of U.S. imports and to allocate oil imports, to negotiate with suppliers to develop a purchase mechanism and to take any other steps necessary to end the stranglehold the OPEC nations and the major oil companies now have on the American economy.

While every effort must be made to increase domestic production of oil and natural gas, there is an urgent need to develop all alternate sources of energy. The two sources most likely to be of greatest significance in the short run are coal and nuclear power. The accelerated development of nuclear power and coal must be realized while protecting the environment and maintaining stringent safety and health standards.

The United States has about 450 billion tons of coal reserves -- more than 700 times the national annual usage. The country could double or treble coal consumption and still have reserves that would last more than 200 or 300 years.

Nuclear power currently constitutes a little more than two percent of total energy supply. The accelerated development of nuclear power could considerably enlarge that figure and make a major contribution to the resolution of the energy problem. To accomplish this, the licensing of nuclear reactors should be expedited and safe federal repositories established for nuclear waste.

At the same time, programs for development of alternative sources must be directed towards such other sources as solar, biomass, fusion, geothermal, gasohol, coal liquefaction and gasification, wind, tidal and any other sources.

Private industry, left to itself, cannot or will not develop the alternative energy sources needed by this country. For that reason, the AFL-CIO believes an Energy Independence Authority should be established to help achieve energy security for the United States, including the power to launch projects for the production and distribution of energy patterned after the TVA concept.

But the immediate threat of gasoline shortages means that the United States can no longer wait before implementing a conservation program that is fair, realistic and effective.

We believe any attempt to ration gasoline by raising prices, either directly or indirectly, is inherently unfair and will not work. Likewise we believe rationing based only on registered motor vehicles, without any provision for allocation on the basis of need, adjustment of inequities or the alleviation of individual hardship, must be prevented.

We urge the Department of Energy to consider more than just the views of industry sources. A program designed without meeting the concern of labor and consumer groups would be suspect on its face and would be certain to fail.

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Statement by the AFL-CIO Executive Council

on

Hospital Cost ContainmentBal Harbour, Florida
February 26, 1979

The AFL-CIO urges prompt congressional action on a hospital cost containment program which effectively reduces runaway inflation in hospital costs without providing additional burdens on already low-paid hospital workers. Hospital wages only account for 10 percent of hospital cost increases, according to the Council on Wage and Price Stability.

While we believe that the cost control features of the Health Care for All Americans Act are superior to single programs, such as hospital cost containment, we recognize that the fight against inflation requires immediate action on hospital costs.

The major factors in hospital cost inflation are duplicative services, unnecessary hospital beds, sloppy administration and unnecessary procedures. No voluntary effort will be successful to control these costs. And a program which totally ignores increases in professional fees would be a failure.

Therefore, we urge Congress to promptly consider a mandatory hospital cost control program, with appropriate safeguards for hospital workers.

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Background Report

AFL-CIO Executive Council

On

Hospital Cost Containment

Bal Harbour, Florida

February , 1979

In the last Congress, two hospital cost containment bills received serious consideration. One was an administration bill and the other was a bill introduced by Senator Talmadge (D-Ga.) entitled the Medicare-Medicaid Administrative and Reimbursement Reform Act.

At the Executive Council meeting on May 10, 1978, the AFL-CIO supported hospital cost containment in principal, but with the following reservations:

- * Hospital cost containment should not interfere with free collective bargaining in the hospital industry, and, specifically, there should be a provision for a pass-through of any wage increases negotiated for low-paid nonsupervisory hospital workers in the final legislation.
- * Except for six states that had, at that time, state hospital rate control commissions established and operating, any federal cost containment legislation should be administered by the federal government. If, however, the final legislation did allow more states to supercede the federal program, there would have to be a federal requirement that such state laws would also be required to provide a wage pass-through for nonsupervisory employees

Without these employee protections, the AFL-CIO made it clear to the Administration and Congress that the AFL-CIO would oppose passage of the legislation when it came to the floor of either the House or the Senate. Hospital workers continue to rank among the worst paid of all nonsupervisory employees earning an average of \$35 a week less than nonsupervisory employees in other industries.

Moreover, the Council on Wage and Price Stability in a staff report, "The Rapid Rise of Hospital Costs," showed that hospital wages were the source of only one-tenth of the increase in hospital costs. The main cause of inflation in hospital charges has been nonlabor costs.

In the final days of the last Congress, the Talmadge bill was reported out by the Senate Finance Committee and was debated on the floor of the Senate. Senator Nelson (D-Wis.) introduced an amendment that guaranteed workers in the hospital industry the right of free collective bargaining in any hospital cost containment program, federal or state, set up pursuant to the legislation. With strong support from the AFL-CIO and its affiliated unions in the hospital industry, both the Nelson amendment and the amended bill passed the Senate but not the House.

No hospital cost containment legislation was, therefore, enacted in the 95th Congress. The Administration has announced it will push for passage of such a bill in the current Congressional session.

The Nelson amendment gave the hospital industry an opportunity to implement a voluntary cost containment program. Only if the voluntary effort had failed would the mandatory cost containment provisions of the Talmadge bill, as amended, have become operable. The main reason why the AFL-CIO and its affiliates in the hospital industry supported the Nelson Amendment was that it would have instituted mandatory controls on hospital costs, in the event the voluntary effort failed, and would have left the wages of hospital workers subject to free collective bargaining.

To date, it does not appear the voluntary effort of the hospital industry to control hospital cost inflation is working. Therefore, if the voluntary effort continues to be inadequate, legislation assuring mandatory cost containment, with proper safeguards for hospital workers, is needed.

The AFL-CIO had some reservations with respect to the cost containment bill which the Senate passed. These included:

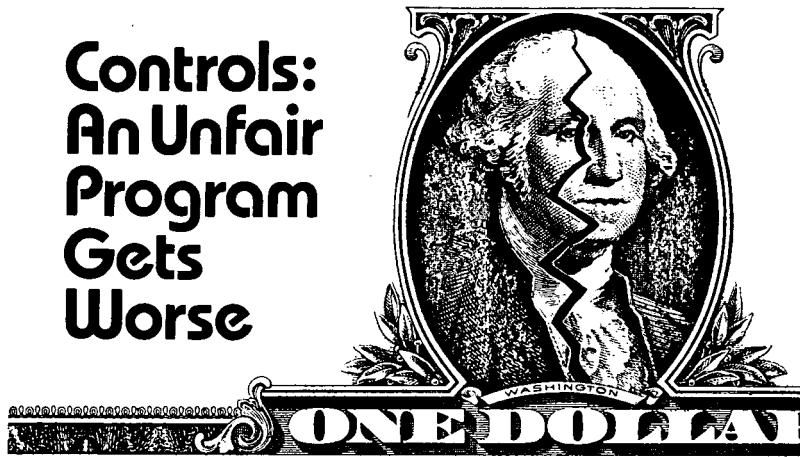
- * Whether legislation that focused solely on containing hospital charges could control total health care costs. It is too easy for hospitals to shift expenses from their own budget to the other segments of the health industry. For example, pathologists and radiologists can shift from salary to fee-for-service and bill patients for x-ray and laboratory work previously billed by the hospital. This decreases the on-budget costs of the hospital but increases total costs unless doctors' fees are also regulated. Effective control over health care costs can only be achieved when all parts of the medical care delivery system including hospitals, nursing homes, home health services and, especially, doctors' fees can be brought under budgetary ceilings.
- * Whether legislation focused on hospital cost containment would be compatible with a comprehensive and universal national health insurance program.

The Health Care for All Americans Act which the AFL-CIO supports would phase-in temporary cost controls over both hospital costs and physician fees until an administrative structure for implementing the Act could be established.

It is anticipated the Administration will shortly introduce a new cost containment bill. Senator Talmadge is also expected to re-introduce a revised version of his bill.

The AFL-CIO will support hospital cost containment legislation if it includes effective employee safeguards and is compatible with the stronger cost control features of the Health Care for All Americans Act.

Controls: An Unfair Program Gets Worse



The Administration's wage and price program is a one-sided wage control program with no appropriate procedures for redress of injury to workers, and with many workers harmed by the wage standards themselves. It proceeds from the mistaken notion that wages are the cause of the current inflation. It fails to deal with many of the major factors influencing inflation, particularly price inflation in the necessities of life—food, energy, medical care, housing and interest rates.

The Administration's program exempts many types of price changes. It sets a precise measure for wage changes, but a vague standard for prices. It basically ignores profits, dividends, rents and interest.

The price guidelines do not even cover all items—and indeed they do not even pretend to control the major causes of inflation. Additionally, the basic price deceleration guidelines allow those who raised prices the most in the past two years to profit further from that conduct.

For wages there is a single 7 percent number, easily remembered, widely publicized, applicable across-the-board, enforced by every employer in the

country, from multi-billion dollar corporations to the individual firm employing only a single worker.

The 7 percent is a maximum applicable to every employee unit. Not every unit will receive as much as 7 percent, but none may get more. The wage controls are self-enforcing—through the mechanism of employers anxious to cooperate with the government in holding down their employees' pay. There is no flexibility as far as wages are concerned.

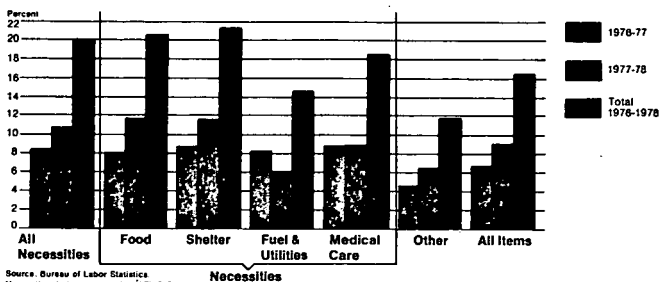
The price guidelines are a striking contrast. There is no single number. Coverage is not universal. There is no self-enforcing mechanism of organized resistance to price raises. Enforcement mechanisms are partial at best, and largely dependent on government's ability and willingness to dispense or withhold favors through regulatory and procurement contract mechanisms. This machinery has no basis in law and, in fact, constitutes a control program by indirection in the face of congressional action denying the Executive Branch the authority to institute controls.

The general public will have no way of knowing whether particular price increases—no matter how large—are in compliance or not. Because allowable rates of price increase are computed on the basis of individual company price histories, never before compiled and not on the public record, the individual citizen will have no means of making an independent check on compliance. Wide latitude is allowed for

THIS ARTICLE is taken from testimony by the AFL-CIO at House hearings in early 1979. The testimony was presented by AFL-CIO Legislative Director Kenneth Young and Research Director Rudy Oswald.

Principal Causes of Inflation, 1976-1978

Percent of Increase



price increases on particular product lines and particular products, and there are alternative methods of testing compliance other than through price deceleration.

There are actually several price guidelines in addition to the originally announced "price deceleration" guideline, and there are a number of important exclusions even from the price deceleration guidelines. Additionally, companies are allowed considerable flexibility in the choice of their accounting methods and in whether to report as a single company or as separate units within a single company.

Finally, and perhaps most importantly, there are certain situations in which no restraint applies. Essentially excluded, for all practical purposes, are the four basic necessities of life for the average family—food, housing, energy and medical costs. Thus there is little or no attempt to hold down prices on the items no family can do without.

Price Deceleration Standards

The program for "price standards" is complex, written in arcane statistical formulas, incomplete in coverage and so flexible as to accommodate practically any price increase a company might wish to put into effect. It is an elaborate structure of hocus-pocus.

• **Variety of Price Change Rates:** The general price deceleration standard calls for each company to hold its average rate of price increase in the year beginning Oct. 1, 1978 to 0.5 percentage points below its own average annual rate of price change from the last quarter of 1975 to the last quarter of 1977.

This produces a variety of price change rates, ranging from 1.5 percent to 9.5 percent. A minimum price increase of 1.5 percent is allowed automatically. The maximum to be allowed for the current "program year" is 9.5 percent, for companies that had increases of 10 percent or more in the 1976-77 period.

There is no logic to the notion that the companies with the largest price increases in the base period should continue to be allowed the largest price increases in the current year. A company's highly inflationary behavior in the past two calendar years hardly seems an adequate basis for preferred treatment in the current program. To be consistent with the wage controls, an overall maximum should logically be set for all products.

• **No Maximum for Product Line or Product Increases:** Within the company-wide overall average, there are no limits on price increases for either individual product lines or individual products. The sky is the limit as long as there are offsetting hold-down (or possibly decreases) that will keep the company's overall price increase average at least 0.5 percentage points below the overall 1966-77 rate of price increase. This will enable a company to hold down prices on products where competition is keen and engage in price gouging on products with little competition. The more lines a company has and the greater the number of products within product lines, the more leeway it has.

Since product line mix may have shifted considerably since 1976-77, an unknown element of artificiality is introduced into overall average price increase comparisons. This could be eliminated only by having the price deceleration requirements apply separately to each product line.

New and discontinued product lines are excluded

from the computation of average annual price increases. Custom lines are also excluded.

While some special treatment may be needed for such product lines, their exclusion aggravates the artificiality of price comparisons. "New products" introduced during the program year could be set at any price, without affecting the company's computed rate of allowable increase. In order to insure that "new products" do not become a major loophole, effective policing and enforcement is essential.

• **No Limit on Profits Except Wages Deceleration Pass-Through:** There is no limit on profits or profit margins for companies complying with the price deceleration standard. In particular, there is no requirement for a pass-through of cost savings a company might realize—say from a fall in raw materials prices or an increase in productivity—except for one item: a decrease in the rate of wage and salary increases.

It is doubtful that the pass-through of savings from wage deceleration by itself would have much noticeable impact on prices. While the Council on Wage Price Stability (COWPS) has constantly stressed the idea that wages, salaries and fringe benefits comprise 75 percent of company costs, this is only true in the special "value added" accounting used in the National Income Accounts. In the National Income Accounts, the cost of materials used in production is subtracted out, so there is little else to count in costs except wages and profits. In ordinary accounting, however, a company's cost for "materials"—a term which includes such items as energy in addition to raw or semi-finished production materials—are very much present.

According to a Standard and Poor study, wages, salaries and fringes as a percent of sales range down to 7 percent (for oil companies). Use of 7 percent in the wage deceleration pass-through example produces a total additional deceleration requirement of less than one-tenth of a percentage point.

A company can also increase its profits through manipulation of price increases for particular product lines and products—increasing prices for high profit items and hold them down on low-profit items.



Products Exempted

One section of the guidelines lists a number of product lines which sellers are told to exclude from their computations of average price increases. These are basic exemptions from price deceleration requirements (the aforementioned new and discontinued product lines and custom lines appear in this list, but except for custom lines, are not really basic exclusions). These exclusions cover raw materials prices (both farm and industrial), prices for scrap, prices for materials sold on commodity exchanges, and interest rates. Export prices are also excluded as are "product lines exchanged in other than open arms

length transactions," presumably intra-company sales.

The complete list includes prices of agricultural and industrial raw materials (including crude petroleum and natural gas); industrial scrap (metal scrap, wastepaper); prices of commodities whose historical and current price changes are closely tied to price movements in an organized open exchange; exports, with imports dropped from this list, but still excluded according to the COWPS Questions and Answers; prices of products delivered during the program year where price is determined by contracts existing before Oct. 2, 1978; prices of product lines exchanged in other than open and arms-length transactions; prices of new or discontinued product lines; custom product lines; interest rates.

The basic exclusions cover the most inflationary elements in the entire economy. The program speaks of dealing with them in other ways—through general government policies affecting their supply and demand. Additionally producers may be held to a "profit margin limitation" in lieu of a price deceleration standard. Where possible the buyers of such products are to be held to the price deceleration standard, but if they cannot do so, they too will use the "profit margin limitation."

• **Treatment of Sellers:** The effect of the exclusions varies according to which exclusions are involved and how important they are in the company's sales mix. Revenues remaining after excluding sales of raw materials, scrap, commodity exchange items, exports and items priced under pre-Oct. 2 contracts are called "adjusted net revenues." If "adjusted net revenues" are less than 25 percent of the total, the company is excused from any price or profit standard at all. If the other items on the exclusion list (intracompany sales, new or discontinued products, custom products, and interest rates) make up more than one third of "adjusted net revenues" the company is excused from the price deceleration standard and uses the "profit margin limitation" instead.

• **Treatment of Buyers:** The exempt items become a cost to other companies and distributors as they move into successive stages of production and distribution. These buyers are supposed to observe the price deceleration standards as far as their own prices are concerned. But if such costs are a large factor, it may develop that a company "cannot achieve" deceleration, in which case it too will be permitted to use the "profit margin limitation."

The ultimate impacts of the exclusions could be considerable.



The Profit Margin Limitation

Under the profit margin limitation, written as an "exception" to the price deceleration standard, a company is in compliance with the guidelines if (1) its "program year" profit margin does not exceed its "profit margin base" (i.e., the weighted average of

the two biggest profit margins during the three fiscal years ended before Oct. 2, 1978) and (2) its dollar profit does not exceed profit in the four quarters ended Oct. 1, 1978 by more than 6.5 percent plus the percent increase in real volume of sales. The profit margin is defined as operating profit as a percent of sales.

The standard is to be used by certain sellers of excluded products and by any company unable to "comply with the price deceleration standard because it is impossible to calculate its average price change or because of uncontrollable price increases in goods and services it buys." Uncontrollable cost items are not defined in the regulation, but presumably would at least include high costs of exempt raw materials and other items excluded from sellers' price deceleration requirements.

Under a profit margin standard, the effect is to allow a percentage pass-on of all cost increases, thereby enlarging total dollar profits and magnifying the price increase to the next buyer. The regulation does attempt to abate this effect by setting a dollar limit on profits. The formula could still generate considerable price increases however, in the case of a company with falling sales volume and shrinking profit margins in the program year. A simple dollar-for-dollar pass-through of "uncontrollable cost increases" would serve as a more effective check on prices.

Other Price Standards

In addition to the "price deceleration standard" and the "profit margin limitation," special "options" have been added for wholesale and retail trade, using gross profit as a percentage of sales, and for food manufacturing and food processing, using gross dollar profit margins. For professional fees, the average rate of increase in the program year is not supposed to exceed 6.5 percent and the increase for any single service is limited to 9.5 percent. Undoubtedly, further special options and alternatives for particular industries or types of enterprises are in the making.

Federal, state and local governments are included in the definition of "company" in the COWPS guidelines for pay standard purposes. For price purposes, however, only "government enterprises" are covered—port, transit, or water authority, public hospital, or municipal utility. User fees charged by a government body primarily supported by taxes are not covered.

According to COWPS' official Questions and Answers, companies starting operations after December 1977 are excluded from the price program, "since none of the required information is available." Such companies are expected to observe the pay standard, however, and to adhere to the "spirit" of the program in making their price decisions.

By its very nature, the price program cannot be monitored by the public at large. With each company having its own private rate of allowable price in-

crease, calculated according to its own confidential records, and with enormous leeway to vary its price increases to its own advantage, the public is helpless and in the dark.

The public will have to rely solely on COWPS to catch up with those who might offend its slippery standards, a job which COWPS is obviously not equipped to perform.

Price Laxity Shows in Profits

Profits in the fourth quarter of 1978 certainly show no signs of being affected in any way by the price guidelines. No expressions of concern are voiced by Administration officials or by COWPS about the substantial increases in business profits. Surging profit increases are not in keeping with the "austerity" and "sacrifice" which the Administration is urging upon the public at large, but evidently they are entirely acceptable under the anti-inflation program.

The Wall Street Journal recently reported, "Most companies will report fourth quarter profits well ahead of a year earlier." While the overall figures are not yet available, the reports for individual firms indicate a large surge in fourth quarter earnings, particularly among banks.

For example, Bank America Corp., the parent of the nation's largest commercial bank, reported its operating earnings surged by 34 percent for the final quarter of 1978 and by 30 percent for the year. Chase Manhattan reported a surge in fourth quarter operating income of 62 percent. Citicorp, parent of the nation's second largest bank, reported an operating earnings' increase of 28 percent while Manufacturers Hanover Corp., the fourth largest bank holding company, reported an increase of 12.9 percent. First National Boston Corp., parent of the First National Bank of Boston, also indicated a 21 percent climb in operating earnings for the fourth quarter with yearly earnings' increase of 33 percent.

According to a special survey of the 98 largest banks made by the investment banking firm of Salomon Brothers, the average gain in operating earnings came to 29.6 percent for the year and 25.8 percent for the quarter. According to the Jan. 29, 1979, New York Times report on the Salomon study, "Bankers and bank analysts cited the absence of jawboning, or public urgings from Washington, for banks to hold down their interest rates as a major reason for the impressive earnings. As interest rates surged throughout the economy, banks were able to keep pace by raising their own rates—in particular, the prime rate, the rate charged their most credit-worthy corporate customers. The most surprising thing is the lack of political pressure . . . But it hasn't happened. That's because we don't have people running around in Washington claiming that the bankers are raping the country."

In addition to banks, many other corporations have

The Lack of a Legal Basis

The Administration's program is described as "voluntary," but it establishes various penalties for those failing to comply. Penalties are the essence of a controls program and the antithesis of a "voluntary program."

In September 1978 the Senate passed a "sense of the Senate" resolution opposing the concept that wage-price or other stabilization policies be enforced by the direct or implied threat of administrative actions or decisions pursuant to various laws. That resolution pointed out that "the employment of such discretionary powers to promote unrelated, unauthorized and arbitrarily chosen wage/price objectives constitutes a fundamental abuse of executive power, would arbitrarily burden some sectors, industries and economic groups more than others depending upon the discretionary power to compel compliance available to the Executive Branch in each case, and is incompatible with our constitutional framework of divided powers, proper statutory delegation of authority, and legislative rather than ministerial pre-eminence in public policy-making." It also stated that "the use of such discretionary powers to compel compliance with specific, numerical wage and price standards amounts to a de facto wage-price control program."

The proposed use of the federal procurement process as the enforcement tool for the Administration's wage and price stabilization program is in labor's view unlawful. Congress has denied the Executive Branch the power to control wages and prices.

First, Congress chose not to renew the Economic Stabilization Act of 1970, the legislative authority for the wage and price controls promulgated by President Nixon.

Second, in passing the Council on Wage and Price Stability Act, Congress provided "Nothing in this act authorizes the continuation, imposition, or reimposition of any mandatory economic controls

with respect to prices, rents, wages, salaries, corporate dividends, or any similar transfers."

So there could be no misunderstanding, the Senate report stated: "This bill would grant no mandatory or standby control authority over the economy."

These legislative determinations cannot be avoided by the soft euphemism that the Administration's program is voluntary. However labelled, a system that provides the penalty of debarment for noncompliance with its standards is "mandatory" and is "wage-price control."

But even if this use of government procurement as an enforcement tool were not illegal, the regulations now in effect are discriminatory. The program does not provide due process and does not take into account the practical differences between separate classes of government contracts.

In a broadly diversified firm, a single violation of the wage guideline anywhere—even if inadvertent—could theoretically subject the firm to cancellation of the government contract, as well as to damages.

The price guidelines are so vague that for all practical purposes this is an enforcement of the wage guideline alone. Since data on price changes generally will not be calculated until some time in 1980, there is no effective way of determining price compliance.

The "termination for default" procedure not only deters a potential contractor from bidding but also allows the government to move against a contractor who has received an award for the costs of reprocurement.

The procurement process is not an appropriate means of enforcing a wage-price program. This should be done directly through appropriate legislative authority granted to a special body whose position it would be to enforce an economic control program.

shown substantial increases in the fourth quarter with Honeywell's profits up 56 percent, General Foods' profits up 79 percent, IBM up 27 percent, Mobil Oil up 10 percent and Alcoa's earnings up 124 percent.

Wage Controls

The 7 percent wage control figure lacks any conceptual basis. It is simply an arbitrary number.

Wage increases are based on many factors—increase in the cost of living including increased tax burdens, securing an appropriate share of productivity gains, maintenance of comparability with other workers, the employers' profitability, and other factors.

In one way or another, all previous U.S. mandatory wage control programs took these elements into consideration. The present program does not.

The 7 percent figure does not even maintain real income in light of a current inflation rate of 9 percent and the additional taxes levied on higher earnings. Previous programs allowed special consideration for improving fringe benefits. This program does not.

In the light of this 9 percent inflation rate, the wage control figure is well below the equivalent figure of the Nixon Pay Board in the wake of controls that Administration imposed in August 1971. At the time of that control program, prices were increasing at a 4 percent rate, the wage standard was set at 5.5 percent and the goal of that program was to reduce inflation to 2.5 percent in the coming year. The 5.5 percent wage standard assumed that workers were to receive an increase equivalent to the projected full cost of living (2.5 percent) plus 3 percent for the general increase in productivity. The current administration plan does not allow workers to participate in productivity gains.

While the current new program does provide a few minor exceptions, it ignores many of the exceptions contained in the Pay Board program of 1971. The Pay Board was required by Congress to allow for additional increases for special fringe benefits such as pensions and health plans. Such fringe benefits were provided by the Pay Board, an extra 0.7 percent over and above the general 5.5 percent wage standard. This new program does not recognize the special nature of pension and health benefits. Such benefits do not expand current demand for goods and services, but rather set aside money for these future contingencies.

Under the COWPS rules, increased costs associated with maintaining the first 7 percent of health benefits will be charged against the wage standards, as though the parties could control the costs. No earlier control program made such a charge. It is not fair to charge these against the wage standard while allowing employers to pass through other costs over which they have no control under the price standard.

A "catch-up" exception was also provided by the

Nixon Pay Board rules to allow workers with particularly low wage increases during the previous 3 years to catch up somewhat and negotiate increases 1.5 percent above the general overall standard. No "catch-up" exception is included in the present program.

Low-Wage Exemption

A low-wage exemption has been included in all previous control programs. In 1971, when the House amended the Nixon controls program, it clearly set forth the intent to assure that low-wage workers not bear the brunt of the program. In the report of the House Banking and Currency Committee the committee stated: "This section forbids the President, under the authority granted by this title, from regulation or otherwise restricting the wages of the working poor or persons whose earnings are otherwise substandard. It is the intention of the committee that this exemption from control apply to all persons whose earnings are at or below levels established by the Bureau of Labor Statistics in determining an income necessary to afford adequate food, clothing and shelter and similar necessities. Absolute exemption from wage controls under this act is also provided in this section for persons whose earnings are at or below the federal minimum wage."

In a Jan. 18, 1972 letter, Rep. Wright Patman, then chairman of the House committee, wrote: "It is the clear intention of Congress that the authority of this act should not be used to penalize wage earners by retarding progress toward achievement of an adequate standard of living. Certainly that standard of adequacy cannot begin much before the \$7,000 income level is reached. Granted, this would leave the income of a large number of the nation's workers unregulated under the act, but by the same token, no one is arguing that the wages received by these people and the wage increases granted to them constitute a major element in the inflationary conditions that prevailed before implementation of Phase I."

That same concern for the working poor should exist under this program. As set up by COWPS, it does not. The Department of Labor's lower level Urban Family Budget referred to in the 1971 amendments would today establish a low-wage exemption at \$5 an hour if the last published budget for the fall of 1977 were used. That amounted to \$10,481. If those figures were updated to the end of 1978 to reflect changes in the consumer price index (CPI), the lower level budget would be \$11,726, or \$5.64 an hour.

The low-wage exemption in the 1971 controls legislation was related to the lower-level Urban Family Budget. The Nixon Pay Board refused to abide by the legislative requirements and set the low-wage exemption at \$1.90 an hour. After court

proceedings, this figure was raised first to \$2.75 an hour and finally to \$3.50 an hour. Today that figure based on the same budget would work out to \$5.64 and not the \$4 set in the current program.

Current COWPS Procedures

The procedural rules set forth by COWPS are one more example of the one-sided nature of the so-called "voluntary" wage and price program. While these rules request firms to provide price changes or profit margins for 1976 and 1977, they do not provide COWPS with any enlightenment about current price changes.

The requested price and profit margin information is for the base period only, with no provisions for "follow-up" reports during the program year. Thus, no remedy has been established for the basic deficiency in the ability of COWPS to determine whether or not the companies are in fact complying with the price part of the program. Follow-up reports are not requested on either a quarterly or half-year basis to determine compliance with the profit margin tests on a quarterly basis or the half-year price deceleration requirement.

COWPS already has data on collectively bargained wages—available as public information—and on a current basis. As soon as a union contract is signed, it is public information and frequently reported in the newspapers for all to evaluate. Specific changes in non-union wages and changes in executive pay and perquisites are not regularly reported or matters of public knowledge.

Price increases are still basically not reported and not evaluated under COWPS procedural regulations. The procedural rules allow COWPS to interfere into even the smallest collective bargaining relationships as it stands ready to judge whether any contract, regardless of size, is in compliance.

Not so on prices. Only the largest firms are asked to supply any data on prices.

Companies with 5,000 or more employees are to file with COWPS information on "the method of computation" for the wage standard. But these data are not required to be furnished to unions directly related to such companies. Since this may in many instances affect union collective bargaining relationships, such information should be provided by the companies to all unions that have a relationship with such companies. Affected unions should have the ability to challenge the proposed method of "computation" for wage purposes.

COWPS illegally assumes for itself the authority to require prenotification and approval for wage and price exceptions. The issue of prenotification of wage and price decisions was considered by Congress when it was passing the legislation establishing and con-

tinuing COWPS. But that legislation does not include any provisions that grant COWPS the authority to require any prenotification on wages or prices.

COWPS rules set up COWPS as rulemaker, prosecutor, judge, and jury—with no procedure to guarantee a fair hearing, or a fair determination. The rules give to one unrepresentative administrative body control over the economic destiny of the country, and over the wages earned by millions of workers throughout the country. Substantive decisions may depend entirely on administrative "discretion." For example, COWPS allows an exception to the wage standard for a "gross inequity" but then arrogantly defines a "gross inequity" as "any situation that in the council's judgment, is manifestly unfair." It allows for no effective appeal from the council's unilateral determinations.

Only miniscule recognition of the necessary involvement of employees in COWPS procedures is accorded. The clear right of employees and their representatives to participate in all proceedings affecting them and to receive all communications concerning pay standards are not fully and expressly enunciated in the rules.

Coupled with the "reconsideration" procedures, the entire processing of a disputed issue could be an extremely time-consuming matter. Parties making requests and comments are held to strict time periods for filing documents, but the council reserves such time for itself as it may need to reach its determinations. The process could drag on for months.

The COWPS rules do not accomplish fairness and due process, because there is no recourse from an adverse or arbitrary council determination other than the council itself. No notice is given that an injured party could appropriately seek relief through the courts. The council promulgates the standards, interprets them, prosecutes them, enforces them, and is the judge of its own interpretations, all without statutory authority.

The system does not provide for comprehensive review by an adequate staff nor does it insure due process. The price standards need not be complied with by all firms, but just those that are government suppliers. The staff of COWPS is not large enough to carry out even the minimal monitoring program and cannot give firms and workers due process or a fair hearing.

Federal employees are singularly discriminated against by the current economic controls program. Wage and salary comparability laws provide that federal salaries are to be comparable to those paid in the private sector. Arbitrarily in 1978, a 5.5 percent limit was placed on federal salary increases, and that same 5.5 percent increase is projected for 1979. The wage control figure for federal workers, at 1.5 percent below the figure for all other workers, is clearly discriminatory and calls for a degree of sacrifice quite beyond that demanded of others.

Representative BOLLING. Congressman Reuss, would you please assume the Chair, I have to leave.

Representative REUSS [presiding]. Yes; thank you, Mr. Vice Chairman. Welcome, Mr. Oswald and Mr. Young.

I share Vice Chairman Bolling's evaluation that you have made a real contribution to our hearings this year.

In your prepared statement, Mr. Oswald, you are in the midst of listing hopes that the AFL-CIO had, and how they have been pretty much dashed. But when you get to point 7, a note of cheer enters, because there, you say—you quote from the need for community development—that the administration's proposed National Development Bank would facilitate such community development, and should be approved by Congress.

Actually, between the time that your prepared statement was sent to the mimeographing room and this minute, the future tense has changed to a future perfect tense. It should have read, "The administration's proposed National Development Bank would have facilitated such community development, and should have been approved by Congress," and so forth. It is too bad that it has now been withdrawn by the administration, and, hence, the Congress effort to approve it would run into presumed administration opposition, and the whole thing must, therefore, be forgotten about. Wouldn't that be a more accurate statement?

Mr. OSWALD. Yes. I was disturbed with that. One of the points the President made very strongly was that the National Development Bank was the backbone of what he proposed as an urban policy, approximately a year ago. There has not been the rehabilitation of some of the centers of depressed cities, as well as some smaller communities in rural areas. It was the hope that the National Development Bank would provide funds for that type of development, both through loans and loan guarantees, as well as, in some cases, some direct grants.

We have a separate statement of the executive council precisely on that point, because they also thought that it had such specific proposals for helping to bring jobs into areas.

Representative REUSS. Have you had an opportunity—I have not—to look at the fine print in that administration reorganization to see what they did with the money—I think it was something like \$3 billion in grants, loans, and guarantees—hitherto allocated to them, the proposed—but now defunct—National Development Bank?

Mr. OSWALD. At one point, I recall \$1.5 billion was allocated and I am not sure what the current plans are with the withdrawal now.

Representative REUSS. Do you know, Mr. Young?

Mr. YOUNG. I don't know.

Representative REUSS. I would like to ask the committee staff to determine that at this point, and let's have it in the record. I think it's very important.

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

President Carter's fiscal 1980 budget included a request for \$3.5 billion in new budget authority for the proposed National Development Bank. The allocation of the requested \$3.5 billion by activities is provided in detail in the following table:

NATIONAL DEVELOPMENT BANK

NATIONAL DEVELOPMENT BANK

(Proposed for later transmittal, proposed legislation)

Program and Financing (in thousands of dollars)

Identification code	95-3201-2-1-452	1978 actual	1979 est.	1980 est.
Program by activities:				
	1. Administration of the bank		4,236	12,423
	2. Interest subsidies (loan guarantees)			1,247,000
	3. Interest subsidies (long-term debt)			263,000
	4. Grants (EDA/Commerce)			275,000
	5. Grants (HUD)			275,000
	6. Liquidity facility (loan purchases)			1,000,000
	7. Disbursements for guarantee claims			32,000
	8. Payments to the Federal Financing Bank of interest on borrowings to purchase qualified debt			22,500
10.00	Total program costs, funded—obligations		4,236	3,126,923
Financing:				
14.00	Offsetting collections from: Non-Federal sources:			
	Sale of qualified debt to Federal Financing Bank			-500,000
	Redemption of defaulted loans			-1,100
24.40	Unobligated balance available, end of year:			
	Appropriation			404,600
24.47	Unobligated balance available, end of year:			
	Authority to borrow			500,000
	Budget authority		4,236	3,530,423
Budget authority:				
40.00	Appropriation		4,236	3,030,423
47.00	Authority to borrow (appropriation act)			500,000
Relation of obligations to outlays:				
71.00	Obligations incurred, net		4,236	2,625,823
72.40	Obligated balance, start of year			211
74.40	Obligated balance, end of year		-211	-2,431,232
90.00	Outlays		4,025	194,802

Source: The Budget of the United States Government, Fiscal Year 1980: Appendix, p. 1009.

Although the National Development Bank proposal has been withdrawn, a substantial proportion of the requested budget authority and program activities have been submitted by the President in S. 914, the National Public Works and Economic Development Act of 1979. The programs would be administered by the Economic Development Administration, U.S. Department of Commerce. The budget authority requested in the NPWEDA for fiscal 1980 includes:

1. Title I—\$90,780,000, for Economic Development and Adjustment Planning Assistance and Technical Assistance.
2. Title II—\$595,200,000, for Grants for Public Works and Other Economic Development and Adjustment.
3. Title III—\$569,350,000, to be appropriated for Development Financing programs, including direct loans and interest subsidies, plus \$1,800,000,000, to be authorized for loan guarantees.
4. Title IV—\$4,000,000, for Research, Evaluation and Demonstration.
5. Title V—authorizes the appropriation of such sums as may be necessary for the Administration of the act.

Representative REUSS. I know several hundred additional millions were allocated to UDAG, and if so, that is good, but—

Mr. OSWALD. Yes.

Representative REUSS [continuing]. I would like to see what happened to the total figures, if those total figures were maintained and if they are put in useful places, then we needn't cry forever at the bier of the National Development Bank. But if the doing-in of the bank is accompanied by a further belt tightening, you would share my nonpleasure at that; would you not?

Mr. OSWALD. Yes, yes, very much. The only additional money which we recall at all in the budget in that area was \$150 million for a new targeted aid to communities which is a very small amount of money in total.

Representative REUSS. Now, on these various youth employment programs and structurally unemployed programs—

Mr. OSWALD. Yes.

Representative REUSS [continuing]. Which, I agree with you, are vitally important, and which have been cut in the current budget, the administration tends to answer criticism of those cuts by saying, "Oh, no, we just cut off summer programs for middle-class kids and we don't really need it," and so on, and so on, can you comment on that?

Mr. OSWALD. On the youth program, the specifics are that the middle-class kids are not eligible, should not be eligible. If they were given any of the job slots, it was a misuse of the program. Clearly, the high levels of unemployment, particularly among black teenagers, in our country indicate the need for a continuation of that program. Those unemployment levels are still running well over 30 percent. In terms of the national manpower programs, which really were outreach programs and beginning skill programs, the amount of money that was cut was very small, \$50 million, but they were some of the most effective programs run by the Urban League, by the AFL-CIO itself, in terms of its Human Resources Development Institute, and a number of unions in terms of outreach, senior citizens, rural Americans. We were told that the administration didn't know, itself, what it was doing when it was cutting those programs. They thought it was some discretionary funds of the Secretary, and they just cut out \$50 million.

As to the \$1 billion cut on the CETA, that was not because people didn't think that those jobs didn't count, but just because it

became a victim to the attempt to automatically bring the budget deficit below \$29 billion.

Representative REUSS. I completely agree with the AFL-CIO and your testimony that funds to combat structural unemployment should have been increased, not decreased, in a time when, although you may not agree with—and don't agree with—the administration's specific fiscal and monetary policies, I would think and hope that the AFL-CIO would agree on a macroeconomic basis that we need moderate fiscal and monetary policies.

Mr. OSWALD. Yes.

Representative REUSS. We don't want to turn on all the steam and really create the demand inflation which some people say we are really suffering from.

Mr. OSWALD. We are in agreement with that, and our differences in terms of the total amount of the budget involve fairly small amounts of money. The cuts amount to about \$12 to \$15 billion, and the impact on inflation is very small, one-tenth of 1 percent. That is really not the inflationary problem.

We are concerned that with these cuts in the structural unemployment programs, cuts in social security, which people thought was an insurance to which they had benefits entitlement—that is what they paid for. We are not against budget cuts if the programs are no longer necessary or no longer of value, and we are not for deficits when we have full employment.

It's just that even at the current level of economic functioning, we still have substantial levels of unemployment, higher than other times, still fairly high levels of plant underutilization and most of the inflation pressures are coming from specific areas of the economy—the food sector, the energy sector, and housing, which is affected very heavily by the use of the monetary route to tighten the whole economy.

Representative REUSS. Having said that—as you have, I think—you would have much preferred to see a modestly greater budgetary allocation to the overall program of fighting structural unemployment, that doesn't mean that the AFL-CIO is cast in concrete on any one particular structural unemployment combating program, does it? I say that because, in my view—and I would like to ask yours—the CETA program, while it contains much that is good, also contains a lot of foolishness, and that, had there been appropriate restrictions and cuts in CETA, more than made up by additions to other programs for fighting structural unemployment, we might be better off. Would you agree?

Mr. YOUNG. Congressman—

Representative REUSS. Would you agree CETA is as good as it says?

Mr. YOUNG. I don't think you can solve the structural unemployment problem with any one specific Federal program, or, for that matter, any State and local program.

It's a package of programs that try and get at the problems.

As you know, CETA itself is a package. I think people in Congress, a lot of people around the country and, certainly, the media, talk about the public service employment features. There are many other features of CETA dealing with training, dealing with upgrading, dealing with outreach, title III, the one Mr. Oswald referred to,

consisting of the national programs to reach into the community where community-based organizations as well as various groups seek to bring structurally unemployed people into the private sector to provide jobs and provide skilled training.

I think the "soft" public works program that the administration originally proposed last year, and is no longer proposing, was a way of providing training and help.

The programs under title I and title II of CETA clearly get into this area. The countercyclical program has an impact because when those funds are out there, it obviously provides for other funds that can be utilized or should be utilized for structural-type programs.

Even the title VI countercyclical program of CETA, which is not aimed at the structurally unemployed, we feel, has a direct bearing, because as long as you have high unemployment among the semiskilled and skilled workers, then the private sector is not going to employ the structurally unemployed. They know that the skilled and semiskilled are more productive, more effective, and have more work experience. In fact, the semiskilled and skilled work force is long-term unemployed by definition, becomes structural, and that is counterproductive. I guess in summation, we look upon the structural unemployment problem as requiring a package of efforts, the only real way to get at it. We are not tied to one specific program. We have been trying to support many of them.

Representative REUSS. The administration's scenario for unemployment is to increase it from 5.8 percent to 6.2 percent in 1979.

Mr. OSWALD. Yes.

Representative REUSS. Let me ask you—one or both of you—this question. Suppose that you were asked to accept as a given fact that the budget deficit must be reduced to the \$29 billion which is the President's projected deficit. Do you not think, as I do, that even with that budgetary stringency, it would have been perfectly possible to heighten the attack on structural unemployment, spend somewhat more on it, in considerably better coordinated programs, and find the—not huge, as you point out—additional sums elsewhere in the budget, whether by plugging tax loopholes or doing away with this or that obsolete or counterproductive spending program, and, thus, by thickening the tax on structural unemployment, come out with an overall unemployment rate which doesn't go down? I'm being conservative, I'm saying, "Keep it at 5.8 percent."

Mr. OSWALD. Yes.

Representative REUSS. Couldn't that have been done, and isn't that the real tragedy of the administration's approach?

Mr. OSWALD. That is the real tragedy, because we spend large amounts of money through tax loopholes that nobody really looks at. Many of those loopholes go to the very wealthy in our society, where they escape paying the taxes that could be used to offset costs of worthy programs. One example of such programs is a union program which has trained many workers to become ironworkers through some of these manpower programs.

The spending is about \$2 million a year for that training. Well, the people who have gone from unemployment, from unskilled jobs, to working at jobs that pay over \$10 an hour, as ironworkers, and

paying taxes on that, more than pays off a couple of years of the spending for these structural programs. It is our concern that when you cut back, you really leave people for a long time in this pocket of nonproductive work, of not using their abilities that could be heightened through training programs, to bring them into the mainstream of the economy and move them forward.

That is what this budget, in essence, does.

Representative REUSS. And who knows better than you representatives of the AFL-CIO, there isn't a meeting of minds between you and the administration on the general question of what is called an incomes policy, wage price suasion, and so on.

The general view of the AFL-CIO is that it is unfair to ask working people to abide by a belt-tightening wage ceiling when so much of the rest of the economy is either uncontrolled, or sees its economic efforts crowned by profits and rewards unparalleled in the history of the Republic.

That's been one of the reasons why we don't have in this country what they have in Austria, where, as you know, at the beginning of the year, the Chancellor gets together with the representatives of business, and the representatives of labor, and they work out harmonious goals and the pot is sweetened for workers by some control over the structure of pricing and profits, and by a whole series of benefits, and by a practical guarantee of full employment.

If the AFL-CIO operated in Austria, do you think Herr Meany would be willing to sit down with his opposite number at the head of state and do some meaningful negotiating?

Mr. OSWALD. Congressman Reuss, undoubtedly we would be more than willing to sit down and do the negotiating on that type of issue.

Our whole concern is that the current program is so inequitable. As you well know, as chairman of the House Banking Committee, for example, the banks have come up with the largest increase in profits during the fourth quarter of last year ever, and it was the first quarter under this new program.

On the price side, the Council on Wage and Price Stability says we can't develop any guidelines even for the price mechanism of what banks charge in terms of their interest rates over and above the discount rate or anything else.

Mr. Meany, on many occasions, has indicated a willingness to cooperate in a national effort to try and curtail inflation in terms of the labor movement. It's very difficult, however, to do it if there is no one to negotiate with, and that is basically part of the problem.

Mr. YOUNG. What we find—

Representative REUSS. Are you talking about your opposite numbers in business or the administration?

Mr. OSWALD. Both.

Mr. YOUNG. What we find so hard to live with, Congressman, is that the employer finds it very patriotic to enforce the wage guideline and when we go to the administration and say, "How do we do something about enforcing the other side of the guidelines in terms of legislative proposals," we are told, "These are terribly complex, very difficult to deal with, and we just can't come up with an answer."

We have suggested, for example, that there could be an excess profit margin tax tied to the real wage insurance program as one way of raising revenue.

We, in our testimony before the Ways and Means Committee, Mr. Oswald and I, both talked about some of the inequities in that proposal, and said we would be more than willing to work with the committee and, also, suggested this type of tax.

Then, as I'm sure you know, the Joint Committee on Taxation gave us an estimate that the real wage insurance proposal, instead of costing the administration's estimate of \$2.5 billion, would probably go to \$5 or \$6 billion.

Again, we have said, "OK, one of the ways of recovering some of that revenue is to go the other route, and we will work with you, let's develop some fair proposals that, in effect, do put some degree of controls on something besides wages." And, again, we were being told, "We just don't know how to do it. We don't have the answers. It's complex. It's tough. The idea may have some merit."

The real way that we can see, the easy way we can do something about inflation, Congressman, is to put these guidelines in and then get some compliances from employers who say they'll live with them.

Our people just think that's terribly inequitable, and so do we, of course.

MR. OSWALD. I would like to add one other thing in terms of just the level. This is the first time that the wage guidelines, for example, in all of our experience with control programs, was just established in this fashion, so that the guideline is actually below the rate of inflation.

During World War II, workers under the most severe economic conditions were able to get increases in line with the rate of inflation under what was called the "little steel" formula. Even under the late Nixon program, there was the 5.5 percent guideline established when the rate of inflation was 4 percent, and it was predicted it would get down to 2.5 percent, and there would be a 3.5 percent productivity gain. Now, 7 percent guidelines exist when you have a rate of inflation of 9.3 percent, which means a real severe cut in workers' ability to just maintain their standard of living.

Representative REUSS. Well, what might have been is also a sad business to contemplate, but we still have a little time.

Maybe we would do better.

Turning to another subject, I like your approach to inflation very much, as I distill it from your statements and the attachments. It comes down to this, that while you recognize the need—as you said before—for moderate and sensible fiscal and monetary policies, that to try to tighten fiscal monetary policy until the pipsqueak is not going to combat the commanding heights of inflation which are concentrated, at least for the average family, on food, housing, energy, and health care—

Mr. YOUNG. That's right.

Mr. OSWALD. Yes.

Representative REUSS [continuing]. Which have been the big upward items, and that—you don't quite put it in these terms—it

makes no sense to have a heroic fiscal policy and a supertight monetary policy which is seeing a decline of M_1 in the last months.

Mr. OSWALD. Yes.

Representative REUSS. And an attempt, by Government action, to bid up the price of russet potatoes because they come from somebody's district, and bid up the price of sugar because that comes from somebody else's district, and bid up the price of winter tomatoes because they come from somebody else's district, and raise the price of gasoline because that comes from still another person's district.

Mr. OSWALD. Yes.

Representative REUSS. But we are, at one and the same time, making more inflation and flirting with recession when we do that. Is that a fair statement of your position?

Mr. OSWALD. That is a fair statement, Congressman. I wouldn't put it in terms of saying, though, that it is in relation, particularly, to any Member's district.

Representative REUSS. Of course not, you're more tactful. [Laughter.]

Mr. OSWALD. But I think, also, that part of the issue that we would like to look at is that part of inflation gets related to some of the trade pressures and other things. We get very concerned when there are big increases in domestic prices that may be related somewhat to the efforts of American buyers as they try and purchase items going out as exports. For example, in hides and leather goods, the wholesale prices went up 54 percent in 1 year, last year.

Part of that was caused by the decline in cattle slaughtered, but we also upped our exports substantially. Wheat prices went up substantially, about 25 percent. We also increased our exports of wheat about 29 percent. Yes, we need to encourage exports, but we shouldn't do it at the expense of a domestic inflationary impact. I think we need to look much more on some of this relationship between specific products and things.

Representative REUSS. Since leather goods are made in my district, I didn't mention that. Thank you very much. [Laughter.]

We are very grateful to you. I could visit with you all day, and I would like to, but we have another witness, and you have to get back to work. Thank you very much, Mr. Oswald and Mr. Young. We appreciate it.

Mr. OSWALD. Thank you.

Representative REUSS. We will now hear from the United Auto Workers. Mr. Howard Young, special consultant to the president, pinch hitting for Mr. Douglas Fraser, president, who, I am sorry to hear, has a common malady, the bad cold.

STATEMENT OF HOWARD YOUNG, SPECIAL CONSULTANT TO THE PRESIDENT, UAW, ACCOMPANIED BY JERRY TUCKER, LEGISLATIVE OFFICE

Mr. YOUNG. Thank you, Congressman Reuss.

Representative REUSS. Mr. Young, we have a comprehensive prepared statement from your president which, under the rule and without objection, will be received in full in the record.

You may proceed in any way you like.

Mr. YOUNG. I have with me Jerry Tucker of the UAW legislative office here in Washington. As you noticed, President Frazer has a very bad head cold, and just this morning called and asked if he could be excused and he apologizes to the committee.

What I would like to do if it is satisfactory with you is read some excerpts of the prepared statement we submitted and then try to answer any questions you may have.

The committee's work in reviewing the 1979 Economic Report of the President is especially important because it is the first report to be presented under the guidelines of the Humphrey-Hawkins Full Employment and Balanced Growth Act. That law is a commitment for the Congress and the President to move the Nation steadily toward full employment.

It is true that the law contains an inflation goal for 1983 of 3 percent along with the original goal of 4 percent unemployment. But the language of the bill specifically rejects "tradeoff" economic policies—efforts to hold down inflation by raising the rate of unemployment.

In establishing the inflation goal the law says unequivocally:

Policies and programs for reducing the rate of inflation shall be designed so as not to impede achievement of the goals and timetables * * * for the reduction of unemployment.

The act reflects the conclusion "that sole dependence upon fiscal and monetary policies or both to combat inflation can exacerbate both inflation and employment." It calls on the President also to initiate "specific targeted policies" or "structural policies" to reduce inflation.

Likewise, the Humphrey-Hawkins law retains its original thrust of stressing the need for Government action to meet national priorities. The act addresses the question of the share of gross national product accounted for by Federal outlays—but it does not explicitly seek a reduction in that share—only "the lowest level consistent with national needs and priorities." The bill also seeks to achieve a balanced Federal budget—but only if this is "consistent with the achievement of the medium-term goals" for unemployment and inflation.

THE TARGETS OF THE ECONOMIC REPORT

Unfortunately, we are forced to conclude that the 1979 Economic Report of the President walks away from the commitments made so recently in the Humphrey-Hawkins Act.

We are still being offered rhetorical statements that are encouraging. In his state of the Union address this year the President told the Congress and the Nation that "it is a myth that we must choose endlessly between inflation and recession." Rather, he said that we could "build the foundation for a strong economy with lower inflation, without contriving either a recession with its high unemployment or unworkable mandatory government controls."

In his economic message he promised, "We will not try to wring inflation out of our economic system by pursuing policies designed to bring about a recession. * * * Stop-and-go policies do not work."

Yet, when we look at the more detailed report of the Council of Economic Advisers—we find a clear message that the goal of stead-

ily reducing unemployment is to be sacrificed to an effort to reduce inflation by slowing down the growth of the economy.

The annual targets projected for the next 5 years reflect this tradeoff philosophy. The Economic Report does not recommend steady progress toward the goal of reducing unemployment to 4 percent within 5 years. Instead it recommends policies designed to increase unemployment from its current level of 5.8 percent to an average 6.2 percent for 1979 and 1980.

It then shows that very rapid reductions in the rate of unemployment "would be required" to reach the goal of 4 percent by 1983. The policies described would seem to be precisely the "stop-and-go" policies that the President assures us "do not work."

There is the very real danger that the "fiscal and monetary restraint" will overshoot its mark and plunge the economy into a major recession. The administration's goal is "to moderate growth without producing a recession."

But since 1948 we have had five periods of economic slowdown that lead the Nation into major recessions with sustained periods of high unemployment—beginning in 1954, 1958, 1960, 1970, and 1974. We should have learned by now that it is hard to flirt with recessionary forces without ending up by getting pregnant.

In short, the policies of this administration are skating on very thin ice. If the ice breaks—if we lapse into a recession—it is the working people of America who will plunge into the chilly waters. Indeed, it will be those workers with the least seniority—blacks, teenagers, women, and low-wage workers—who will suffer most from the increase in unemployment.

The administration is apparently willing to have them bear that risk. The Economic Report forecasts that its anti-inflation program of "fiscal and monetary discipline" will slow down economic growth and increase unemployment to 6.2 percent.

But it goes on to argue that "the inflationary problem can be dealt with most successfully by persisting with the discipline of anti-inflation policies for an extended period even if economic growth for a time should fall below the path that is now forecast."

I think that the verdict on this kind of approach was written 2½ years ago:

Now any system of economics is bankrupt if it sees either value or virtue in unemployment. We simply cannot check inflation by keeping people out of work.

Those words were spoken by Jimmy Carter before the 1976 Democratic Convention. I think they are as valid today as when they were spoken.

The second reason why the administration policies will not work is that they will make it far harder to achieve the goals of the Humphrey-Hawkins Act.

If we are to achieve the goal of 4 percent unemployment by 1983, we have 5 years in which to reduce unemployment by roughly 2 percent. If we begin now and apply ourselves steadily to the task, it will mean an average reduction of about four-tenths of 1 percent each year.

But if we spend the next 2 years going in the wrong direction—increasing unemployment to 6.2 percent in 1979 and 1980—that

will leave us with only 3 years in which to reduce employment by 2.2 percent.

The whole logic of the Humphrey-Hawkins Act is that the Government should gear up now for a vigorous but gradual assault over the next 5 years on the problem of structural unemployment. Instead, the administration proposes to slip backwards for the next 2 years—making the ultimate task all the more difficult.

The Joint Economic Committee has important new responsibilities under the Humphrey-Hawkins law. Section 302 requires the committee to report to the House and Senate Budget Committees its own recommendations for short-term and medium-term economic goals.

The deadline for that report is March 15—less than 2 weeks from today. If you agree with us that the employment goals in the President's Economic Report are inadequate—that they move away from rather than toward the goals of Humphrey-Hawkins—then we strongly urge you to propose an alternative set of goals.

Minimum goals for the next 2 years should be that they each carry us one-fifth of the way to the 5-year goal. We urge this committee, then, to propose as targets that the unemployment rate be lowered—from the 6-percent average for 1978—to no more than 5.6 percent for 1979 and no more than 5.2 percent for 1980. The 1980 target would thus be a full percentage point lower than the 6.2 percent proposed in the Economic Report—and represent 1 million fewer Americans out of work.

The common estimate is that that also would represent \$20 billion additional available for Federal purposes. Targets for subsequent years should also show steady progress—no more than 4.8 percent in 1981, 4.4 percent in 1982 and 4 percent in 1983.

For the next 2 years, clearly we must have a different mixture of policies if the economy is to continue to progress toward full employment.

Detailed comments on the 1980 budget proposed by the President are attached to the prepared statement. I shall not read those.

For now, I will only point out that the 1980 budget is too restrictive. In particular, we must not cut back on jobs programs in a time when unemployment threatens to increase. On the contrary, if we are serious about the goals of Humphrey-Hawkins we need an immediate expansion of jobs programs that are targeted on those workers with the highest rates of unemployment—including minorities, teenagers, and female heads of households—and on those areas with the highest rates—including our older industrial cities.

In addition, the present policy of monetary contraction must be reserved to help maintain demand for housing and business investment.

The conservative economist Milton Friedman has recently warned that maintaining the present restrictive monetary policy would eventually plunge the American economy into a recession. But going beyond the short-term dangers of recession, a faster rate of monetary expansion is needed to avoid choking off investments to renew our stock of housing and to stimulate productivity growth.

The Economic Report is frankly pessimistic that the Nation can reach the employment goals of Humphrey-Hawkins and maintain reasonable price stability at the same time. That pessimism will be

self-fulfilling if we maintain a business-as-usual approach to the employment goals of the bill and if we continue to stress aggregative solutions to problems that are structural in origin.

What I suggest today is that we adopt a positive, "can-do" attitude toward the employment goals—and we begin to think together of the new policy tools that must be created in the coming months if those goals are to be realized.

The Federal Government must create an active process of planning for full employment, including a command center located in the Executive Office of the President. Such a center would be a source of ideas for new programs to reduce unemployment in particular parts of the economy.

In order to reduce unemployment nationwide we have got to address the problem of "runaway shops"—manufacturing operations that are shifted from one part of the country to another, leaving behind workers without jobs and communities without tax bases. One part of that problem is the growing array of special subsidies and special tax cuts that States and local governments offer to new business.

We in the UAW have a simple name for this practice among the States: We call it "economic cannibalism."

Even when companies do not relocate, they use that interstate competition as a threat to extract new concessions from their home communities. They even pit one community against another within the same State, and efforts by State government to control that are undercut by the competition from other States.

We propose that Congress prevent the States or localities from imposing one level of taxes—or providing one level of services—for existing businesses, but providing much more favorable treatment for new or expanded businesses. States use other objectionable forms of competition—such as inadequate workers' compensation and unemployment insurance programs, and undercutting workers' collective bargaining ability. Better national standards are needed in those areas also.

There are, of course, other causes of economic dislocation. The potential unemployment should be avoided when possible, otherwise its impacts must be alleviated.

All across the country there are communities that stand under the shadow of sudden and substantial job loss. Those communities would welcome the creation of a standby program that might rescue their economic future if they should be suddenly struck by the closing of a major plant, office, or mine. Such a program should include standby public works and standby Federal procurement programs designed to meet national needs as well as to provide jobs. It might include temporary Federal subsidies under some circumstances. It should also include the availability of investment funds to help create a new and more permanent economic base for a stricken community.

We need a number of other steps to minimize economic dislocation and its impact on workers and their families. Plants should be required to give advance notice of a planned closing, with time allowed for negotiations with representatives of the workers and the community.

If a plant does eventually close, workers should be provided with substantial aid in seeking and in being trained for new employment and resettling in a new community. Employers should be required to guarantee transfer rights within a corporation and to cover the worker's reasonable expenses of relocating in a new community.

We should go beyond the notion that the only acceptable public job programs are ones sponsored by State and local governments. Many of our national needs will only be addressed through projects defined and conducted by the Federal Government. The Tennessee Valley Authority served to provide jobs while meeting broad regional needs during the 1930's.

Many of today's national needs—in such fields as transportation and energy—may best be addressed through public investments. A program of public investments—at the times and places where jobs are most needed—can be a useful tool in our movement toward full employment.

To adequately address the problem of localized unemployment we must adopt new ways of directing private investment to areas of chronic joblessness.

The existing investment tax credit is too often used to help finance the movement of jobs out of a community with high unemployment and into areas with low employment, or in other ways to undercut the effort to achieve full employment. It should be repealed.

If Congress feels that some tax incentive for investment is needed, then a targeted investment tax credit would be better than the present approach. Investment in areas of chronically high unemployment should be one of the eligibility conditions for that credit. Such investments could include structures as well as equipment installed in those areas.

From your earlier conversation, Congressman Reuss, apparently there has been some change in the National Development Bank proposal, but we still believe that a National Development Bank would be a useful way to direct investment to economically depressed areas.

These, and other Government actions, to more specifically direct the pattern of private investment would be preferable to the present efforts that rely on interest rates, generalized tax incentives, and hopes for satisfactory response from business.

We can still learn from experimentation. We would urge that the Congress move quickly to establish pilot programs in 8 or 10 communities around the country in which a variety of tools would be used to achieve full employment for the existing residents. These "full employment communities" should include a mixture of urban, suburban, and rural areas.

The employment programs established should be primarily federally funded but include a mixture of State, local, and Federal operation to insure that they cover a wide range of projects and tasks.

We should be aiming to create a permanent system of aid to areas of high unemployment to include both budgetary assistance and public service employment. At a time of general prosperity

such a system would primarily deal with areas of structural unemployment and meet priority needs neglected by the private sector.

But with a general economic downturn, the same system would be automatically triggered to provide jobs and budgetary relief to those areas hardest hit by recession. Only by operating both jobs and budgetary relief simultaneously can we avoid the sort of conflicts that arose during the darkest days of 1975 and 1976.

We need to retain vital public employees as well as to absorb new employees laid off by the private sector. Only the Federal Government can provide the resources to meet those needs in areas of high unemployment.

In conclusion, when last year and the year before our members and our allies marched and rallied for the passage of Humphrey-Hawkins, we took the goal of full employment very seriously. We thought the Congress took it seriously, and we thought the President took it seriously. Today, we must look to you in Congress to redeem our confidence.

The goal of reducing unemployment to 4 percent can be met—and it should be met. It cannot be met through conventional policies and conventional attitudes, but only through new exertions of intellect and of will.

This is our challenge today. By thinking and acting optimistically and creatively, we can yet achieve full employment and bring a new definition of security and prosperity into every home in America.

Thank you very much, Congressman Reuss.

Representative REUSS. Thank you very much, Mr. Young.

At this point, Mr. Fraser's prepared statement will appear in the record.

[The prepared statement of Mr. Fraser follows:]

PREPARED
STATEMENT ON THE
1979 ECONOMIC REPORT OF THE PRESIDENT
PRESENTED TO THE JOINT ECONOMIC COMMITTEE
BY
DOUGLAS A. FRASER, PRESIDENT
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE
AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW

March 2, 1979

I am Douglas Fraser, President of the International Union, UAW. It is a pleasure and a privilege to have the opportunity of speaking before this Committee on behalf of 1.7 million members of the UAW.

Your work in reviewing the 1979 Economic Report of the President is especially important, because it is the first report to be presented under the guidelines of the Humphrey-Hawkins Full Employment and Balanced Growth Act. Our union worked tirelessly over many years to secure passage of that bill. We judge the current Economic Report -- as we hope you will judge it -- by how well or how badly it reflects the mandate that Congress laid down when it passed Humphrey-Hawkins last fall.

The Meaning of Humphrey-Hawkins

There were times during the congressional debate on the Humphrey-Hawkins bill when we feared that it would be too loaded down with amendments to retain its original thrust. Now that the bill has become law, however, we can see its major purpose intact -- a commitment by the Congress and the President to move the nation steadily toward full employment.

The Humphrey-Hawkins law retains its original title -- the Full Employment and Balanced Growth Act of 1978 -- and it "declares and establishes as a national goal the fulfillment of the right to full opportunities for useful paid employment at fair rates of compensation of all individuals able, willing, and seeking to work."

It is true that the law contains an inflation goal for 1983 of 3 percent along with the original goal of 4 percent unemployment. But the language of the bill specifically rejects "tradeoff" economic policies -- efforts to hold down inflation by raising the rate of unemployment. In establishing the inflation goal the law says unequivocally: "policies and programs for reducing the rate of inflation shall be designed so as not to impede achievement of the goals and timetables ... for the reduction of unemployment." The act reflects the conclusion "that sole dependence upon fiscal and monetary policies or both to combat inflation can exacerbate both inflation and employment." It calls on the President also to initiate "specific targeted policies" or "structural policies" to reduce inflation.

Likewise, the Humphrey-Hawkins law retains its original thrust of stressing the need for government action to meet national priorities. The act addresses the question of the share of gross national product accounted for by federal outlays -- but it does not explicitly seek a reduction in that share -- only "the lowest level consistent with national needs and priorities." The bill also seeks to achieve a balanced federal budget -- but only if this is "consistent with the achievement of the medium-term goals" for unemployment and inflation.

The Targets of the Economic Report

Unfortunately, we are forced to conclude that the 1979 Economic Report of the President walks away from the commitments made so recently in the Humphrey-Hawkins act.

We are still being offered rhetorical statements that are encouraging. In his State of the Union address this year the President told the Congress and the nation that "it is a myth that we must choose endlessly between inflation and recession."

Rather, he said that we could "build the foundation for a strong economy with lower inflation, without contriving either a recession with its high unemployment or unworkable mandatory government controls." In his economic message he promised, "We will not try to wring inflation out of our economic system by pursuing policies designed to bring about a recession ... Stop-and-go policies do not work."^{1/}

Yet, when we look at the fine print -- when we read the more detailed report of the Council of Economic Advisers -- we find a clear message that the goal of steadily reducing unemployment is to be sacrificed to an effort to reduce inflation by slowing down the growth of the economy. We are warned that "a further reduction of the unemployment rate during 1979 would run some risk of generating excess demand and creating inflationary pressures in labor markets."^{2/} Beyond this, we are told that "to avoid creation of excess demand, economic growth needs to slow to a pace at, or somewhat below, the long-term potential rate of expansion"^{3/} -- in other words, too slowly to absorb a growing labor force.

The annual targets projected for the next five years reflect this tradeoff philosophy. The Economic Report does not recommend steady progress toward the goal of reducing unemployment to 4 percent within five years. Instead it recommends policies designed to increase unemployment from its current level of 5.8 percent to an average of 6.2 percent for 1979 and 1980. It then shows that very rapid reductions in the rate of unemployment -- to 5.4 percent in 1981 and 4.6 percent in 1982 -- "would be required" to reach the goal of 4.0 percent by 1983. The policies described would seem to be precisely the "stop-and-go" policies that the President assures us "do not work."

Let me be more specific about why I agree with the President that the policies he proposes will not work.

^{1/} Economic Report of the President, p.7

^{2/} Economic Report of the President, p.67

^{3/} Economic Report of the President, p.79

The Danger of Recession

There is the very real danger that the "fiscal and monetary restraint" that he advocates will overshoot its mark and plunge the economy into a major recession. The Administration's goal is "to moderate growth without producing a recession."^{4/} But since 1948 we have had five periods of economic slowdown that led the nation into major recessions with sustained periods of high unemployment -- beginning in 1954, 1958, 1960, 1970 and 1974. We should have learned by now that it is hard to flirt with recessionary forces without ending up by getting pregnant.

The Administration's program of economic restraint comes at a time of growing consensus among private economic forecasters that we are already on the brink of a recession. At the end of last year the six most prominent forecasting groups were coming in with an average prediction for 1979 of slower real economic growth and a substantially higher rate of unemployment -- 6.6 percent as against the 6.2 percent in the Economic Report.^{5/} The Congressional Budget Office places unemployment of 6.2 percent at the bottom of its range of predictions for the end of 1979 -- and can see the Administration's policies increasing unemployment to as high as 7.2 percent.^{6/}

^{4/} Economic Report of the President, p.79

^{5/} The individual estimates were:

<u>Forecast</u>	<u>Change in Real GNP</u>	<u>Unemployment</u>
Data Resources	2.0%	6.6%
Chase Econometrics	1.1	6.8
RSQE, University of Michigan	2.0	6.7
Conference Board	1.9	6.5
Wharton, U. of Pa.	2.6	6.2
Business Council	2.0	6.7

^{6/} CBO, "An analysis of the President's Budgetary Proposals for Fiscal Year 1980," January, 1979, Tables 2 and 4.

In short, the policies of this Administration are skating on very thin ice. If the ice breaks -- if we lapse into a recession -- it is the working people of America who will plunge into the chilly waters. Indeed, it will be those workers with the least seniority -- blacks, teenagers, women, and low-wage workers -- who will suffer most from the increase in unemployment.

The Administration is apparently willing to have them bear that risk. The Economic Report forecasts that its anti-inflation program of "fiscal and monetary discipline" will slow down economic growth and increase unemployment to 6.2 percent. But it goes on to argue that "the inflationary problem can be dealt with most successfully by persisting with the discipline of anti-inflation policies for an extended period even if economic growth for a time should fall below the path that is now forecast." ^{7/}

I think that the ultimate verdict on this kind of approach was written two-and-a-half years ago:

"Now any system of economics is bankrupt if it sees either value or virtue in unemployment. We simply cannot check inflation by keeping people out of work."

Those words were spoken by Jimmy Carter before the 1976 Democratic Convention. I think they are as valid today as when they were spoken. I think that they -- more than any new words I might utter today -- condemn the policies now being advocated by the Administration.

Moving Away from the Unemployment Goals

The second reason why the Administration policies will not work is that they will make it far harder to achieve the goals of the Humphrey-Hawkins act.

The enactment of these goals was not some hasty and reckless action of Congress foisted on an unwary Administration. Indeed, they are far more modest than what Mr. Carter advocated during the presidential campaign, when he said that a "reasonable" goal would be "3 percent adult unemployment at the end of four years."^{8/}

^{7/} Economic Report of the President, p.78 Emphasis added.
^{8/} Financial World, September 15, 1976.

This would imply a goal of overall unemployment of 4 percent by the year 1980. The goal of reaching 4 percent more slowly -- and the entire framework of the revised bill introduced in late 1977 -- was negotiated out over many months between the White House and representatives of Senator Hubert Humphrey and Congressman Gus Hawkins. From that time on the bill enjoyed the vocal support of the President.

If we are to achieve the goal of 4 percent unemployment by 1983, we have five years in which to reduce unemployment by roughly 2 percent. If we begin now and apply ourselves steadily to the task, it will mean an average reduction of about four-tenths of a percent each year. But if we spend the next two years going in the wrong direction -- increasing unemployment to 6.2 percent in 1979 and 1980 -- that will leave us with only three years in which to reduce unemployment by 2.2 percent -- requiring an average reduction of more than seven-tenths of a percent each year.

Here is what the Economic Report says about the problems of approaching full employment:

"Structural unemployment represents an unacceptable waste of economic resources and a severe social problem. But the problem cannot be dealt with by an expansive aggregate demand policy without generating further inflationary pressures the task must be addressed with measures ... aimed directly at those who cannot find jobs even in a relatively fully employed economy."^{9/}

Unfortunately, the President's budget message proposes cutbacks -- not increases -- in the levels of many of these structural programs.

At the same time that the Administration is planning an increase in overall unemployment it is proposing (in real terms) a 14 percent cut in outlays for employment and training and a cut as high as 12 percent in outlays for youth employment programs. It is also proposing to eliminate more than 400,000 jobs now provided under the countercyclical public service employment program -- a cut of some 58 percent.^{10/}

^{9/} Economic Report of the President, p.77

^{10/} Estimates by the Office of Management and Budget and the U.S. Conference of Mayors.

The whole logic of the Humphrey-Hawkins act is that the government should gear up now for a vigorous but gradual assault over the next five years on the problem of structural unemployment. Instead, the Administration proposes to slip backwards for the next two years -- making the ultimate task all the more difficult.

Alternative Targets

The Joint Economic Committee has important new responsibilities under the Humphrey-Hawkins law. Section 302 requires the committee to report to the House and Senate budget committees its own recommendations for short-term and medium-term economic goals. The deadline for that report is March 15 -- less than two weeks from today. If you agree with us that the employment goals in the President's report are inadequate -- that they move away from rather than toward the goals of Humphrey-Hawkins -- then we strongly urge you to propose an alternative set of goals.

In suggesting alternative goals our most important criterion must be that we aim to reduce the unemployment rate steadily between now and 1983. Minimum goals for the next two years should be that they each carry us one-fifth of the way to the five-year goal of reducing overall unemployment by two percentage points. We urge this Committee, then, to propose as targets that the unemployment rate be lowered -- from the 6.0 percent average for 1978 -- to no more than 5.6 percent for 1979 and no more than 5.2 percent in 1980. The 1980 target would thus be a full percentage point lower than the 6.2 percent proposed in the Economic Report -- and represent one million fewer Americans out of work.

Targets for the subsequent years should also show steady progress -- no more than 4.8 percent in 1981, 4.4 percent in 1982 and 4.0 percent in 1983. In fact, it will be easier to achieve the goals of Humphrey-Hawkins if we begin at a faster pace than I have described -- to allow room for a slower pace in the later years. But whatever the precise path, the 1983 employment goal is central to the purposes of the law -- and it can be met. We must have steady progress toward meeting that goal over the next five years.

Policy in the Short Run

For the next two years, clearly we must have a different mixture of policies if the economy is to continue to progress toward full employment.

Detailed comments on the 1980 budget proposed by the President are attached to my statement. I shall not read that, but request that it be entered in the record of this Committee's hearings.

For now, I will only point out that the 1980 budget is too restrictive. In particular, we must not cut back on jobs programs in a time when unemployment threatens to increase. On the contrary, if we are serious about the goals of Humphrey-Hawkins we need an immediate expansion of job programs that are targeted on those workers with the highest rates of unemployment -- including minorities, teenagers, and female heads of households -- and on those areas with the highest rates -- including our older industrial cities.

In addition, the present policy of monetary contraction must be reversed to help maintain demand for housing and business investment. From April 1975, to September 1978, the money stock (M_2) grew at an annual rate of 10 percent. But since September money stock has been growing at an annual rate of less than 3½ percent. This is far below what is necessary over the next few years to accommodate the inflation already built into the economy and to permit real growth of production and employment. It is true that -- as in many previous times of high interest rates -- money has been turning over faster than it was early last year. But this growth in the velocity of money is probably not sustainable.

The conservative economist Milton Friedman has recently warned that maintaining the present restrictive monetary policy would eventually plunge the American economy into a recession.^{11/} I do not propose to be the first president of the UAW to be less concerned about the dangers of recession than Milton Friedman. But going beyond the short-term dangers of recession, a faster rate of monetary expansion is needed to avoid choking off investments to renew our stock of housing and to stimulate productivity growth. The Economic Report repeatedly attributes much of our current inflation to an alleged slow growth of productivity, which it partially blames on a slowdown of business investment in recent years. A significant increase in the present growth rate of the money supply will be required for the banks to be able to finance continued growth of productive investment.

Chairman Miller of the Federal Reserve has lowered his target for monetary growth (again, M_2) from a previous range of 6½ to 9 percent to a new range of 5 to 8 percent. While we are concerned this may be too low a target, a shift to a more expansionary monetary policy is needed even to get into that lowered range. We urge that the Federal Reserve Board begin that shift immediately.

^{11/} Newsweek, February 19, 1979

New Tools to Reach Full Employment

The Economic Report is frankly pessimistic that the nation can reach the employment goals of Humphrey-Hawkins and maintain reasonable price stability at the same time. That pessimism will be self-fulfilling if we maintain a business-as-usual approach to the employment goals of the bill and if we continue to stress aggregative solutions to problems that are structural in origin.

What I suggest today is that we adopt a positive, "can-do" attitude toward the employment goals -- and that we begin to think together of the new policy tools that must be created in the coming months if those goals are to be realized.

I. A Planning Process for Full Employment

The Federal government must create an active process of planning for full employment, including a command center located in the Executive Office of the President. Such a center would monitor national and regional job developments, alert government agencies -- including the Federal Reserve System -- as to the impact of their actions on jobs, and be a source of ideas for new programs to reduce unemployment in particular parts of the economy.

It could also be charged with other important tasks: expanding the statistical basis for employment planning, developing comprehensive projections of labor supply and demand, providing systematic input into state educational planning, and fostering more detailed surveys of the causes and consequences of individual unemployment.

An important part of the process will be to consider major economic sectors -- such as housing, business investment, motor vehicles, and other consumer durables -- which are subject to large employment fluctuations. It is likely that development of policies targeted toward those sectors, would help achieve balanced growth of the total economy.

2. Ban on Interstate Competition for New Business

In order to reduce unemployment nationwide we have got to address the problem of "runaway shops" -- manufacturing operations that are shifted from one part of the country to another, leaving behind workers without jobs and communities without tax bases. One part of that problem is the growing array of special subsidies and special tax cuts that states and local governments offer to new business.

We in the UAW have a simple name for this practice among the states: we call it "economic cannibalism". If this country is serious about moving toward full employment, it cannot let a patchwork of state and local incentive programs lure jobs away from the workers who have held them for many years.

Even when companies do not relocate, they use that interstate competition as a threat to extract new concessions from their home communities. They even pit one community against another within the same state, and efforts by state government to control that are undercut by the competition from other states.

We propose that Congress prevent the states or localities from imposing one level of taxes -- or providing one level of services -- for existing businesses, but providing much more favorable treatment for new or expanded businesses. States use other objectionable forms of competition -- such as inadequate workers' compensation and unemployment insurance programs, and undercutting workers' collective bargaining ability. Better national standards are needed in those areas also.

Many states perceive that they have a strong vested interest in incentive programs for business expansion. Unfortunately, in the current climate of "dog eat dog", they do have such a stake. We ask them to look beyond the present climate to a time in which there is no need for one state to compete with artificial incentives because no other state is offering such incentives. When that time comes every worker in America will enjoy greater job security -- and we will be that much closer to our goal of full employment.

3. Economic Dislocation

There are of course, other causes of economic dislocation. The potential unemployment should be avoided when possible, otherwise its impacts must be alleviated.

All across the country there are communities that stand under the shadow of sudden and substantial job loss of the sort recently experienced in Youngstown, Ohio. All segments of those communities would welcome the creation of a standby program that might rescue their economic future if they should be suddenly struck by the closing of a major plant, office or mine. Such a program should include standby public works and standby federal procurement programs designed to meet national needs as well as to provide jobs. It might include temporary federal subsidies under some circumstances. It should also include the availability of investment funds to help create a new and more permanent economic base for a stricken community.

We need a number of other steps to minimize economic dislocation and its impact on workers and their families. Plants should be required to give advance notice of a planned closing, with time allowed for negotiation with representatives of the workers and the community. If a plant does eventually close, workers should be provided with substantial aid in seeking and in being trained for new employment and in resettling in a new community. Employers should be required to guarantee transfer rights within a corporation and to cover the worker's reasonable expenses of relocating in a new community.

4. Public Investment

As we consider how to create a full employment economy, we should go beyond the notion that the only acceptable public job programs are ones sponsored by state and local governments. Many of our national needs will only be addressed through projects defined and conducted by the federal government. The Tennessee Valley Authority served to provide jobs while meeting broad regional needs during the 1930s. Many of today's national needs -- in such fields as transportation and energy -- may best be addressed through public investments. There are new energy sources to be explored, and there are old railroad beds to be developed -- and there is no reason why these activities should be monopolized by the private sector. A program of public investments -- at the times and places where jobs are most needed -- can be a useful tool in our movement toward full employment.

5. Targeted Investment Incentives

To adequately address the problem of localized unemployment we must adopt new ways of directing private investment to areas of chronic joblessness.

The existing investment tax credit is too often used to help finance the movement of jobs out of a community with high unemployment and into areas with low unemployment, or in other ways to undercut the effort to achieve full employment. It should be repealed.

If Congress feels that some tax incentive for investment is needed, then a targeted investment tax credit would be better than the present approach. Investment in areas of chronically high unemployment should be one of the eligibility conditions for that credit; such investments could include structures as well as equipment installed in those areas.

A targeted credit would be more efficient; it would produce more desirable investment for each dollar of credit. Even if only part of the general tax credit were transformed into a substantially more generous targeted credit, there could be less tax expenditures, but greater incentive to draw private investment back to older industrial cities and depressed rural areas.

The Administration's proposal for a National Development Bank is a useful way to direct investment to economically depressed areas. The budget anticipates spending authority at about \$2.6 billion per year, between 1981 and 1984, for that Bank.

These, and other government actions, to more specifically direct the pattern of private investment would be preferable to the present efforts that rely on interest rates, generalized tax incentives, and hopes for satisfactory response from business.

6. Full Employment Communities

As we move toward a nationwide effort to achieve 4 percent unemployment, we can still learn from experimentation. We would urge that the Congress move quickly to establish pilot programs in eight or ten communities around the country in which a variety of tools would be used to achieve full employment for the existing residents. These "full employment communities" should include a mixture of urban, suburban and rural areas. The employment programs established should be primarily federally funded but include a mixture of state, local and federal operation to insure that they cover a wide range of projects and tasks. Such experimentation could, for example, evaluate partial wage subsidies as a means of easing the transition of workers from public service employment to the private sector.

7. Permanent Program of Countercyclical Aid

With the lapsing of authority and funding for the program of countercyclical budgetary aid to localities, there will be significant gaps in our aid to distressed communities.

Instead, we should be aiming to create a permanent system of aid to areas of high unemployment to include both budgetary assistance and public service employment. At a time of general prosperity such a system would primarily deal with areas of structural unemployment and meet priority needs neglected by the private sector. But with a general economic downturn, the same system would be automatically triggered to provide jobs and budgetary relief to those areas hardest hit by recession. Only by operating both jobs and budgetary relief simultaneously can we avoid the sort of conflicts that arose during the darkest days of 1975 and 1976. Mayors wanted to use federal jobs money to retain police who would otherwise be laid off, but federal agencies insisted that the funds be used to create new jobs. It is time to recognize formally that both needs must be met during a recession. We need to retain vital public employees as well as to absorb new employees laid off by the private sector. Only the federal government can provide the resources to meet those needs in areas of high unemployment.

We do not think that the President's proposals -- which will slash the level of budgetary assistance and target it on a very limited number of cities^{12/} -- will be adequate to meet the immediate and standby needs of local governments.

^{12/} The countercyclical program provided \$1.3 billion to local and state governments in FY 1978. By contrast, the Administration proposal would be for \$0.25 billion in FY 1979 and \$0.15 billion in FY 1980.

Conclusion: For many years the UAW has been active in the struggle to achieve full employment in America. We felt we had achieved a major victory with the passage of Humphrey-Hawkins, but today we are less sure. We had hoped that by today we would all be marching together toward the goal of 4 percent unemployment within five years. Instead, we are confronted with an Economic Report that begins by calling for a hasty retreat over the next two years and concludes by offering excuses for ultimate defeat. As we read the words of the Report, we begin to feel like the ancient navigators who set sail in search of the horizon and found it to be an ever-receding goal -- always visible, but somehow always out of reach.

When last year and the year before our members and our allies marched and rallied for the passage of Humphrey-Hawkins, we took the goal of full employment very seriously. We thought the Congress took it seriously, and we thought the President took it seriously. Today, we must look to you in the Congress to redeem our confidence.

The goal of reducing unemployment to 4 percent can be met -- and it should be met. It cannot be met through conventional policies and conventional attitudes, but only through new exertions of intellect and of will.

This is our challenge today. By thinking and acting optimistically and creatively, we can yet achieve full employment and bring a new definition of security and prosperity into every home in America.

UAW Comments on FY 1980 Budget Proposal

February 28, 1979

Last year, the UAW told Congress that the FY 1979 budget went in the right direction, but it did not go far enough. After examining the budget released last month, we have reached the opposite conclusion: the policies in the 1980 budget would take us too far in the wrong direction.

We have been also led to remember the events of some years back. In early 1975, the UAW estimated that a "bare minimum" program to fight recession and combat unemployment would take a deficit \$15 billion higher than what the Ford Administration had requested. At the end of that year, a deficit of that level had actually developed, not as a result of the more stimulative policies we urged, but as a result of lower revenues, higher public assistance payments, and other sequels to the depressed economy.

Congress must not allow that to happen again with this year's budget. The Administration's budget, if enacted, will end up showing a deficit almost as large as what it would take to bring it up to a current policy level right from the beginning. But it will do so at a cost of lost jobs, human misery, and lost income. In economics, as in health care, the right policy is prevention rather than cure.

The UAW cannot support this year's budget. Its statement of priorities runs contrary to our concept of good, effective, and fair government on several counts:

- * equity, as it plans a departure from the reformist social policies first devised and implemented in the 1960s;
- * sound economics, as its much-vaunted austerity would not defeat inflation but would raise unemployment;
- * meeting our national needs, as it advocates a substantial addition to a military budget which is already needlessly high.

We urge Congress to set aside those proposals that would reduce our nation's commitment to human resources and social programs below current policy level, and to finance the first installment of several long-overdue initiatives out of the excesses in the defense budget.

1. The 1980 Budget is Bad Economics

The Administration has pronounced inflation to be America's foremost enemy -- a threat to society's welfare, a cancer taking the heaviest toll from the poor and from those with low or fixed incomes.

Our union recognizes that inflation is a problem. We worry about it as we watch many workers, among them some of our own members, suffering disproportionately from the rapid rise in prices; as our retirees bitterly complain to us that their hard-won pensions are eroding steadily. Their problem must be met, but not with a cure that is much more painful than the disease, a cure that actually inflicts a "double whammy" on the people we are most trying to protect.

We should study past experience, with respect to inflation and the actions used to combat it, in order to better plan the future.

From a historical perspective, the recent average rate of inflation -- both at wholesale and at retail -- has been less than during previous inflationary periods starting in 1810. During the course of this century, there have been three inflationary bouts; the current one is the mildest.

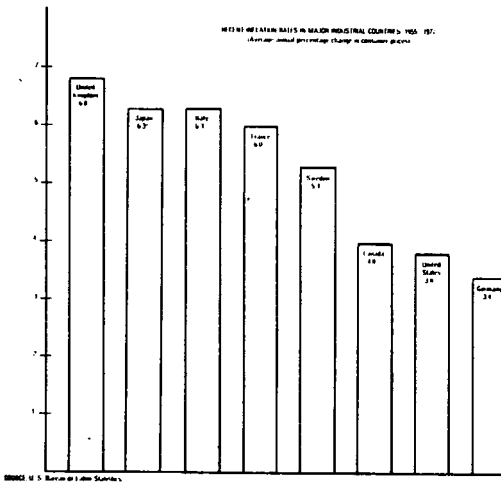
U. S. Inflation Rates During Periods of Inflation, 1810-1978*

Period	Average Annual Percentage Rate of Price Change	
	Consumer Prices	Wholesale Prices
1810-1814	7.6%	8.6%
1861-1865	14.2	20.0
1915-1920	14.6	17.3
1940-1948	7.0	9.7
1965-1978	5.8	6.1

* The interim periods show falling prices or prices growing at annual rates of under 2 percent.

SOURCE: Gardner Ackley, "Recent U.S. Inflation in Perspective". Paper presented at The 26th Annual Economic Outlook Conference, University of Michigan, November 16-17, 1978. Extracted from Table I.

If we take a shorter-run approach, i.e., the post-World War II period, comparative data (see chart below) show that the U.S. price record since 1955 is superior to that of each of the other major industrialized countries except Germany. (In recent years, this exception is mainly due to the less expansive policies that Germany has promoted since 1974.)



Every poll indicates that the American people are fed up with inflation. We suspect that what most working people are expressing to the pollsters is disappointment with their real incomes. And rightly so: in the last five years, average real weekly earnings (of nonfarm production or nonsupervisory workers) have dropped almost five percent. But this disappointment is scarcely a mandate to throttle the economy —which will inevitably require further sacrifices of real income.

The Administration has attempted to fend off criticism of its restrictive fiscal and monetary stance by pointing to its guidelines policy. Indeed, the wage and price standards were designed to cool the rate of inflation without relying exclusively on slowing the economy. When they were first established, we expressed our support and hope for their success in spite of many reservations about their fairness, equity, and administrative shortfalls.

Four months have gone by, and time is running out on the guidelines. Two items give a clue: On the one hand, producer prices showed an across-the-board annualized increase of 11.6 percent from October to January, which accelerated to 15.6 percent from December to January. On the other hand, the Wall Street Journal (2/15/79) reported that one survey of 634 big companies found that 73 percent have cut budgets for salary increases to 7.1 percent instead of the 8.5 percent previously planned. Thus, we are on a collision course. Even chief inflation adviser Kahn recently wondered "how long can we expect labor to come in with 7 percent when prices are rising at a faster rate." And his deputy John N. Gentry expressed "qualms of conscience" to try to hold unions to the 7 percent wage standard in the last half of 1979 if food prices soar in the first half.

The problem goes beyond a question of fairness. If wages and prices follow a divergent path long enough, we may be facing an economic downswing as a consequence of the biased application of the guidelines.

The proposed budget includes funds for the Real Wage Insurance (RWI) program, which the President has accurately described as an essential aspect of the price-wage guidelines. We have expressed our agreement and support of this program, along with a detail of our reservations about its design and implementation, to the House Wayne and Means Committee earlier in the session.

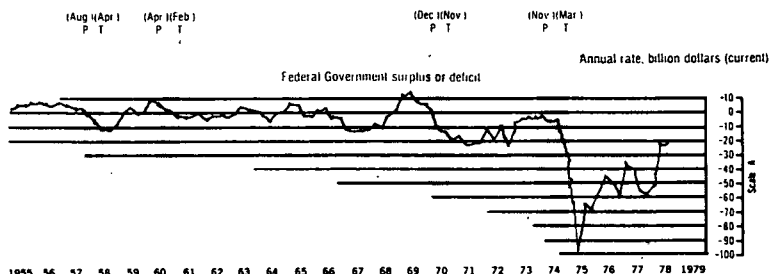
It should be emphasized that one of our criticisms of RWI rests on the lack of proposed funding beyond FY 1980. That is inconsistent with the Administration's repeated characterizations of the guidelines as a long term program; just recently CWPS stated that work is underway on guidelines for 1980. We believe that RWI must be provided for as long as guidelines restrain wages.

The Federal Deficit

We strongly object to the Administration's repeated reference to the government deficit as the cause -- or fuel -- of inflation. It is not good economics and it helps perpetuate a myth among the public.

To begin with, there is nothing intrinsically inflationary in the impact of a government deficit over and above its effects on aggregate demand. A recent Brookings study*, using a simple statistical model on 1954-1977 data, tests and rejects the hypothesis that there is a direct causal connection between budget deficits and inflation. The view that the present inflation is caused by deficits or that cutting the deficit would help eliminate inflation without causing recession should thus be put to rest. Historically, as shown in the chart below (where the shaded bars represent recession), most deficits have come from the operation of built-in stabilizers (unemployment compensation, public assistance, etc.) during periods of underemployment, or during periods of war.

* George L. Perry, "Slowing the Wage-Price Spiral: The Macroeconomic View" in Papers on Economic Activity, 1978, 2.



SOURCE: Business Conditions Digest,
U. S. Department of Commerce
December 1978

Rather than an attempt to divert additional resources from private to public use, the current deficit is still, to a large extent, the result of the 1974-75 recession and of the programs undertaken by the government to alleviate its consequences and stimulate the recovery. Current overall rates of utilization of labor and productive capacity do not suggest "overheating" which a somewhat larger deficit would exacerbate.

Second, no justification is given for picking a deficit limit of \$30 billion. In fact, the Administration's own OMB Associate Director was quoted as estimating that, were the deficit \$15 billion higher, only 0.2 percentage points might be added to the inflation rate.* The focus on a \$30 billion deficit appears to be a misguided public relations exercise on the part of the Administration. It must not distract the attention of Congress from the much more meaningful task of setting adequate figures for overall federal spending and for the different budget functions. In a 2.5 trillion dollar economy, unforeseeable domestic and international events (bad weather, OPEC pricing, the Iranian conflict) can have an impact on government finances which could easily translate into several billion dollars worth of government deficit.

* Wall Street Journal, 12/14/78, p.2

Third, as previously noted Germany is the only large industrial nation which has sustained a lower inflation rate than ours; but its government deficit as a percent of gross national product is larger than the U.S.

In fact, the U.S. deficit has been steadily dropping. As a proportion of GNP it is now only 1.1 percent; if we remove the effects of fluctuations in the economy, and look at the high employment concepts, it has come very close to zero:

Surplus or Deficit (-) as a Percent of GNP

<u>Calendar Year or Quarter</u>	<u>Actual</u>	<u>High-employment</u>
1973	-0.5%	-0.6%
1974	-0.8	0.2
1975	-4.6	-1.8
1976	-3.2	-1.3
1977	-2.5	-1.3
1978: I	-2.6	-1.4
II	-1.1	-0.4
III	-1.1	-0.4
IV	n.a.	-0.2

n.a. - not available

SOURCE: Economic Report of the President, January 1979, table 10, p. 46.

The President is publicly putting too much stock on the size of the deficit, and too little on the relationship of the deficit to the nation's productive capacity. There is a danger that this will boomerang; undue emphasis on the budget deficit is only buttressing the proponents of a balanced budget amendment, the latest and most far-reaching effort of the conservative groups to turn back the clock 50 years on issues of welfare, government intervention and regulation, society's responsibility to its needy members, and countercyclical economic policies.

The Administration's approach to the deficit is also seriously questionable on the grounds that, as a target, it is only approached from the side of the federal spending programs. No effort is afoot to reduce the vast amount of dollars given away as tax expenditures.

Yet, tax expenditures are found in all the budget categories into which direct spending programs are divided; indeed, there are many items of tax expenditures which should be cut before some of the proposed cuts in spending programs are made. Instead, they are the first to be funded — automatically. A recent study* examined several of the proposed reductions in the budget along with the pertinent tax expenditure categories, and found some glaring inequities. For example:

- * the special milk and lunch program for school children comes under OMB's knife for a proposed \$358 million cut — but the over \$2 billion subsidy for the well off in lavish meals and martini lunches on expense accounts remains untouched;
- * the \$255 survivor's benefit in the Social Security Act would be eliminated at a "savings" of \$206 million — but the exemption of tax on the gains in property transferred at death will continue at a cost of almost \$10 billion (most of it accruing to the top one percent of families);
- * low- and middle-income housing programs are being slashed by 17 percent — but tax preferences for real estate construction to the tune of \$1.3 billion have been spared.

Budget Receipts

The way to eliminate this defective and inequitable allocation of austerity measures — and of revenue dollars generally — is by carrying out a thorough reform of the tax code which would eliminate all of the unwarranted privileges that are now part of the law. None of this is proposed in the FY 1980 budget.

* Statement by Senator Edward M. Kennedy released January 14, 1979.

The UAW has long stood for justice in taxation. Congress made a mockery of the concept in its last session by enacting a bill that was grossly tilted to benefit the rich and business. We do not urge Congress to work for tax reform in this session; the political realities dictate otherwise. But in dividing up the pie of government spending, it should be remembered which groups got the biggest piece already.

The Economic Outlook

The Administration's budgetary policies will have little effect on inflation. However, along with the crusade of tight credit and slower growth of the money supply on which the Federal Reserve has embarked, these policies will have a recessionary impact on the economy.

That much is clear from a comparison between the pre-November economic forecast of CBO and its post-FY 1980 budget projections for the current year:

	<u>CBO Projections, 1978-1979</u>	
	<u>July 1978</u>	<u>January 1979</u>
GNP (1972 dollars, percent change, 4th quarter to 4th quarter)	2.7 to 4.2	-0.1 to 1.9
Inflation (percent change in the GNP implicit price deflator, 4th quarter to 4th quarter)	6.2 to 7.2	7.0 to 9.0
Unemployment rate (end of period, percent)	5.2 to 6.0	6.2 to 7.2

SOURCE: "An Analysis of the President's Budgetary Proposals for Fiscal Year 1980," Congressional Budget Office, January 1979, Tables 2 and 4; "Inflation and Growth: The Economic Policy Dilemma," Congressional Budget Office, July 1978, p. xii.

The table distinctly shows the slowdown imparted to the economy by these relatively recent policy measures; note the difference in real growth and in the unemployment rates. Most private economists and econometric models agree with CBO: they now forecast very small or negative growth for late 1979 and/or 1980, and correspondingly higher rates of unemployment.

Predictably, the Administration denies the possibility of recession in its own forecast for 1979 and 1980, which is the most optimistic in town — although it still expects a rise in the unemployment rate to 6.2 percent by the end of the year, up from 5.8 percent in late 1978.

Even a recession will not be successful in bringing down inflation. The same Brookings study mentioned earlier shows that, in a realistic sense, there is no unemployment-inflation trade-off. For every extra percentage point of unemployment, it estimates that the inflation rate would be only 0.3 percentage points lower after one year. The cost would be astronomical: over 1 million jobs, and some \$60 billion in real production — or about \$280 per capita — each year. What about the impact of that extra 0.3 percentage point of inflation? It would correspond to about \$6 billion in higher prices, which would be transferred mostly from one group of Americans to another — admittedly in sometimes cruel and arbitrary ways. Even if all of it would go abroad (e.g., in larger payments for oil to OPEC countries), the per capita loss would come at most to only one-tenth of what we would forego under the alternative of higher unemployment.

A recession, moreover, would quickly boost the deficit; the extra percentage point in the unemployment rate would take approximately \$20 billion from the federal coffers (about \$5 billion in unemployment compensation, Medicaid, food stamps, etc., plus \$15 billion in lost revenues). There would be a negative impact on the finances of state governments as well.

As economic statistics are starting to suggest, the talk of recession may soon leave the realm of speculation for the realm of hard facts. Paul Samuelson's words appropriately describe the process:

"Mr. Carter's decision to fight inflation and defend the dollar has tipped the betting odds toward an outright recession. So, when and if the next recession comes, you will read lettered on its bottom: 'Made in Washington.'"

II. The FY 1980 Budget is Bad Social Policy

The composition of budget outlays shows President Carter going back on many of the promises made on the campaign trail.

Item:

"We should make major investments in people and not in buildings and weapons. The poor, the aged, the weak, the afflicted must be treated with respect and compassion and with love." (Acceptance Speech for Democratic Presidential Nomination, July 15, 1976, Congressional Quarterly, July 17, 1976.)

Simple justice dictates that people receive from the government what government promised. The proposals to cut some of the benefits now provided under the Social Security Act are not just -- neither are they a sign of respect or compassion. Other cuts requested in the budget would decrease the allotment of human resources programs below their current policy level.

Item:

"Our present welfare system robs the taxpayers who support it, discourages the people who administer it, and sometimes degrades the people who really do need help. It is an extraordinarily complex and difficult problem, even more so than I had expected.

* Financial Times World Business Weekly, 1/8/79.

"Two weeks ago I outlined the principles that must underlie the reform of the system, and we will have legislative proposals ready by the end of this summer." (Address to the 25th UAW Constitutional Convention, May 17, 1977.)

Last year, President Carter envisaged an allocation of \$1.4 billion in FY 1980 for his "Better Jobs and Income" program, with the expectation that in FY 1981 the requests would increase to \$14.4 billion and to \$38.8 billion the year after that. This year, he intends to submit a reform package for which he is allowing nothing in FY 1980, \$1.5 billion in FY 1981, and \$5.5 billion in FY 1982. At the same time, the President is proposing several legislative changes in the AFDC program which would cut these outlays substantially.

Item:

Q: "During the campaign, you spoke of cutting the defense budget \$5-7 billion. Will you be able to meet that commitment?"

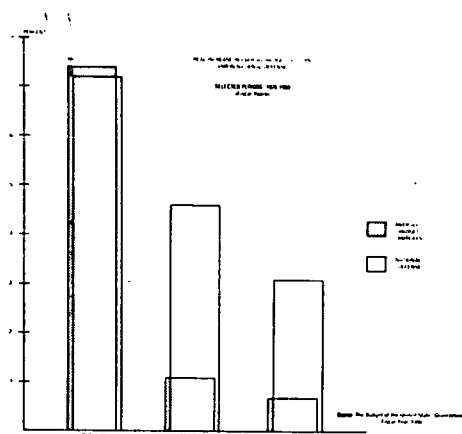
A: "If I don't, I will be very disappointed that (sic) the performance of the Secretary of Defense and the deputy secretary of defense. Yes, we'll start immediately with efficiencies and economies in the Defense Department, relating to organizational structure, long-range planning, predictable kinds of purchases for rapid delivery once the placements of orders have been made. We'll bring up to date, I hope, the repair and maintenance of our defense capabilities, and we'll be working very hard to cut down the unnecessary personnel assignments. The cumulative total, I think, of those and other changes will result in an adequate amount of savings to meet my commitment"

News Conference, December 21, 1976, Congressional Quarterly, December 25, 1976.

The record speaks otherwise: from FY 1978 to FY 1980, the requested increase in defense comes to \$20.2 billion, or virtually a 20 percent increase.

No dramatic changes have been proposed in the allocation of budget outlays. However, there is a perceptible trend towards a bigger share for defense since FY 1976.

This is clearly shown in the following chart, where the bars represent the real increase in overall budget outlays and in national defense for the fiscal periods 1976-1980, 1978-1980, and 1979-1980.



By contrast, the "controllable" portion of the outlays requested for human resources programs — which benefit not only the poor but the middle-income groups as well — would decline, in constant dollars by almost 15 percent from the FY 1979 estimate. This is equivalent to \$5.3 billion in FY 1980 budget dollars, and would put the controllable spending in human resources at the lowest proportion of total outlays in the last three years. The total allocation for human resources would go up 2.3 percent in real terms from FY 1979 to FY 1980, but that is due to the "relatively uncontrollable" payments to individuals.

**Human Resources - Controllable and Relatively Uncontrollable Outlays
Fiscal Years 1978 - 1980**

	Actual 1978	Estimate	
		1979 (billions)	1980
Human Resources Total	\$253.3	\$259.0	\$283.2
Minus: Payments to individuals (relatively uncontrollable)	203.8	223.1	250.5
Total controllable outlays	\$ 31.5	\$ 35.9	\$ 32.7
Total budget outlays	\$450.8	\$493.4	\$531.6
Controllable as percent of total outlays	7.0%	7.3%	6.2%

SOURCE: The Budget of the United States Government, Fiscal Year 1980, table on p. 85, table 14 (p. 560), table 17 (p. 568).

The conclusion from this brief analysis is that President Carter is reducing the portion of the budget where he can dictate his own policy. At the same time, he is proposing cutbacks in the programs which are the legacy from previous government action (in the form of relatively uncontrollable outlays).

Both types of actions are reflected in the difference of \$12.5 billion between current service budget outlays and the Administration's request. Of this amount, over half of the decline is scheduled in human resources (notably CETA, education, and Social Security) and the balance in the rest of the non-defense budget (notably natural resource and environment programs, commerce and housing credit, and anti-recession fiscal assistance).

During the "lean" years of the Nixon-Ford Administration the UAW looked forward to a time when uplifting the poor and the less privileged would once again become an opportunity for the President to exercise leadership, rather than to be dragged along. So we have been rightly shocked and dismayed to see the President become the spokesman of the groups which want to turn America away from the progressive programs forged by previous Democratic administrations on the pretense that America can no longer afford them.

Although the Administration should (and probably does) know better, this attitude rests on misperceptions of what actually happened during the last decade. For example, the view that the set of programs to aid the poor has increased enormously — along with the views that federal expenditures have risen sharply and that the budget is out of control — is contradicted by the facts.

The Administration has tried hard to dispel the notion that the poor are being hurt by the cuts in the FY 1980 budget. Yet our calculations, based on OMB's own listing, show that in real terms the programs for low income people remained at a standstill between FY 1978 and FY 1979, and are proposed to be cut by almost 1 percent in FY 1980.

I. The Budget By Function

National Defense

The Department of Defense is one agency in Washington which was spared the sharp budget-cutting knife mercilessly wielded at HEW, DOL, and HUD. The Administration proposes a 1.4 percent real increase in budget authority and a 3.1 percent real increase in budget outlays, by far the most generous increase of federal funds for FY 1980. These figures are in fact larger when the supplemental appropriations for FY 1979 are subtracted (see table below).

The overall real increases in the defense budget mask the much steeper gains in procurement and research and development:

Proposed Change for FY 1979 to FY 1980

	<u>Budget Authority</u>		<u>Budget Outlays</u>	
	<u>Nominal</u>	<u>Real</u>	<u>Nominal</u>	<u>Real</u>
Overall Defense Budget	10.2%	3.3%	10.6%	3.8%
Procurement	17.1	9.9	14.9	7.8
Research and Development	10.5	3.6	13.8	6.8

NOTE: Budget authority and budget outlays for FY 1979 are current service estimates. These are below Administration estimates by \$2.4 billion (supplemental appropriation) in authority and \$0.8 billion (supplemental appropriation) in outlays.

SOURCE: Special Analysis, Budget of the United States Government, Fiscal Year 1980, tables A-13 and A-14.

That is partly because, while the overall defense budget has a target of 3 percent real growth, substantial subcategories are scheduled for a real decrease: for example, Department of Defense personnel pay is restricted to the nominal 5.5 percent increase dictated by the guidelines for federal employees.

By focusing on defense activities as a major priority, the Administration is once again disregarding the views of many security experts who, in study after study, have concluded that recent and proposed levels of military spending have far exceeded the real security needs of our nation. Convinced by those studies, last year the UAW urged Congress to transfer at least \$5 billion out of the proposed defense authority and into areas of basic human needs. We remain convinced that at least that much could be squeezed out of the defense budget, without reducing our security. At the same time, there are many unfulfilled needs in our society -- welfare reform, urban aid, and child care to name a few -- where government spending could and should make a difference.

In implementing any transfers of funds, sufficient attention should be paid to the problem which will be faced by employees adversely affected, and by the communities in which affected facilities are located. Indeed, it is our view that such attention should be forthcoming in any event. Even increased military outlays do not eliminate the problems of dislocated workers: programs are continuously being terminated, cancelled or cut back at the same time that the overall level of military spending is on the upswing.

Elsewhere the UAW has developed extensive rationale for the need for conversion programs and outlined the form they should take. If conversion is found not to be feasible, adjustment assistance must be provided to displaced workers and affected communities as a backstop measure. This assistance must encompass cash payments, fringe benefit continuation, and retraining and relocation allowances in the case of affected workers, and special payments in lieu of tax revenues lost in the case of communities.

Our primary objection is to excessive military output, but even those expenditures for procurement and research and development (R&D) which may be necessary result in shortages of human and material resources needed to move forward in civilian areas. Thus too few scientists, skilled workers, and others with critical talents are available to attack unsolved problems in areas such as energy, health, transportation, etc. In addition, there is evidence that some of the slowdown in productivity increase is due to the drain imposed by military priorities.

Therefore, the budget should provide adequate funds to draw additional resources into non-military R&D, and also to train and upgrade the skills of additional workers, in order to avoid these shortages.

For example, the impact of stepped up spending on defense R&D and military procurement will put demands on sectors of the labor market which have already started to tighten up:

	<u>Unemployment Rate</u>		<u>Percentage Point Difference</u>
	<u>Pre-recession Low, 1973</u>	<u>January 1979</u>	
All Workers	4.6%	5.8%	+1.2
Professional and Technical	1.9	2.5	+0.6
Managers and Administrators	1.3	2.0	+0.7

At the same time, employment and training funds are being cut in real terms. Instead there should be more effort in that area. There are surplus workers available who could be put to work on important projects; with training, many of them could handle the more skilled jobs that otherwise will remain unfilled.

	<u>Unemployment Rate</u>		<u>Percentage Point Difference</u>
	<u>Pre-recession Low, 1973</u>	<u>January 1979</u>	
Operatives, except transport	5.8%	7.6%	+1.8
Transport equipment operatives	3.1	4.9	+1.8
Nonfarm laborers	8.2	9.4	+1.2

Finally, it is particularly incongruous that this Administration, whose overriding concern is inflation, chooses to propose such substantial increases in military spending, the most inherently inflationary type of federal outlay.

We urge Congress to prune the President's excessive request for military spending.

Social Security

From its inception over 44 years ago, the Social Security system has been based upon a trust between the American people and their government. In return for contributions to the system, workers and their families are promised future protection against the risks of income loss due to retirement, disability or death.

The Carter Administration's proposed budget for FY 1980 includes several cost-benefit reduction recommendations for Social Security. Although small in the context of the \$116.6 billion outlays budgeted for FY 1980, the \$600 million cutbacks would surely impact significantly upon the finances of the affected households. Furthermore, that is just the initial impact; the results would be much greater in the future.

Our immediate concern is about "savings" that the President wants to squeeze out of the disability insurance benefits program. First, benefits would be limited to 80 percent of averaged indexed monthly earnings. Second, benefits for younger workers would be reduced by counting against them the low earnings most workers have when they enter the work force.

Neither of these changes are justified. Both have arisen out of the Administration's concern over the increased number of beneficiaries of disability benefits, the substantial increased cost of the program, and the projections of further continued increases. There are several reasons to believe these projections are unduly pessimistic. The incidence rates of newly eligible disabled workers have declined since 1975, in sharp contrast to the trend established between 1970 and 1975 on which the high cost estimates are based. Furthermore, the 1977 amendments cut future benefits 5 percent across the board and the new benefit formula already weighs each year's earnings more equitably.

The disability insurance benefit program is too important to America's workers to consider changes as a reaction to an assumed crisis.

The Administration's proposed budget also recommends eight other benefit reductions; among those are:

- * The phase out of post-secondary student benefits that would affect approximately 800,000 students over the age of 18 who are now eligible to continue to receive benefits under Social Security until age 22 if they are full time students. The Administration's suggestion that it is more appropriate for the surviving children of deceased workers to apply for education grants and loans provided by HEW is not relevant to the concept of Social Security as an insurance program.
- * The removal of the automatic lump sum death benefit from the Social Security program. Even though a modest benefit, it still helps families at a time of large expenses. Its replacement by a welfare benefit under the Supplemental Security Income Program is unacceptable.
- * Stopping benefits of parents who have a child in their care age 16 or older. The Administration points to the increased proportion of employed widows with children. However, the present Social Security law already includes a control on the benefits received by working parents through the earnings limitation provisions.

These, and the rest of the Administration's proposal, would undermine the confidence the American people have in the long-term continuation of the program, and thus the basis for the Social Security system itself.

We agree that the programs that make up the system should be examined carefully and continuously; that indeed is the task of the Social Security Advisory Council which the law mandates to meet every four years to review the operation of the programs and to develop recommendations. The current report of the Advisory Council on Social Security is scheduled to be published in October. Furthermore, Congress recently established a Commission on Social Security whose work is just now beginning.

The Administration is bypassing these mechanisms in the interest of misplaced budgetary concerns. The UAW urges Congress to reject these as the basis for reducing earned protections under Social Security.

Health Care

The proposed health budget indicates a lack of commitment to improve health care services. It effectively reduces the research budget of the National Institutes of Health by 8 percent. It would eliminate capitation payments to medical, nursing and other health professions schools. It would seriously reduce training funds and the availability of loan and scholarship funds. It would impair the development of young researchers — the real hopes for future medical and scientific breakthroughs.

The proposed budget undermines the health care system because it strikes at research, education and training. We need to provide medical services to those who need them today. But it is shortsighted to slow the development of new knowledge; to stem the process of developing new treatments; to force schools to cut back training of our doctors, nurses, and scientists of the future. Together, these programs of research, education and training provide a basis for our health care system that must be strengthened — not undermined.

Over 34 separate health programs received absolute cuts; and over 24 additional programs are funded well below the current policy level. The dollars involved are relatively small, especially in relation to the problems which would result.

Employment and Training

The budget proposals for this function are clearly inadequate when coupled with the Administration's forecast of 6.2 percent unemployment for FY 1980. Here are some of the highlights:

- * by OMB's estimate, request for outlays in FY 1980 is 8 percent — 14 percent in real terms — below the current service estimate. This amounts to \$1.3 billion. By CBO's estimate, which assumes a higher unemployment rate and thus a higher level of eligibility, the Administration's proposal is \$3.1 billion, or 43 percent, below current policy levels.
- * the countercyclical public service employment program is phased down by about 302,000 jobs from the 1978 level of 725,000 (U.S. Conference of Mayors' estimate).
- * the "targeted" public service employment program remains at the same level of 267,000 jobs.
- * additionally, youth programs are also scheduled for real cuts — as high as 12 percent — in 1980. Summer youth programs are scaled down from 1 million in 1978 and 1979 to 625,000 in 1980 (U.S. Conference of Mayors' estimate).

Some initiatives for which funds are requested, such as private sector employment programs, may prove useful in the long run. But they cannot be expected to bridge the gap opened by the reduction of the countercyclical jobs programs right away.

The President is proposing these actions in an economy where:

- * the Administration's own -- overly optimistic -- forecast indicates an increase of 500,000 in the number of jobless for FY 1980;
- * those groups of workers who have traditionally been the "last hired" are sustaining very high rates of unemployment even at this late stage of the expansion:

	<u>Highest Unemployment Rate in 74-75 Recession</u>	<u>January 1979</u>
Black workers	14.5%	11.2%
Black adult women	12.6	10.6
Black teenagers	41.0	32.7

The indications are that these groups have already seen the bottom --even if at shamefully high levels -- of their jobless rates for this economic cycle.

Public employment programs have been an important part of the economic recovery; they should not be phased out when the expansion seems on the verge of exhaustion. The UAW urges Congress to reject the President's recommendations to cut funds for unemployment and training back from current policy levels, and to stand ready to increase those funds if unemployment goes up further.

Aid to Cities

The cuts in CETA would affect not only individuals and families, but entire communities as well. Cities that have been struggling to recover from years of urban decline aggravated by the 1974-75 recession are now fearful that lack of federal funds will plunge them right back into fiscal instability, reduction in essential services, cutbacks in manpower, etc.

Countercyclical aid was one important source of federal funds. This past October, Congress failed to renew the anti-recession financial assistance program. Since late 1976, the program had pumped more than \$3 billion of countercyclical funds into cities and states with unemployment rates above 4.5 percent, so long as the national rate exceeded 6 percent.

The FY 1980 budget makes clear that the past few years of expansion of U.S. aid to cities is ending. Rather than reviving the countercyclical program, the Administration proposes a transition program to aid a few hard-pressed localities. Budget authority would be \$250 million in FY 1979 and \$150 million in FY 1980; in FY 1978, the anti-recession program paid out \$1.3 billion to eligible local and state governments.

Most state and local governments will not be able to make up the loss in federal funds, and — because of the regressive nature of most non-federal taxes — those that do raise taxes will put increasingly inequitable burdens on their lower- and middle-income residents.

Aside from the disappearance of anti-recession financial assistance programs and the cutbacks in CETA, communities will see their funds for local public works (aid to local governments for construction programs) practically eliminated as well.

The budget proposes a National Development Bank with budget authority projected at about \$2.6 billion per year between 1981 and 1984, to support badly needed investment in economically depressed areas. We believe that this initiative would increase jobs in areas with high unemployment far better than such blunderbuss investment incentive measures as the general investment tax credit and depreciation allowances.

In our huge economy, not all regions and cities grow and prosper at the same rate. Many of our regions and cities rely heavily on one or a few industries for their economic well being. When one of those industries declines in a region, the entire region generally suffers. Such regions face rising unemployment and underemployment as family and social ties keep people from departing to look for work in more prosperous regions. Regions can become more depressed than others simply because their communities want to remain intact. A National Development Bank could assist the creation of jobs in depressed regions and maintain the integrity of their communities by boosting economic growth. We strongly recommend enactment of this budget item.

Again, it will take time to get the activities of the NDB rolling, assuming it gets congressional approval. In the meantime, cities should not be allowed to slip back into a downward financial and social spiral; adequate federal funds should be forthcoming.

Housing and Community Development

Overall HUD budget authority appears to be scheduled for a \$2.2 billion increase. However, this difference is more than accounted for by carryovers from FY 1978 to FY 1979; in fact, there is a drop in new authority.

Out of the total \$33.3 billion for HUD, most of it -- \$27.4 billion -- is for housing assistance, a function that is planned for a major cut: the budget proposal for FY 1980 is \$4.3 billion -- or 14 percent -- below what HUD estimates to be the current service level. As a result, additional Section 8 and public housing units are being reduced from 360,000 in FY 1979 to 300,000 in FY 1980, a drop of 17 percent.

(But a longer perspective, going back to 1976, would show a drop of 72 percent in the number of unit reservations.) The Section 8 Housing Assistance Program has been HUD's number one program of aid to lower-income families since its passage in 1974. These families are mostly female-headed, often elderly, and often black or Hispanic. We seriously question the timeliness and wisdom of the cutbacks in Section 8: those groups which constitute its main clientele have certainly not stopped growing, nor do they have recourse to any other type of aid to fulfill their need for housing.

Operating subsidies for public housing and modernization funds would be cut substantially as well. Thus, the present budget would force managers to either cut back on services and maintenance to low income households, or increase rental income -- which in many cases could only be done by serving families at higher income levels.

None of the cuts in new authority nor the slowdown from the pace at which new authority was requested in the past appears tailored to the actual housing or community needs of our urban, low income population. We hope that after Congress has carried out a detailed scrutiny of the Administration's proposals most, if not all, of the programs in these functions will be funded at current policy levels.

Congress should approve the proposed inland energy assistance program. The federal government should have a general policy to assist states, localities and, as proposed here, Indian tribes to mitigate the wrenching dislocation that can be imposed on communities by our fast changing economy. Short of such a comprehensive approach, programs such as this one that deal with specific causes of dislocation deserve congressional enactment.

Energy

The UAW strongly supports research and development in the field of renewable energy sources. Thus last year we were pleased to see the substantial role that this and related items received in the FY 1979 budget. The news this year is not as encouraging: the budget would effect significant cutbacks on solar commercialization, thus undermining the President's commitment to the increased utilization of solar energy.

The request for funding of solar applications -- i.e., commercially available solar technology -- is cut back by about 15 percent, or \$27.7 million from the previous fiscal year.

At the same time, the budget rules out solar space heating as a "commercializable" technology, in spite of the dozens of space heating projects already developed commercially and in service.

The budget also proposes to cancel government plans to buy a large number of photovoltaic devices which could make the technology competitive for a wide variety of uses by 1985.

We are encouraged by the recognition given in the budget to the trend toward slower growth in electricity demand. That will permit us to proceed with the caution necessary with respect to nuclear energy.

As a general statement the UAW wants to stress that the energy budget continues to be weakest on the supply side of the energy equation. For example, it is disturbing that public R&D efforts, which we support, often result in a subsidy to the U.S. energy industry, which adopts publicly-financed technologies and then turns around and calls for an end to public sector regulation.

What the nation needs is greater direct federal involvement in actual fuel production. For example, in the fossil fuel area, the proposed budget reflects the government's continued refusal to expand its role on the supply side. The UAW supports R&D in coal gasification and liquefaction, oil from shale, and "alternative surface mining techniques" but that must be supplemented by direct activity in exploration and production on public lands, and in the importation process. There is simply no way to determine true costs, and no way to have a truly national energy policy, except by the government being one of the active participants in sourcing of fuels.

Federal Credit Ceilings

The President has made the beguiling proposal that Congress set one annual ceiling on all federal credit activity as a part of the budget process. In addition to its role of acquiring new debt, the federal government plays an important role in the extension of credit in our economy. By guaranteeing loans and lending directly, the government supports the nation's investment in such areas as housing, urban development and small business. Federal agencies involved in the extension of credit need more flexibility than can be permitted by a single annual federal credit ceiling.

We do not object to frequent and timely consolidated reports to Congress on credit of all types projected to be extended or guaranteed by the government. Nor do we doubt that federal credit activity deserves greater congressional attention. When it determines the stimulus needed for the economy during a fiscal year, Congress should insure that federal credit actions coincide with planned budgetary fiscal policy. However we simply believe that a single credit ceiling would unduly restrict federal credit agencies as they respond to changes in the economy during the fiscal year.

Credit extended or backed by the federal government rose from \$36.6 billion in 1977 to \$59.0 billion in 1978. Most of the change can be traced to increases in the credit extended to banks and thrift institutions to support their mortgage credit. New, higher interest certificates helped but were insufficient by themselves to maintain the flow to these institutions of funds needed for housing.

This fiscal 1978 experience provides a good case in point against a federal credit ceiling. The amount of credit needed during that period to support mortgages could not have been foreseen in September 1977. A ceiling set at that time for fiscal 1978 would have been too low in all likelihood. Examples of other agencies with similar need for flexibility could also be shown.

* * *

There are other areas of the budget — such as education and transportation — which also cause us concern, but could not be adequately analyzed for inclusion in this paper.

We do not mean to imply that every program should be maintained at current service levels, or that reduction — or even elimination — of certain programs would not be justified. Such determinations must be based on the merits of each program. However, it is clear that the Administration's proposal — which starts with an arbitrary, and unnecessary, limit on the deficit — attacks programs which are more often inadequately funded to begin with, rather than being a careful reduction of wasteful activity.

Representative REUSS. Congressman Rousselot.

Representative ROUSSELOT. Thank you, Congressman Reuss.

Mr. Young, you mentioned in the earlier part of your statement what you thought the "add-ons" to the Federal budget should be to achieve the goal of higher employment, and less unemployment. I think you said the target should be 6 percent for 1978, 5.6 percent for 1979, and 5.2 percent for 1980.

Mr. YOUNG. Yes.

Representative ROUSSELOT. Then you put a price tag on that of \$20 billion to be spent by the Federal Government to achieve that?

Mr. YOUNG. No, sir. What I tried to say was that the general estimate is that if unemployment is 1 percent lower, then, there will be \$20 billion additional available to the Federal Government both because of increased revenues and because of decreased expenditures on things like unemployment insurance.

Representative ROUSSELOT. More people paying taxes is what you are saying.

Mr. YOUNG. Right. If we could have 5.2 percent unemployment that would be 1 percent lower than the President anticipates.

Representative ROUSSELOT. Right. Well, you have a laundry list here of things that you think should be enacted or engaged in by the Federal Government in order to achieve this lower level of unemployment, and higher level of employment. Could you give us a list of where you would spend money at the Federal level to achieve this?

Mr. YOUNG. Well—

Representative ROUSSELOT. You are critical because you believe we are not doing enough, right?

Mr. YOUNG. Yes.

Representative ROUSSELOT. We ought to spend more money to do this, you say, and the way you do that is by having the Federal sector more involved. Where would you spend it besides countercyclical?

Mr. YOUNG. Let me answer that in two parts, if I may.

Representative ROUSSELOT. You see, we can't be quite as nebulous as you have been. We have to really be a little more specific.

Mr. YOUNG. Well, in terms of the immediate future, the 1980 budget.

Representative ROUSSELOT. Right.

Mr. YOUNG. We do have some detailed suggestions there, but I think the important point that should be made is that apparently no one other than the people who made up the budget believe that it will produce a deficit of \$29 billion. If we follow the policies in that budget, the estimate of CBO, for example, is that it will produce a \$41 billion deficit.

In other words, we will suffer the ills and then we will spend money to pay for the cure.

We are saying it would be better to spend that money to prevent the problems in the first place. So, with respect to the 1980 budget, we have proposed, really, the very modest goal of saying that it ought to be at least maintained at current services level. The estimate for that is roughly \$12 billion additional expenditures. The specific places they would go would generally be to maintain

services at the current policy level, though, obviously there could be some shifts in that area.

That will not do the job—

Representative ROUSSELOT. \$12 billion more than recommended by the President, is that what you are saying?

Mr. YOUNG. Yes.

Representative ROUSSELOT. Did you break out where that \$12 billion would be spent?

Mr. YOUNG. We did not detail that in the sense that—

Representative ROUSSELOT. Or where it would be added on to the President's program?

Mr. YOUNG. In the President's programs, we would advocate most of the employment programs, and the social-security program be maintained at the current policy levels. Those numbers are laid out in the CBO report.

We think that some of those programs should be expanded, but that that could be done within the \$12 billion figure because, as you will recall from the budget committee testimony, President Fraser suggested that perhaps \$5 billion as a very modest goal could be moved out of the defense budget and into other programs.

Representative ROUSSELOT. You favor moving it out of defense yourself?

Mr. YOUNG. To that extent, yes, sir.

Representative ROUSSELOT. So, if you take \$5 billion out of defense, where would you move it—CETA? Where do you want to put it?

Mr. YOUNG. Into employment programs, for example, into these experimental full-employment communities that we suggest. When Mr. Oswald testified, Congressman Reuss said, "Are we wedded to CETA?" No; we think there should be experimentation with a lot of different programs and—

Representative ROUSSELOT. Are you talking about a pilot program, 8 or 10 communities?

Mr. YOUNG. That is right.

Representative ROUSSELOT. What is the price tag you suggest on that?

Mr. YOUNG. We have not put a price tag on that.

Representative ROUSSELOT. How would we go about determining what it was going to cost?

Mr. YOUNG. I think if you were willing to allocate \$2 or \$3 billion to that, then we would design a program that would fit within that framework.

[The following letter was subsequently supplied the committee by Mr. Young with respect to the above response:]

SOLIDARITY HOUSE,
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE &
AGRICULTURAL IMPLEMENT WORKERS OF AMERICA-UAW,
Detroit, Mich., March 6, 1979.

Re Joint Economic Committee.

Senator LLOYD BENTSEN,
Russell Senate Office Building,
Washington D.C.

DEAR SENATOR BENTSEN: During the Committee hearing on March 2, Congressman Rousselot asked me the amount of funds which might be needed for the "full employment communities" demonstration projects recommended by the UAW.

My response that \$2 to \$3 billion might be used went well beyond that particular program. We estimate that a smaller amount, on the order of \$1.5 billion should be adequate for those demonstrations.

I regret any misimpression or confusion which may have been caused by my initial response.

Sincerely,

HOWARD YOUNG,
Special Consultant to the President.

Representative ROUSSELOT. \$2 or \$3 billion?

Mr. YOUNG. Yes.

Representative ROUSSELOT. How much employment is that going to produce, new employment?

Mr. YOUNG. That program in itself would not produce a great deal because it would be an experimentation and demonstration to develop models that then could be used nationwide.

So, I would not see that as suddenly creating a large number of jobs in itself, but it would be like any kind of a preparatory program.

Representative ROUSSELOT. So, if we spend \$2 to \$3 billion on the full employment community program, it would not produce any new jobs, it would just be a pilot program to look at it for \$2 or \$3 billion?

Mr. YOUNG. That particular program.

Representative ROUSSELOT. You see part of our problem here is that we have looked at a lot of these programs, like CETA, where we spend approximately \$10.5 billion, and we begin to get complaints from some of the local levels that they don't all think it is really productive work. For instance, in Ventura, Calif., we had under the CETA program a census taken of pets, I think it was, for \$380,000. That really does not achieve a very long-running productive goal in producing long-term jobs.

We just keep talking about piling more dough into these programs, and when we look at them at the local level, they don't always produce these long-term productive jobs that you and I are both interested in.

That is where we are now when you suggest spending \$2 to \$3 billion for an experimental pilot program, that may, sometime down the road, produce some jobs. We do not know how long it will take, or if any permanent productive jobs will be created.

That is what my Governor is now concerned about in California. He is looking at some of these programs a little more critically. That is why some of us kind of feel some of that pressure a little bit now.

All the money we have spent on these programs does not really produce long-term permanent jobs in many of these areas. Don't we need to look at that, too?

Mr. YOUNG. Certainly, too—

Representative ROUSSELOT. If we are really going to achieve full employment.

Mr. YOUNG. We would not claim that every program that starts out is defensible and is needed, but I think in an economy as large as ours you have got to expect some false starts. I mean, even in private business one gets false starts, as we are frequently told in the auto industry that attempts are made to solve problems, they don't work, so you have to experiment.

Representative ROUSSELOT. The difference is in the private sector, usually they are shut off if they don't produce.

Mr. YOUNG. We would—

Representative ROUSSELOT. They just keep going on and on in the Government. We never really put an end to inefficient programs.

Mr. YOUNG. We don't think that should happen. We think—

Representative ROUSSELOT. Have you got a list of some of the ones that are not doing the job in producing responsible jobs? Do you have some of those that we might cut back on which would be helpful to us? You mentioned cutting \$5 billion out of defense.

Mr. YOUNG. Yes.

Representative ROUSSELOT. And move that over to what, this other \$12 billion worth of "add-on" programs?

Mr. YOUNG. Yes.

Representative ROUSSELOT. Are you convinced after careful study that those really produce real jobs and a long-term commitment also?

Mr. YOUNG. We are convinced that the bulk of those programs produce real jobs and we are convinced that similar programs of the same nature can produce jobs and are needed to produce real jobs; yes.

Representative ROUSSELOT. Thank you, Congressman Reuss.

Representative REUSS. Thank you.

You have given excellent testimony. Tell Mr. Fraser that his line in his prepared statement, "I do not propose to be the first president of the UAW to be less concerned about the dangers of recession than Milton Friedman," is worthy of a Churchill. [Laughter.] It is really great.

I like very much the proposal which my colleague, Congressman Roussetot, just referred to, the full employment communities' suggestion, in fact, what you are talking about here, as I see it, is very largely something which depends on management, inspiration, charisma, organization, and a gung-ho spirit as much as it does on dollars; is that so?

Mr. YOUNG. To a substantial extent. We are faced with a very pessimistic attitude at the moment of "we can't achieve" things, that we have to settle for shortfalls, and there does not seem to be objective circumstances that justify that attitude.

In fact, with some more positive approaches we are convinced that we can do much better; yes.

Representative REUSS. In fact, there is now in place a program of combating structural unemployment and making for full employment communities which is both open ended and untried; namely, the tax credit provision which gives an employer a governmental subsidy for hiring a structurally unemployed person during the first year or two of employment; is that so?

Mr. YOUNG. Yes, sir. We refer to the wage subsidies as one of the forms of experimentation that could be used.

Representative REUSS. What I am getting at is since you have not got that—and a number of other programs, some of them underfunded, but the wage subsidy tax credit is not underfunded, it is open ended, and if you can get enough new industries making the things that people of this country need, you could really put a dent in the unemployment situation.

Suppose in these seven or eight communities around the country that you are talking about, you, the President would appoint, say, full-employment coordinators in each of the communities, people like—picking them out of the air—Jim Rouse, the gung-ho developer of Columbia; and Quincy Market in Boston and the development in Philadelphia; or Felix Rohatyn, the Wall Street smart financier who has helped keep New York away from the sheriff; or John Wayne, conservative—but beloved and gung ho; or Beverly Sills; or Coretta King; or Henry Aaron the baseball player or any one of a number of others, if you put them in charge, and gave them the existing tools, might this not turn things around?

Mr. YOUNG. I think what you are probably getting at is that a number of programs involve better organization and use of money and resources that are now already available; and that is very clear. Not all of the proposals that we have listed involve new expenditures. Some of them involve better ways of doing things

On the other hand, we should not send someone into that battle with that kind of a charge by not being prepared to give them the resources that they will need to make it work.

So, I think it is a combination of the two, that there has to be better organization, there also have to be resources when needed and, of course, that investment would help pay for itself because there is a recovery to both the Federal treasury and the State and local treasuries if there is less unemployment and less low-income work going around.

Representative REUSS. We have come to expect of the UAW new ideas that are well worth examining. It seems to me this is one of them. Do you have anything else, Congressman Rousselot?

Representative ROUSSELOT. Yes; thank you, Congressman Reuss.

Mr. Young, we have had several economists tell us that the present unemployment rate of 5.8 percent or maybe slightly lower, 5.6 percent, really, pretty much represents full employment. What is your reaction to that? Obviously, in your testimony you disagree, but I mean, can you give us a little different rationale?

Mr. YOUNG. We have studied the material that has been put out of that nature, and I would characterize that as a kind of defeatist approach. In effect, those economists say, well, the demography of the work force has changed and we have more people in the work force who historically have had higher unemployment rates so, therefore, we would accept the fact that there are higher unemployment rates.

That is just not what, in our view, the game is all about. If, in fact, as it appears, there has been a change among the attitude of women toward entering the work force and toward being fully employed, then to go back and to say, well, women have always been the marginal group of employees and have had higher unemployment rates, and, therefore, we must now cut back on our standards and our goal of achievement because of that, is resigning oneself to defeat rather than saying it is a problem that has to be overcome and dealt with.

So, I think that those people have not concluded that there is a reason for high unemployment. They have explained away the high unemployment without trying to do anything about it.

Representative ROUSSELOT. As you know, there is a group studying this whole issue of what is the real makeup of those that are critically unemployed, and so forth. I can't disagree with your comment that because many more women have decided to enter the work force on a permanent basis that, therefore, we have tried to justify the higher rates, that maybe the higher level of unemployment would be more acceptable.

Except the issue is sometimes made that when you have two, three, four people in a family working that, whereas, traditionally there had been one breadwinner type of thing, that that might somehow distort the unemployment picture when the second or third person in a family feels greater flexibility not to work full time.

Mr. YOUNG. Except that the data—

Representative ROUSSELOT. Therefore, that might distort the unemployment figure.

Mr. YOUNG. Yet, on the other hand, when one looks at something like the quit rate, which presumably is what that would affect, it is not high by historical standards, particularly when you adjust it for what the historical rate has been among those groups that are now entering the work force.

So, most people who are unemployed apparently are not unemployed through their own choosing; they are unemployed because somebody lets them go or somebody does not hire them.

If the kind of rationale that is being offered—these people are kind of indifferent about working—then you would expect them to be quitting their job, but that is not what is happening.

Representative ROUSSELOT. What about that group that is now— for lack of a better term, we call them in the subterranean economy—working for cash, and they don't report much of it; it is a second or third job, maybe. Do you think that distorts the unemployment figure.

Mr. YOUNG. I have read some of that material and talked to Ferman out at the University of Michigan, who is doing some of those studies, but I must admit I don't have a feel of how big that is or how significant it is in the economy.

Representative ROUSSELOT. Therefore, for some of those individuals that are in that "economy" or however we refer to it, don't report income, they may receive unemployment benefits. Have you checked that very much? Should we be concerned about that?

Mr. YOUNG. I think that we certainly should be concerned with administering the programs properly. If people are not entitled to benefits, certainly, we should check into that.

Again, I don't know how large an issue that really is or how significantly it would change the overall picture.

Representative ROUSSELOT. Thank you, Congressman Reuss.

Representative REUSS. Thank you. And thank you, gentlemen. You have made a real contribution, too, and we are grateful to you.

Mr. YOUNG. Thank you.

Representative REUSS. We will stand in recess until March 8 when we shall resume our hearings.

[Whereupon, at 11:26 a.m., the committee recessed, to reconvene at 10 a.m., Thursday, March 8, 1979.]

THE 1979 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, MARCH 8, 1979

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

The committee met, pursuant to recess, at 10 a.m., in room 6226, Dirksen Senate Office Building, Hon. Parren J. Mitchell (member of the committee) presiding.

Present: Representatives Mitchell, Brown, and Wylie; and Senators McGovern, Sarbanes, Javits, and Jepsen.

Also present: Louis C. Krauthoff II, assistant director-director, SSEC; David W. Allen, William R. Buechner, Kent H. Hughes, M. Catherine Miller, and L. Douglas Lee, professional staff members; Mark Borchelt, administrative assistant; and Katie MacArthur, press assistant; and Stephen J. Entin, minority professional staff member.

OPENING STATEMENT OF REPRESENTATIVE MITCHELL, PRESIDING

Representative MITCHELL. This hearing will now come to order.

Good morning. We would like to welcome both Secretary Kreps and Secretary Marshall here this morning. Later on today we will have the opportunity to hear from Mr. Ronald Brown, who is the vice president of the National Urban League.

Secretary Kreps, as you are well aware, a fundamental improvement in our trade position is critical to a healthy dollar. We have a lot of work cut out for us to achieve a healthy dollar—a \$34 billion trade deficit last year cannot be dismissed lightly. I know that forecasts call for a considerable decline in our deficit by the end of 1979 due to fewer imports and enhanced competitiveness of our goods from the depreciation of the dollar.

But I believe we have to do more than let market forces carry the ball. Madam Secretary, you have made export policy trips to Japan just last fall, to Russia this winter and are planning a trip to our newest potential market—the People's Republic of China—this spring. Although we are running minor surpluses with the latter two countries, we ran a deficit of \$11.5 billion in 1978 with Japan, one of our major trading partners.

These trips are an obvious expression of your interest in developing our export policy. Can you tell us what substantive policy changes have been made as a result of these trips? How does the Commerce Department intend to use those \$20 million in funds earmarked to aid small- and medium-sized businesses in their export efforts?

Turning to our domestic economy, we would like you, Secretary Kreps, to tell us if you see any sectoral imbalances that may be developing in the near future. We have seen a few scattered signs; that is, housing starts and industrial production indicating an initial slowing down of the expansion. Yet, there has been some discussion about the existence of excess demand pressures. What is your judgment on those issues?

As a final point, excessive and unnecessary Government regulations are an important cause of inflation. One of the most effective ways we could bring down these costs is through a regulatory budget that would put a cap on the costs each agency could impose on the private sector. Secretary Kreps and our chairman, Senator Bentsen, have discussed this in the past, and I hope we can have a progress report on the Commerce Department's efforts in this area.

I have some comments I will make very briefly to you, Mr. Marshall, and then turn to the testimony.

The President has said, Mr. Secretary, "We will not reduce inflation at the expense of the most vulnerable members of our society—the poor, the elderly, and those who have difficulty finding jobs even in a higher employment economy." I think it is a joint task of Congress and your Department to make sure that promise is kept.

However, I find it difficult to be sanguine when the administration's forecast this year is an increase, not a decline, in the unemployment rate.

The Humphrey-Hawkins bill set the goal of a 4-percent unemployment rate by 1983. Don't you think an unemployment rate rise this year will deal a serious setback to the achievement of that goal? How does your Department intend to deal with an increase in those cyclically unemployed as well as the enormous backlog of the structurally unemployed? I hope you can give us some reassurance that the Department of Labor is prepared to meet both of these problems.

Now, Madam Secretary, as I understand it, you are on a very tight time schedule, that you must leave by 11:15. We do have copies of your prepared statement. If you so desire, you may submit that for the record in its entirety; however, if you care to speak from it, fine.

Let me confer with my colleague Congressman Brown to see if he has an opening statement.

OPENING STATEMENT OF REPRESENTATIVE BROWN

Representative BROWN. Thank you. It is always good to have you as Secretary up here and to see labor and management together.

I have just heard as I drove over to this side of the Hill that we now have a wholesale price index announcement that indicates that it jumped 1 percent last month at the 12-percent annual rate and that this is the wholesale price index which is going to be translated through to the general consumer price index, I assume, within a month or so, indicating that we are moving into a double-digit inflation rate.

In your comments—I know they are prepared—but in your additional comments I would like to have you address that, which I

consider to be our endemic problem, a very serious problem and one which I hope we have some new solutions for that are somewhat different from those which we have tried in the past because they seem to be the same solutions we tried for the last dozen or 20 years, and they seem not to be working, if the wholesale price index this morning is any indication of the trend, and I think it is a continuation of the trend.

So, if both of you have the opportunity to address that problem for us, not because I am not sensitive to the problems which my colleague and respected friend Parren Mitchell has raised with reference to the chainlike structural unemployment and legislation on that area and other problems that are in the area of social concerns that grow out of our economic situation, but precisely because I am concerned about those things, because I see the same pattern continuing in this current situation where we are going to a sharper and sharper inflation rate, higher and higher interest rates, and eventually that peaks out and drops over the edge, and we all suffer for it except the people who suffer most are those about whom we should all be concerned, the deprived, like the unskilled, and so forth, because they are the ones least able to cope with that kind of evolutionary process.

So I would hope that you would address yourself to how we can avoid that peaking and ultimate collapse that has been patterned now that seems to be repeating with increasing severity, with shorter degree times in between in the rhythmic curve, and one which I think carries with it what I would consider as again to be the major problem in our economy, and that is inflation.

We seem to have been using what I guess I would call a trickle up theory, and that is that we spend money at the Federal level and then hope that that is good for the rest of the economy.

I would say that the only thing that is sort of unusual in that policy of trickle up that is accomplished is that we are defying the law of gravity, at least as far as inflation is concerned.

Representative MITCHELL. I would like to make a suggestion if I may. Let us take testimony from both of the Secretaries and then ask questions, if that is agreeable with you.

Secretary MARSHALL. Yes.

Secretary KREPS. Yes.

Representative MITCHELL. Madam Secretary, we are in your hands.

STATEMENT OF HON. JUANITA M. KREPS, SECRETARY OF COMMERCE

Secretary KREPS. Thank you, Mr. Congressman.

In the questions which you raised with respect to international trade funds which you had asked me to address, you raised several questions which I hope my testimony will address. I will be glad to go very quickly through that testimony.

Representative MITCHELL. Before you do, would you like me to ask for a unanimous consent request so that all of your testimony will be submitted for the record, since you will be speaking extemporaneously?

Secretary KREPS. Yes.

You raised, Mr. Congressman, a question of whether we could not find ways to define exports in spite of the fact that you did not want to rely on market forces altogether. From my testimony, you will see that the administration has attempted to bring about certain policy changes, particularly under the national export policy, that will speak to that particular problem.

You raised the question of cyclical imbalances in trade. I would like to speak to those problems.

I also would like to address the question of geographical imbalances.

Finally, I would like to address the question of the basic explanation that is being given for some of the negative trade balances, in particular the question of productivity and the question of innovation and our ability to compete nationally.

You have heard, Congressman, a great deal of testimony about the domestic outlook; I shall leave that topic to Secretary Marshall. The state of the domestic economy is very closely related to the international accounts and to our dollar components to the extent that we are able to subdue inflation, which would strengthen our competitive position therefore improving our trade balance by promoting exports. Only in this way can we strengthen the dollar value and hope for our stability in international markets.

Focusing my remarks here on the balance of trade and the policies that we need to adopt to increase our foreign trade, I should like to comment on the Department's work on another issue that is directly related; this is innovation and productivity.

Representative MITCHELL. I am sorry. I didn't hear your last statement. I think you need to pull your mike a little closer to you.

Secretary KREPS. I am not sure it is working. Is it? Is it working now?

Representative MITCHELL. I can hear you. I don't know whether the rest of the audience can.

Have the staff check the mikes and see if they are working properly, please.

Secretary KREPS. All right.

The international trade balance can be analyzed in any one of a number of ways. We are all acquainted with the recent history of the deficit in the aggregate. The deficit that you mentioned, the \$34 billion in 1978, and an unprecedented deficit of \$75 billion over the past 3 years. The 1978 current account deficit—including payments for services, income on foreign investments, and certain other "invisible" items—of \$17 billion.

It should be noted, however, that last year the quarterly figures suggested that there was a turning point. The trade deficit peaked in the first quarter at an annual rate of nearly \$45 billion, but declined by the fourth quarter to a rate of \$30 billion, even though during this time oil imports had actually increased.

The factors that are responsible for this narrowing in the deficit led us to expect a further decline in 1979.

Our projections which were made prior to the recent oil disruption have indicated that in 1979 we will have an improvement of perhaps \$9 billion from the 1978 trade deficit. This will, of course, be affected by the recent changes in oil availability and oil prices,

but it is also affected by the possibility of some reduction in oil consumption.

The situation is currently uncertain with respect to the deficit and our Department is working on new projections growing out of the Iranian oil problem. We will be glad to furnish you those estimates as soon as they are ready.

Our trade balance can also be analyzed in bilateral terms; you referred to this in your opening questions. The most commonly discussed bilateral balance is that with Japan. It has recently surpassed Canada as the single largest exporter of manufactured goods to the United States. In 1977-78, our bilateral deficit in merchandise trade with Japan rose from \$8 billion to \$12 billion, our largest deficit with any country.

Japan's surplus is also an important portion of her \$17 billion global current account surplus. This has become incidentally the largest surplus in the world and larger than the OPEC surplus of \$11 billion.

We see that from our point of view the yen appreciation and the policy measures that we have taken have begun to have some effect on our merchandise trade balance with Japan. In the fourth quarter of 1978 this deficit dropped to about a \$9 billion annual rate, but overall continues to be very high. The administration has made clear to the Japanese Government that the problem must be solved in the interests of the world's economic stability.

Each of these ways of looking at the trade balance is important, but it does seem to me that there are at least two perspectives that we ought to concentrate on here. The first is the perspective of manufactured goods.

An examination of our trade in manufactured goods tells us a great deal about our overall international trading relationship. Among both our exports and imports, manufacturers who supply the biggest category of goods have been the backbone of our strength in foreign trade over the last half century. For the last 4 years, however, from 1974 to 1978, the volume of our manufactured exports grew hardly at all. Indeed, manufactures deteriorated from a \$12 billion surplus to a \$6 billion deficit in that period. Now that \$18 billion slide is nearly as large as the deficit of the overall trade balance during that period.

Manufactured goods are the category of trade with the greatest potential for improvement in our view. They comprise the key to resolving our trade problems. Since the first quarter of 1978, the volume of manufactured exports has, in fact, grown at an annual rate of more than 15 percent. We are encouraged by this.

By the fourth quarter of last year our balance in manufactures was back into surplus at an annual rate of \$1.5 billion.

The foreign trade data for January released last week showed a fairly sharp 1-month setback in the balance for manufactures. This setback may not be fully reversed in February, but we don't think it is a pattern that will hold. We will see improvement in part, despite the January deficit which resulted, from increased demand for goods generated by the economy's very high growth rate in the fourth quarter.

Regarding the prospects for a growing surplus in manufacturing, we think that the process of goods this year is good because our

economic growth is slowing while the growth abroad is accelerating, because we are now in the stronger competitive position resulting from dollar depreciation, and because our export promotion efforts, we think, will begin to bear fruit during the coming year.

Of particular importance to our trade balance is the component of capital goods. The export of capital goods represents the strongest category of manufactured goods. Our surplus in this category was \$27 billion last year, which is almost twice as large as our surplus in agricultural goods. However, this too, has remained essentially unchanged for the past 3 years.

The plateau is traceable to the increased imports for our expanding economy and the fact that foreign markets have been hampered by poor utilization of existing capacity.

Again there are encouraging signs, although not a sufficient basis for firm projection yet, in the data on trade in capital goods during the last half of 1978. U.S. exports of capital goods increased in value by about 20 percent over the first half of the year. We expect foreign markets to continue to improve. On the other hand, imports in this area have flattened and, if these trends continue, we will see a needed change in this most important trade category.

If I could turn to the other perspective on the trade balance which needs attention, which is the perspective of the region of the world involved.

Prospects for improvement in our trade balance are good for most areas with the most notable exception being that of the OPEC countries. We registered a \$14 billion deficit with OPEC last year—about \$1 billion less than the average for the preceding 3 years. The stability of oil prices and U.S. oil imports in 1978, plus some growth in our exports to the OPEC countries, brought about this improvement. Higher oil prices and, if supplies are available, the resumption of import growth will worsen our trade position with the OPEC countries in 1979 and for an indeterminate period we will see a decline in our exports to Iran.

The largest improvement in our trade should be a reversal of our declining surplus with the industrial nations which accounted for most of the deterioration in our accounts. We think it is likely that our trade surplus with Western Europe will grow this year, that our deficits with Canada and Japan will diminish.

Turning then to the question regarding China that you raised, this stirs the imagination of the public. Our exports to China, although small, nearly quintupled last year, rising to \$824 million. This year we expect that figure to double again. We think the dollar level, although remaining small, will continue to rise. We should not expect our trade with China to affect dramatically our overall trade balance in the next few years.

Also of importance is the comparative trade performance in our country compared with Western Europe and Japan in third country markets. For example, our respective trade balances over the last 3 years indicate that in non-OPEC developing countries, both Japan and Western Europe have more favorable trade balances than we have. Stated differently, the export performance of Europe and Japan in such third country markets suggest that they have more competitive products, more aggressive marketing, fewer domestic impediments to exporting or some combination of these.

The data have special significance for the importance of our cultivating both new attitudes and new policies with respect to export.

I should like to comment very briefly on the export policies that we have been pursuing.

This committee has recently heard discussions on many of the policies that are relevant to the state of our domestic economy as well as to our international trade situation. Among these are macroeconomic policies, the conclusion and implementation of the multilateral trade negotiations, and others. All of these are important.

We should, however, emphasize the importance of export measures directly; measures that only recently have been recognized in this country as economic policies of fundamental importance.

After decades of development with seemingly limitless natural resources, vast and expanding domestic markets and entrenched indifference to exporting, we have begun as a nation to focus on the importance of exports to our national economic health. The trade deficits and the exchange rate declines created by abrupt spiralling payments for oil and other imports have forced us to give our attention to the export half of the trade equation. President Carter's announcement of a national export policy reflects a recognition of the importance of our trade balance and, indeed, echoes your own sentiment that trade cannot always be left to the market forces.

The national export policy is only a beginning, we recognize this. Greater importance lies in its creation than in its particular elements. Increased authorization of the Export-Import Bank, enhanced export promotion programs at Commerce and State, the ongoing study of export disincentives and a computerized system of foreign market opportunities are important measures, but they fall short of government support that is needed for our own domestic firms in competing with foreign firms.

The national export policy is an important new category of economic policy, albeit its implementation is in its infancy. We cannot expect instant results.

I know that Members of Congress have a strong interest in assisting U.S. exporters and that this subject may be considered this year in connection with the multilateral trade negotiations and other legislation. Indeed, a logical step on export policy may be to integrate implementation of the MTN with a strengthened export expansion drive.

Finally, if I may turn just quickly to the question of productivity, which is an important element of our ability to compete. The decline in productivity growth is central to our domestic problem of inflation and the threat which it poses to the stability of production and employment. Productivity growth lagging behind that of industries abroad, places our producers at a disadvantage in international trade and contributes to the whole complex of problems that arise from a prolonged trade deficit.

The last decade has witnessed a remarkable slowdown in the rate of productivity growth in this country. Last year productivity in the private economy increased by one-half of 1 percent compared to an increase of 1½ percent in 1977. This compares to a trend rate of about 3.1 percent annually between 1950 and 1967.

The greatest slump in productivity growth is centered on non-manufacturing sectors—particularly construction, mining, and retail trade. While overall productivity in manufacturing has declined by much less, serious problems have been encountered in many industries.

A number of possible factors account for this decline in productivity. I should be glad to discuss these, as I am sure Secretary Marshall would. The end of migration out of the low productivity farm sector, the shift toward a younger, less experienced work force, expenditures for pollution abatement and worker safety, the benefits of which are not counted in our national economic accounts, slower growth in the amount of capital per worker; and a lag in research and development expenditures are the factors involved. The Department of Commerce has recently completed a comprehensive review of our knowledge about the causes of the decline in productivity growth, and I have attached to my prepared statement a copy of this paper.

Closely related to the pace of productivity growth is, of course, the innovation in industry. This was the focus of a domestic policy review undertaken in May 1978 pursuant to President Carter's instruction.

This review deals with the effects industrial innovation of such Federal policies as procurement, patents and information, direct support of research and development, environmental, health and safety regulations, and regulations of industry structure and competition.

The role of small business in the innovation process will be a special concern of this policy review which will soon be reported to the President.

We have had senior executives from industry, labor, academic, and public interest groups participate in this review, as well as policymakers.

As I have said, we will be making recommendations to the President by the end of March, and I would hope that they would lead to actions that would be helpful to stimulate productivity growth.

Mr. Congressman, I have sketched through my testimony, and at the appropriate time I shall be glad to respond to questions.

Representative MITCHELL. Thank you very much, Madam Secretary.

[The prepared statement of Secretary Kreps, together with the paper entitled "The Productivity Decline: Its Causes and Effects," follows:]

PREPARED STATEMENT OF HON. JUANITA M. KREPS

Mr. Chairman and members of the Committee, I am pleased to appear before you to testify on the state of the economy. Your invitation presents an opportunity to continue the fruitful relationship that has existed between the Commerce Department and the Joint Economic Committee in the past.

This Committee is familiar with the domestic economic outlook. Employment continued to rise at a healthy rate in January, and the unemployment rate declined another notch to 5.8 percent. New orders, particularly for steel, aircraft and machinery rose sharply. However, industrial production, personal income, and retail sales rose more slowly in January than in the fourth quarter, and housing starts declined sharply. Much of the slowdown in production and housing starts was due to extreme weather in some sections of the country. The recent data are generally

consistent with our expectation that economic growth will slow from the fourth quarter's exceptionally strong pace.

Prices rose sharply in January. The advance was broadly based. While we do not expect this rate of increase to persist or accelerate throughout the year, recent price data demonstrate once again the stubborn nature of our inflation problem and the importance of making our anti-inflation program succeed.

In response to the interests expressed in your letter of invitation, I should like to give you a brief account of the Commerce Department's forecasts for several major subsectors of the economy in 1979. Then, because the health of our domestic economy today depends on the healthy development of our international economic relations, I shall turn to an analysis of the U.S. balance of trade and to policies that in my view would foster further improvement in our foreign trade. In closing, I shall say a few words about our Department's work on the critical questions of productivity and industrial innovation in the American economy.

INDUSTRIAL OUTLOOK

Within the framework of the overall forecast for the economy, we anticipate major differences in performance among key industrial sectors. The Commerce Department's recently released 1979 U.S. Industrial Outlook provides one-year and five-year projections for some 200 manufacturing and service industries. I should like to review some of the highlights of these forecasts.

Construction

Construction spending in 1979 is expected to decline slightly in real terms. For the first time in several years, this important sector will not contribute to the Nation's overall economic growth.

The most significant factor in our construction forecast is an expected decline in housing starts of about 300,000 units from over 2 million units started in 1978. This decline has been much longer in coming than most experts had foreseen. Housing starts in December were at an annual rate of 2.1 million units, the tenth consecutive month above the 2 million mark. The historical pattern of financial disintermediation, whereby savings institutions lost deposits to money and capital markets offering higher yields, was arrested in the middle of 1978 by authorizing these institutions to issue savings certificates with more competitive interest rates. Although this has shielded the housing sector from credit insufficiency in 1978, a moderate decline in credit available and housing starts is expected to occur in 1979. The slump in starts in January to an annual rate of 1.7 million could be the beginning of such a decline, but we think the size of this drop was considerably exaggerated by the weather.

This decline in the housing sector will be partly counter-balanced by growth of other types of construction activity. Industrial and commercial buildings in the private sector and sewer system construction in the public sector promise strong performances in 1979, continuing the 1978 trend. Even after adjusting for inflation, industrial building activity rose by about 25 percent and commercial building by 10 percent during 1978. While growth in these categories will slow in 1979, even the smaller gains will help to offset the housing decline.

The lower number of housing starts will have direct effects on building materials sectors where some scarcities have appeared during 1978. For example, we expect the production of lumber and softwood plywood to decline by about 5 percent. Household furniture sales also are expected to show little growth.

An important corollary of the leveling off of construction activity should be a significantly lower inflation rate in this sector in 1979. During 1978 the price deflator for structures rose by nearly 12 percent compared to a rise in the GNP deflator of 8.3 percent.

Steel

The outlook for Steel in 1979 is favorable, with domestic industry shipments projected to increase nearly 4 percent to over 101 million net tons. The projected 1979 shipment volume will be the third highest on record after the boom years of 1973 and 1974, when the industry shipped about 110 million tons.

The expected increase in domestic shipments results from an anticipated decline in imports to between 16 and 17 million tons (14 percent of the market) from the record high in 1978 of 21 million tons (18 percent of the market).

The import decline reflects the substantial increase in the price of imported steel caused by the trigger price mechanism, which became effective in 1978. From an average of \$298 per ton (foreign value, excluding freight and duty) in the first four months of 1978, the average price had increased to \$376 per ton by December 1978.

Industrial equipment and components

Shipments of industrial equipment and components rose by over 10 percent in 1978 to \$72 billion and this year are expected to increase by another 8 percent. Exports rose by 13 percent to \$13.9 billion in 1978 and are expected to rise 9 percent in 1979.

This industry is comprised of some 16 major subsectors, which include several with growth rates among the fastest projected for any sector in 1979. For instance, shipments of metalworking production machinery, which is vital for the manufacture of thousands of products made from the melting and processing of metal, are expected to grow by 15 percent in 1979.

Shipments of machine tools are expected to rise by 29 percent. Last year's increase in foreign orders for machine tools was very strong. Exports are expected to rise by 22 percent in 1979 to about \$900 million. Domestic new orders for machine tools in 1978 reached a value of nearly \$4 billion, a gain of 44 percent from 1977. The industry at the end of last year had a backlog of nearly \$3.5 billion.

Motor vehicles

Motor vehicle sales are projected to total 14.9 million units in 1979, a 3.3 percent decline from the 1978 record level of 15.4 million units. Passenger car sales are expected to decline to 10.8 million units in 1979 from 11.3 million units in 1978. Truck sales, which were limited by production capacity in 1978, are expected to continue at the record 1978 rate of 4.1 million units.

Domestically produced passenger car sales are forecast at 9.0 million units in 1979 versus 9.3 million in 1978 with the market share of domestically produced cars increasing to 83.3 percent in 1979 compared with 82.3 percent in 1978 and 81.4 percent in 1977. The increased market share of domestically produced cars reflects both the reduced value of the dollar relative to the Japanese yen and German mark and the introduction of more small car lines that compete directly with imports.

Textiles and apparel

The textile and apparel industries experienced slow, steady growth in 1978. Indications are that this will continue in 1979.

Textile mill product shipments in 1978 were \$44 billion, a 3.5 percent gain over 1977. Apparel industry shipments for the year were estimated to have been \$38 billion, 2.7 percent above 1977. The value of textile and apparel imports in 1978 was \$7.0 billion, substantially more than in 1977. The value of exports rose 10 percent to \$2.6 billion. The industry is concerned about the effects of increasing imports, the MTN and regulatory actions, particularly with regard to cotton dust and noise standards.

The Administration recognizes the importance to the industry of an effective textile and apparel program. To that end we have:

Led in the renewal of the international multifiber arrangement which provides a framework for an orderly expansion of international textile trade;

Renewed and strengthened our bilateral agreements that cover 75 percent of U.S. cotton, wool and man-made fiber textile and apparel imports;

Consulted with foreign suppliers and in some cases have taken unilateral actions to prevent disruption from supplier countries not covered by bilateral agreements;

Begun a textile and apparel export expansion program that:

Identifies growing export markets,

Attacks non-tariff barriers to our exports, and

Provides firms the information they need to export.

Established a program to assist apparel industry productivity.

The computing equipment industry

The computing industry, consisting of manufacturers of computer systems, peripheral equipment and parts, shipped more than \$15 billion worth of products in 1978. Shipments in this fast-growing sector are expected to increase by 15 percent in 1979.

Computers are critical to operations of business and government and are expected gradually to find use in the home as well. As a result of continuing, rapid technological change, computer equipment is becoming smaller, less expensive and easier to use. The linkage of computers with telecommunications is anticipated to grow into a major new market—data communications—by the mid-1980's.

Exports of computer equipment and parts in 1978 reached \$4.1 billion with imports totaling \$755 million. The potential for a continued high volume of computer exports in the future is considered strong. The developed countries should continue to offer good market potential, and less developed countries also are looked to as important markets for these products in the 1980's.

Aerospace industry

Industry shipments were about \$39 billion in 1978, a gain of 19 percent over 1977. New orders rose to 39 percent over the 1977 rate. Unfilled orders at year's end totaled \$80 billion, roughly 40 percent more than a year earlier.

As the Nation's leading contributor among manufacturing industries to the balance of trade, the aerospace industry showed a trade surplus of \$8.5 billion in 1978. The industry has produced about 70 percent of the transport aircraft in use today by the world's airlines. Exports of large transport aircraft were \$2.6 billion in 1978, up from \$1 billion in 1977.

Industry shipments are expected to be \$47 billion in 1979. The increase results largely from continued high demand for large transport aircraft. Exports of large commercial transports could approach a value of \$4.9 billion, an increase of 88 percent over 1978. Increased demand for additional seats/cargo space following deregulation of the U.S. airlines accounts for a portion of the increased requirements for large transports.

INTERNATIONAL TRADE

The state of our domestic economy is closely linked to the health of our international accounts and to the dollar's performance in exchange markets. To the extent that we succeed in subduing inflation, for example, we strengthen our competitive position in international trade and help to maintain a stable dollar. On the other hand, to the degree that we improve our trade position through promoting exports or by reducing the barriers facing U.S. goods abroad, we may help strengthen the dollar, thereby relieving one source of inflationary pressure at home.

Our international trade balance can be analyzed from a number of perspectives. We are well acquainted, for example, with the recent history of our deficit in the aggregate: on a balance-of-payments basis, a merchandise-trade deficit of \$34 billion in 1978; an unprecedented deficit of \$75 billion over the past three years; a 1978 current-account deficit—including payments for services, income on foreign investments, and certain other "invisible" items—of \$17 billion.

Last year's quarterly figures suggest a turning point, however; the trade deficit peaked in the first quarter at an annual rate of nearly \$45 billion, but declined as the year progressed to an annual rate of \$30 billion in the fourth quarter, even though oil imports increased during the year. The factors responsible for this trend lead us to expect a further decline in the trade deficit in 1979, although estimating the size of the improvement is complicated by the uncertainties now surrounding the outlook for oil prices and supplies.

Commerce Department projections made prior to the recent oil supply disruptions indicated an improvement in 1979 of perhaps \$9 billion from the 1978 trade deficit. This outlook will be affected by higher oil prices, but it also is affected by the possibilities for offsetting reductions in oil consumption. The situation is currently very uncertain, but our Department is working on new projections which we will be glad to provide when they are ready.

Our trade balance also can be analyzed in bilateral terms. Most commonly discussed is our bilateral balance with Japan, which recently surpassed Canada as the single largest exporter of manufactured goods to the United States. From 1977 to 1978, our bilateral deficit in merchandise trade with Japan rose from \$8 billion to \$12 billion, our largest deficit with any country. Japan's surplus with the United States is nearly half of her \$25-billion global trade surplus. Japan's surplus with us is also an important portion of her \$17-billion global current-account surplus. This huge surplus has become the largest source of economic disequilibrium in the world—exceeding the \$11-billion current-account surplus of the OPEC countries.

Yen appreciation and policy actions on both sides have begun to reduce this imbalance somewhat. U.S. merchandise trade with Japan was in deficit by about \$9 billion at an annual rate in the fourth quarter of 1978, compared to \$13 billion in the first half of the year. This deficit, however, continues to be much too large. The Administration has made clear to the Japanese government that this problem must be solved in the interest of the world's economic stability.

Each of these analyses of the deficit is important, and each has significant implications for U.S. policies. In my discussion today, however, I should like to focus on two other perspectives which I believe offer useful insights into the kinds of policies that we need to follow.

Manufactured goods

Examination of our trade in manufactured goods tells us a great deal about the anatomy of our international trading relationships. Among both our exports and imports, manufactures comprise the biggest category of goods and have been the

backbone of America's strength in foreign trade over the last 50 years. For the four years from 1974 to 1978, however, the volume of our manufactured exports grew hardly at all. From 1976 to 1978, the balance of trade in manufactures deteriorated from a \$12-billion surplus to a \$6-billion deficit (see Table 1). That \$18-billion slide is nearly as large as the decline in the overall trade balance during the period.

TABLE 1.—U.S. TRADE BALANCE BY MAJOR END-USE CATEGORIES

(In billions of dollars, f.a.s. value)

Commodity	1976	1977	1978
Total	\$-5.9	\$-26.5	\$-28.5
Foods, feeds, beverages.....	+8.1	+5.6	+9.7
Industrial supplies.....	-28.9	-42.1	-42.8
Fuels	-29.9	-40.2	-38.4
Other	+1.0	-1.9	-4.4
Capital goods, excluding autos	+27.4	+25.4	+26.8
Automotive vehicles.....	-4.9	-6.6	-9.9
Consumer goods, excluding autos.....	-10.5	-13.0	-17.9
Special category (military goods).....	+2.6	+3.2	+4.5
Agricultural commodities.....	+12.1	+10.7	+14.8
Manufactured goods.....	+12.5	+3.6	-5.9

Manufactured goods are the category of trade with the greatest potential for improvement and comprise the key to resolving our trade problems. In fact, the balance in this key sector now is recovering. Since the first quarter of 1978, the real volume of U.S. manufactured exports has grown at an annual rate of more than 15 percent. By the fourth quarter of last year, our balance in manufactures was back into surplus at an annual rate of \$1.5 billion. To offset the rising deficit for oil and continue reducing our overall trade deficit, this surplus must increase much further.

Foreign trade data for January, released last week, showed a fairly sharp one-month setback in the balance for manufactures. While this setback may not be fully reversed in February, we think that it is an anomaly in a longer-term pattern of improvement, resulting in part from demand for goods generated by the fourth-quarter's very rapid rate of domestic economic growth.

The prospects for a growing surplus in manufactures this year are good for three reasons. First, economic growth abroad is expected to continue or to accelerate moderately, while U.S. economic growth will slow. Second, U.S. firms are now in a stronger competitive position because depreciation of the dollar over the past two years has raised the prices of foreign products relative to those of U.S. products, making our goods more attractive both to foreign buyers and to American customers. Third, we hope that our export promotion efforts, working in this conducive environment, can begin this year to make a long-term contribution to a stronger trade balance.

Of particular importance to our trade balance in manufactured goods is the component of capital goods. Exports of capital goods represent our strongest category of manufactured goods: our trade surplus in capital goods last year was \$27 billion—almost twice as large as our surplus in agricultural goods. However, this surplus has been essentially unchanged for the past three years. During the same three years, the deficit in our accounts for industrial supplies, including oil, rose by over \$14 billion, and our deficit for consumer goods rose by over \$11 billion.

The plateau in our capital-goods surplus is traceable to increased imports for our expanding economy and to the fact that markets abroad have been hampered by poor utilization of existing capacity. Economic expansion is continuing in other industrial countries, and we expect these export markets to strengthen. Moreover, this category of exports can be stimulated through actions to speed technological innovation in American industry, to facilitate export financing, and to eliminate disincentives that impede export growth.

Particularly encouraging signs—although not a sufficient basis for firm projections—are to be found in the data on trade in capital goods during the last half of 1978. Departing from the trend of the past three years, U.S. exports of capital goods increased in value by about 20 percent over the first half of the year. Imports, on the other hand, flattened as the year progressed. If these improved trends continue,

they will provide a needed and welcome change in our most important trade category.

U.S. trade by region

Another perspective on the trade balance comes from an examination of the trade outlook by region. Recent regional patterns, particularly when contrasted with those for our principal trading competitors, Europe and Japan, raise important issues.

The prospects for improvement in our trade balance are good for most areas, the notable exception being the OPEC countries. We registered a \$14-billion deficit with OPEC last year—about \$1 billion less than the average for the past three years. The stability of oil prices and of U.S. oil imports in 1978 plus rapid growth of our exports to OPEC countries yielded this result. Higher oil prices and a resumption of oil import growth will worsen our trade position with OPEC countries in 1979, however, and for an indeterminate period we shall see a decline in our exports to Iran, a country to which we exported some \$3.7 billion worth of goods last year.

The largest improvement in our trade should be a reversal of our declining balance with the industrial nations, which accounted for most of the recent deterioration in our accounts (see Table 2). It is likely that our trade surplus with Western Europe will grow this year, and our deficits with Canada and Japan should diminish.

The area that has captured the imagination of the public this year is China, where the establishment of diplomatic relations and China's vigorous efforts to modernize its economy create new market opportunities for U.S. exporters. Our exports to China nearly quintupled last year, to \$824 million; this year they are expected to double again. The dollar level of such trade remains relatively small, and we should not expect trade with China to affect dramatically our overall trade balance in the next two or three years. However, with a reduction of trade barriers between the two countries and aggressive selling efforts by U.S. firms, our exports to China could rise significantly in the 1980's. Although imports from China also will grow, we can expect to maintain a substantial surplus.

We have paid close attention for good reasons to our bilateral trade balance with other major regions and countries, particularly the arresting figures on our trade with Japan. Also of importance, however, are the comparative trade performances of our country versus Western Europe and Japan in third-country markets.

TABLE 2.—U.S. TRADE BALANCE BY REGION

(In billions of dollars, f.a.s. value)

Country	1976	1977	1978
Total	\$-5.9	\$-26.5	\$-28.5
Developed countries	+3.6	-3.7	-13.4
Canada	-2.1	-3.8	-5.2
Japan	-5.4	-8.0	-11.6
Western Europe	+9.6	+7.1	+3.4
Germany, Federal Republic of	+0.1	-1.2	-3.0
Other Western Europe	+9.5	+8.3	+6.4
Other developed countries	+1.5	+1.0	-0.1
OPEC	-12.5	-19.1	-14.0
Non-OPEC developing countries	+0.2	-5.2	-4.4
Asia—3 countries ¹	-3.0	-4.0	-5.3
Other developing countries	+3.2	-1.2	+0.9
Centrally planned economies	+2.6	+1.4	+2.7
China, Peoples Republic of	-0.1	(²)	+0.5

¹ Hong Kong, Korea, and Taiwan.

² Less than \$0.05 billion.

For Example, our respective trade balance and the trends over the past three years indicate that, in non-OPEC developing countries, both Japan and Western Europe have more favorable trade balances than the U.S. Stated differently, the export performance of Europe and Japan in such third-country markets surpasses our own, suggesting that they have more competitive products, more aggressive marketing, fewer domestic impediments to exporting, or some combination of the

three. These data have special significance for the importance of our cultivating new attitudes and new policies with respect to exporting.

Export policies

This Committee has heard discussions recently of many important policies that are relevant to the state of our domestic economy as well as to our trade situation. Among these are macroeconomic policies, both fiscal and monetary; energy policies; the conclusion and implementation of the multilateral trade negotiations; and others. All are important. I should like, however, to concentrate on the importance of export measures—measures that only recently have been recognized in our country as economic policies of fundamental importance.

After decades of development with seemingly limitless natural resources, vast and expanding domestic markets, and entrenched indifference to exporting, we have begun to focus on the importance of exports to our national economic health. The trade deficits and exchange-rate declines created by abruptly spiralling payments for oil and other imports forced us to devote our attention to the export half of the trade equation. President Carter's announcement of a National Export Policy reflects a recognition of the importance of our trade balance to the overall state of our economy.

The National Export Policy, which is only a modest beginning, is more important for its creation than for any of its particular elements. Increased authorizations for the export-import bank, enhanced export promotion programs at Commerce and State, the ongoing study of export disincentives, a computerized system of foreign market opportunities—these and other aspects of the export policy are all vitally important, even though we must recognize that they fall short of the government support often afforded to foreign firms. In short, the elements of the National Export Policy announced by President Carter last fall are important economic measures; the policy from which they spring, however, is still in its infancy. A primary goal of the National Export Policy is to foster a change in attitude. Policies to provide greater assistance to exporters and to minimize export disincentives are only a small part of the answer. Other policies, including agreements regulating government assistance offered to competing foreign suppliers, will be necessary.

Japan presents unique problems, even though the Japanese have shown greater awareness of their responsibility to reduce their trade surplus. In the Department of Commerce, we are pursuing a strategy to increase U.S. firms' awareness of business opportunities in the Japanese market. It was as a part of this effort that I led a large U.S. export development mission to Japan last October. We also are continuing to campaign intensively through the newly created Trade Facilitation Committee to remove or reduce specific Japanese impediments to imports which our exporters have identified. In their discussions with Secretary Blumenthal last week, the Japanese indicated that they recognize the significance of this problem.

By these steps we have begun to facilitate the exporting process. We cannot expect instant results. I know that you in Congress have a strong interest in assisting U.S. exports, and this subject may be considered this year in connection with the multilateral trade negotiations (MTN) and other legislation. Indeed, a logical next step on export policy may be to integrate implementation of the MTN with a strengthened export expansion drive.

PRODUCTIVITY

Finally I should like to touch briefly on the subject of productivity. The decline in productivity growth is central to our domestic problem of inflation and the threat which it poses to the expansion of production and employment. Productivity growth lagging behind that of industries abroad places our producers at a disadvantage in international trade and contributes to the whole complex of problems that arise from a prolonged trade deficit.

The last decade has witnessed a remarkable slowdown in the rate of productivity growth in the United States. Last year labor productivity in the private economy increased by only 0.5 percent compared to an increase of 1.5 percent during 1977. This compares to a trend rate of growth of about 3.1 percent annually between 1950 and 1967, and a 2.3 percent trend rate from 1967 to 1973.

The greatest slump in productivity growth is centered in nonmanufacturing sectors, particularly construction, mining, and retail trade. While overall productivity in manufacturing has declined by less, serious problems have been encountered in many industries.

A number of possible factors account for declining productivity: the end of migration out of the low-productivity farm sector; the shift toward a younger, less experienced work force; expenditures for pollution abatement and worker safety, the

benefits of which are not counted in our national economic accounts; slower growth recently in the amount of capital per worker; and a lag in research and development expenditures. The Department of Commerce recently has completed a comprehensive review of our knowledge about the causes of the decline in productivity growth. I have attached to my statement a copy of this paper. Our work on the subject is continuing.

Another matter of central importance to the pace of productivity growth is the rate of innovation in industry—the focus of a domestic policy review, undertaken in May of 1978 pursuant to President Carter's instruction. Among other things, this review deals with the effects on industrial innovation of such Federal policies as procurement, patents and information, direct support of research and development, environmental, health and safety regulations, and regulation of industry structure and competition. The role of small business in the innovation process will be a special concern of this policy review.

Senior executives from industry, labor, academic and public interest communities have participated in the review, as well as policymakers from more than 30 Federal agencies. Public participation culminated in a series of public symposia in January. Recommendations will be delivered to President Carter at the end of March.

This study has obvious implications for trade, particularly since the United States' greatest comparative advantage has been in the high-technology industries. Both the rate of industrial innovation and the broader question of general productivity growth affect the whole gamut of the Nation's economic problems and deserve our highest-priority attention. As we continue our work on these issues, which must comprise important elements of any national industrial policy, we shall be happy to keep the Committee informed.

Mr. Chairman, that concludes my prepared remarks. I shall be pleased to respond to any questions the Committee might have.

Attachment.

THE PRODUCTIVITY DECLINE: ITS CAUSES AND EFFECTS¹.

The answer to the productivity enigma probably will be found only among the nuts and bolts of industry (to adapt the "needle-in-a-haystack" metaphor to an industrial setting). The Department of Commerce is examining these nuts and bolts, using its expertise on individual industrial sectors plus its economic and technical specialists.

Significance of the productivity decline

Average labor productivity in the private domestic economy rose by 3.1 percent per year from 1950 to 1967, but its growth slowed to 2.3 percent from 1967 to 1973 and dropped to 1.2 percent from 1973 to 1977, partly because of the recession. For sensible comparisons it is vital to measure productivity growth between years of comparable capacity utilization. Many statements ignore this principle. The years chosen above appear to be the best for comparison, although capacity utilization in 1977 was considerably below that in 1967 or 1973.

Labor productivity is a simplified concept that fails to take account of the amounts of capital and other resources combined with labor in the production process. To the extent that the growth of labor productivity approximates that of total factor productivity, rising real output per hour worked is the basis for rising real income per hour. In fact, slower growth in output per work hour since 1967 has been associated with slower real income growth. If productivity had continued to rise since 1967 at its previous rate, its level (and by inference real income per hour worked) would be more than 15 percent higher than it is.

This income gain would have been realized primarily in terms of lower domestic prices and perhaps a somewhat higher exchange rate. The most marked slowdown in productivity growth has occurred, however, in sectors which are not much involved in international trade.

Confirmed reasons for the slowdown

The end of shift from farming to higher-productivity sectors accounted for one-fifth to one-quarter of the productivity decline; this shift was traceable to a one-time revolution in farm technology that will not be repeated.

¹A synopsis submitted to the Productivity Council. Prepared by the Office of the Chief Economist, Department of Commerce, February 1979.

TABLE 1.—AVERAGE ANNUAL RATE OF GROWTH OF PRODUCTIVITY

	(1) 1950-67	(2) 1967-77	(1) - (2) Change
Construction	3.2	-1.8	-5.0
Mining	4.4	-1.9	-6.3
Transportation.....	2.9	2.3	-0.6
Communication.....	5.2	5.5	0.3
Utilities.....	5.9	2.0	-3.9
Wholesale trade.....	2.6	1.8	-0.8
Retail trade.....	2.3	1.5	-0.8
Finance, insurance, and real estate.....	0.3	0.5	0.2
Services.....	1.2	0.9	-0.3
Durable manufacturing.....	2.2	2.2	0.0
Nondurable manufacturing.....	3.0	3.3	0.3

TABLE 2.—GROWTH IN PRODUCTIVITY WITHIN SECTORS, ANNUAL AVERAGE CONTRIBUTION TO TOTAL

Construction	(1) 1950-67	(2) 1967-77	(1) - (2) Change
Construction	0.24	-0.12	-0.36
Mining15	-.04	-.19
Transportation.....	.19	.13	-.06
Communication.....	.10	.17	.07
Utilities.....	.13	.06	-.07
Wholesale trade.....	.19	.14	-.05
Retail trade.....	.33	.19	-.14
Finance, insurance, and real estate.....	.03	.05	.02
Services.....	.16	.12	-.04
Durable manufacturing.....	.42	.45	.03
Nondurable manufacturing.....	.41	.44	.03
Total private nonfarm	2.35	1.59	-.76

Source: Council on Wage and Price Stability, "Inflation Update," October 1978.

The shift toward a younger, less experienced work force accounts for another 20 to 25 percent of the decline but should be largely reversed in the next 10 to 15 years, as the number of new workers declines and the large group that entered the labor force from 1965 to 1980 moves into its most productive years.

Pollution abatement and worker safety expenditures: Denison has ascribed a growing productivity cost to these factors (cf. Survey of Current Business, January 1978). Their effect on true productivity (including benefits not measured in the national income accounts) presumably was positive in the early stage of implementing these policies, given the heavy industrialization of the United States and the lack of attention to pollution and many aspects of worker safety before the mid-1960's. The costs now are rising rapidly, however, and it is time to reexamine the efficacy of these and other regulatory standards set for the 1980's.

The collapse of productivity in three nonmanufacturing sectors accounted for 90 percent of the net decline in nonfarm productivity growth shown in Table 2.

Construction: Despite intense controversy about the accuracy of the statistics, our research indicates that the productivity decline is more than a figment of the data. Measurement problems cannot account for any substantial part of the apparent productivity plunge. A technical paper by the Office of the Chief Economist, Department of Commerce, is available on this issue. The construction labor force has shown an even greater shift toward inexperienced workers than the economy as a whole, however, and we are continuing to examine this sector to identify other sources of this disappointing performance.

Mining: Mine health and safety regulations, reclamation statutes and new union rules have cut coal mining productivity sharply (40 percent underground since 1969 and 28 percent in surface mines since 1973). Many inexperienced workers also have entered this sector. Reopening of marginal mines also has contributed to declining productivity. Coal prices would have risen anyway after cartelization of oil prices,

and tighter safety and reclamation regulations were good ways to spend some of the revenues. Excess profits seem now to have been absorbed, however, and future policy must proceed with caution to balance needs for energy, exports, environmental protection and worker safety. No such windfall price increases have come to the aid of other mining sectors. Some of the productivity losses in those sectors have been caused by production cutbacks due to low demand.

Retail and Wholesale Trade: The lag in productivity growth in retail trade seems to be concentrated, according to the figures, in foodstores and eating and drinking establishments (30 percent of the retail sector). Productivity in foodstores dropped by about 9 percent from 1972 to 1974, followed by a very meager recovery. At the same time, chain foodstores substantially shortened their hours in the wake of the energy shortages of autumn 1973, which should have boosted productivity. Moreover, automated cash registers introduced in recent years should make inventory and resupply procedures more efficient. Productivity in eating and drinking establishments has been virtually stagnant (growing at 0.5 percent per year) for the period, 1966-1977. This too defies explanation in light of the rapid spread during this period of supposedly efficient fast-food chains. Flagging productivity in these retail sectors was partly offset by the major boost in output per labor hour in gasoline service stations, especially with the widespread introduction of "gas and go" stations since 1975. Productivity growth in wholesale trade remained strong through 1973 but appears to have collapsed since then; this requires explanation. Release of the 1977 Economic Census within the next few months will provide a new basis for examination of this poorly documented sector.

Other debatable propositions about the slowdown

A Slowdown in Capital-Labor Ratios: It often is alleged that slower growth of capital-labor ratios since 1967—in other words, a deficiency of capital investment—is responsible for slower growth of productivity. This would not be surprising in view of the sudden acceleration in labor force growth after 1965 due to demographic factors. If one focuses on business structures and equipment, one finds that the growth of the net stock of this type of capital accelerated in the period, 1966 to 1973, but the capital-labor ratio grew somewhat more slowly than in the earlier period—2.8 versus 3 percent per year. On closer examination, however, lower investment in the farm sector accounts entirely for the slowdown in the capital-labor ratio, for the substitution of capital for labor in farming was largely completed by 1966. In the nonfarm business sector there was a slight acceleration in the capital-labor ratio even after excluding pollution abatement expenditures.

After 1973, however, growth of the capital-labor ratio slowed down. Clearly the recession of 1974-75 had a major negative impact, and the recovery was by no means complete by 1977 (the latest data year). The unprecedented declines in the net capital-labor ratio in 1976 and 1977 stem from the much publicized lag in business investment during this recovery period together with the exceptionally rapid employment growth. The lag in investment presumably was due to the extent of unused capacity in many sectors plus a reluctance to invest in the face of exceptional uncertainty about economic conditions, energy prices and regulatory changes. Also, the prices of capital goods have risen very sharply since 1973.

A slowdown in research and development: Confusingly diverse statements are heard on this subject because of the disparate trends in civilian R. & D. versus military-space R. & D. Total R. & D. declined in real terms from 1968 to 1972, because of reductions in the high levels of military and space R. & D. of the 1960's. It regained its 1968 level only in 1977. Real civilian R. & D. has risen every year except 1975 and, since 1973, has tended to revive somewhat as a share of GNP. In particular, large increases in company-funded R. & D. in 1973 and 1976 plus boosts in federal funding for energy and environmental R. & D. in 1977 and 1978 have raised the total. Projections of civilian R. & D. spending for 1979 indicate little, if any, increase as a fraction of GNP. (See table and charts that follow.)

The shift from goods to services production: The broadly defined services sector has an average productivity level as high as the goods-producing sector, because of the highly capitalized and rapidly expanding utilities, communications and transportation services sectors. The narrowly defined services sector, on the other hand, has grown rapidly with low productivity but remains only about 15 percent of the economy and incapable of explaining a large part of the productivity slowdown. An intermediate version of this proposition might explain more, e.g., one encompassing narrowly defined services plus retail and wholesale trade. We are examining this variant.

It is worth pointing out that productivity growth in manufacturing did not decline significantly before 1973. Its decline since 1973 can be explained largely by lower capacity utilization. Agricultural productivity continues to grow rapidly. This tends

to imply that our lagging trade performance is not due to a productivity bust in sectors engaged in trade (although other nations' manufacturing productivity may be growing faster). It also suggests that proposals to solve productivity problems that concentrate on manufacturing may put the emphasis in the wrong place.

Table 3

Trends in National R&D Funds, Excluding Federal Funds for National Defense and Space; 1969-1979

Year	Federal Government "All Civilian 1/"		Private Industry ²		All Other ^{2/ 3/}		Total	
	(mil. 1972\$)	(percent change)	(mil. 1972\$)	(percent change)	(mil. 1972\$)	(percent change)	(mil. 1972\$)	(percent change)
1969	4,121	--	11,613	--	842	--	16,577	--
1970	4,234	2.7	11,484	-1.1	878	4.3	16,596	0.1
1971	4,751	12.2	11,311	-1.5	931	6.0	16,993	2.4
1972	4,882	2.8	11,698	3.4	960	3.1	17,540	3.2
1973	4,975	1.9	12,718	8.7	985	2.6	18,681	6.5
1974	5,263	5.8	13,204	3.8	1,001	1.6	19,468	4.2
1975	5,456	3.7	12,670	-4.1	1,012	1.1	19,138	-1.7
1976	5,575	2.2	13,356	5.4	1,038	2.6	19,969	4.3
1977 (prelim)	6,324	13.4	13,871	3.9	1,064	2.5	21,259	6.5
1978 (est)	6,903	9.2	14,320	3.2	1,118	5.1	22,341	5.1
1979 (est) ^{4/}	7,125	3.2	14,647	2.3	1,136	1.6	22,908	2.5
Compound Annual Rate of Change 1969-79		5.6		2.3		3.0		3.3

^{1/} 13 areas, including Health, Energy, Science, Environment.

^{2/} Limited amounts of privately funded military and space-related research is included in these categories.

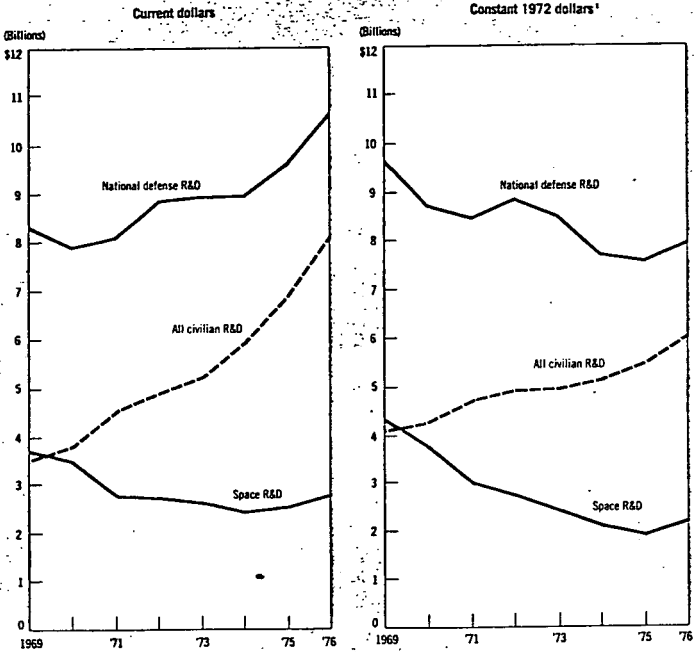
^{3/} Universities, Colleges, and other non-profit institutions.

^{4/} An 8-percent inflation rate is assumed

Source: National Science Foundation

Chart 1

2-9
Federal obligations for R&D by major function, 1969-76



*GDP implicit price deflators used to convert current dollars to constant 1972 dollars.

NOTE: Estimates are shown for 1975 and 1976.

REFERENCE: Appendix Table 2-11.

Thoughts about the future

Maintaining good business conditions is the most important productivity policy. All others are futile without this. Recession would reverse productivity and business investment growth and set them back permanently.

Recognize the potential of natural corrective forces. The progress of knowledge continues, and a backlog of opportunities for productive investments accumulates during periods of poor business conditions such as those dominating the past ten years. This backlog can be unlocked by the return of better business conditions and greater confidence in the future.

Focus regulatory policy to stress the use of approaches based on cost-effectiveness, flexibility in application and clear, well-specified objectives.

The very quick and substantial productivity payoff from relaxing regulation in the airline industry suggests that consideration should be given to actions that unlock existing potential by increasing competition (e.g., in surface transportation, communications, the professions, etc.) and that reduce government-imposed costs through cutting paperwork and other regulatory burdens.

Policies dealing with industrial innovation—patent policies, R. & D. spending, tax provisions or government loans—are the concerns of the Interagency Industrial Innovation Task Force, which will report on its findings shortly.

Other important types of policies affecting productivity are tax policies, training and technology policies, and industrial adjustment policies. No attempt is made here to elaborate on these. Meanwhile, efforts are being made to improve the measurement and analysis of productivity.

AVERAGE ANNUAL RATES OF CHANGE IN OUTPUT FOR EMPLOYEE HOURS FOR SELECTED INDUSTRIES,
1947-66 AND 1966-76

Industry (SIC code)	1947-66	1966-76
Mining:		
Iron mining, usable ore (1011)	3.8	0.8
Copper mining, recoverable metal (1021)	3.6	-0.2
Coal mining (111,121)	6.6	-3.5
Bituminous coal and lignite mining (121)	6.8	-3.6
Nonmetallic minerals (14)	4.1	2.3
Crushed and broken stone (142)	3.9	3.6
Manufacturing:		
Canning and preserving (203)	2.7	3.2
Grain mill products (204)	4.0	2.9
Flour and other grain mill products (2041)	4.0	2.0
Cereal breakfast foods (2043)	2.0	1.2
Rice milling (2044)	8.5	1.3
Blended and prepared flour (2045)	4.7	1.4
Wet corn milling (2046)	2.1	5.3
Prepared feeds for animals and fowls (2047,48)	3	3.4
Bakery products (2051)	2.0	1.8
Sugar (2061,62,63)	4.6	1.5
Candy and confectionery products (2065)	3.5	4.7
Malt beverages (2082)	4.3	6.7
Bottled and canned soft drinks (2086)	2.2	3.2
Tobacco products—total (2111,21,31)	3.7	1.7
Cigarettes, chewing and smoking tobacco (2111,31)	1.4	1.3
Cigars (2121)	6.6	2.7
Hosiery (2251,52)	4.8	8.7
Sawmills and planing mills, general (2421)	3.5	2.1
Paper, paperboard, and pulp mills (2611,21,31,61)	3.9	3.5
Corrugated and solid fiber boxes (2653)	3.2	4.5
Synthetic fibers (2823,24)	4.1	8.1
Pharmaceutical preparations (2834)	5.0	4.8
Paints and allied products (2851)	3.7	2.5
Petroleum refining (2911)	5.9	3.1
Tires and inner tubes (3011)	4.2	2.3
Footwear (314)	1.9	0.4

See footnotes at end of table.

AVERAGE ANNUAL RATES OF CHANGE IN OUTPUT FOR EMPLOYEE HOURS FOR SELECTED INDUSTRIES,
1947-66 AND 1966-76—Continued

Industry (SIC code)	1947-66	1966-76
Glass containers (3221).....	1.3	2.2
Hydraulic cement (3241).....	4.7	1.7
Structural clay (325).....	*3.3	3.5
Clay construction products (3251,53,59).....	*3.1	3.5
Clay refractories (3255).....	*4.0	3.3
Concrete products (3271,72).....	3.2	*1.9
Ready-mixed concrete (3273).....	*2.3	*1.4
Steel (331).....	1.7	1.8
Gray iron foundries (3321).....	*2.4	2.6
Steel foundries (3324,25).....	*1.8	1.9
Primary copper, lead, and zinc (3331,32,33).....	2.6	2.3
Primary aluminum (3334).....	5.3	1.2
Copper rolling and drawing (3351).....	*6.7	-0.5
Aluminum rolling and drawing (3353,54,55).....	*6.6	5.8
Metal cans (3411).....	2.5	1.7
Major household appliances (3631,32,33,39).....	*6.8	4.6
Radio and television receiving sets (3651).....	*6.1	3.2
Motor vehicles and equipment (371).....	*4.8	3.4
Other:		
Railroads, revenue traffic (401 Class I).....	4.6	3.4
Intercity trucking (4213 PT.).....	*2.8	*2.3
Intercity trucking (general freight) (4213 PT.).....	*2.4	*2.0
Air transportation (4511).....	7.9	4.4
Petroleum pipelines (4612,13).....	*9.6	6.0
Telephone communications (4811).....	*7.2	5.6
Gas and electric utilities (491,92,93).....	7.3	3.6
Retail food stores (54).....	*3.1	0.8
Franchised new car dealers (5511).....	*2.5	2.5
Gasoline service stations (5541).....	*2.8	4.3
Eating and drinking places (58).....	*0.9	0.5
Hotels and motels (7011).....	*2.7	1.3

- * 1954-66.
- * 1958-66.
- * 1963-66.
- * 1966-75.
- * 1957-66.
- * 1966-74.
- * 1951-66.

Source: Bureau of Labor Statistics, U.S. Department of Labor.

Representative MITCHELL. Mr. Marshall, before you begin, please understand that I am not attempting to impose any time constraints, but I know that the Secretary has to leave at 11:15 this morning and obviously the members of the committee want to question her. Could you give me an idea as to how long you will be testifying, roughly? In doing so, I can make a determination as to whether or not we go into questions now.

Secretary MARSHALL. It won't take me any more than, I think, 20 minutes at most to do and I can accelerate that if you want me to.

Representative MITCHELL. I would appreciate it. I know the members want to hear your testimony. Would you limit your testimony to 15 minutes.

Secretary MARSHALL. All right.

Representative MITCHELL. That will give us an opportunity to question both of you.

Senator JAVITS. Congressman Mitchell, may I just apologize.

I cannot stay. I am handling the Taiwan bit on the floor. They are both friends, even though I cannot stay for questions.

Representative MITCHELL. We will also be debating the Taiwan issue on the House side.

Mr. Secretary, please proceed.

STATEMENT OF HON. RAY MARSHALL, SECRETARY OF LABOR

Secretary MARSHALL. Thank you.

Congressman Mitchell, members of the committee, the first part of my prepared statement which I will simply summarize with your permission and enter into the record, deals with the progress that we made in dealing with the problem of unemployment.

I think that you are well aware of that but I think it is important to emphasize that we are making substantial progress, and have made substantial progress towards achieving the Humphrey-Hawkins employment goal of 4 percent.

The decline that we have witnessed in the last year is nearly twice as large as the average annual reduction needed to reach that objective and it makes me be optimistic that in spite of the fact that it will be difficult to do it, that we nevertheless can do it; that is, that unemployment was just under 8 percent and is now under 6, and we have gone more than halfway toward that 4-percent objective.

Inflation remains a problem and, as Secretary Kreps pointed out, the decline in the value of the dollar is a problem. We think that, because of the decline of cyclical unemployment, in the immediate future we should concentrate on structural problems in the economy, both on the unemployment side and on the inflation side.

The reason for that is that the most effective way to deal with the problem of inflation at this juncture is to reduce structural unemployment among those who are not in short supply, who have much higher unemployment rates than the average, and, therefore, who will not contribute to the inflationary pressures or labor shortage in any way as a result of their entering the work force.

In fact, we think the contrary is the case, that it is much less inflationary to have people enter the work force than most of the alternatives available. There is a structural aspect of inflation which manifests itself in differential rates of inflation in different parts of the economy.

This is true of the labor market as well as product markets and we think, therefore, that it is important to concentrate on the structural aspects with both inflation and unemployment.

I think it would be a mistake if your opening question implied for us to ignore, however, the possibility of a cyclical downswing. We don't expect a significant downswing but we think we need to be prepared for it in the Department of Labor and in the administration. As you recall on the CETA reauthorization bill we maintained the capability of increasing the countercyclical jobs program if we needed to do that and the problems of rising unemployment are above the amount that we expect.

What we think is required at this stage is to concentrate heavily on the problem of inflation. The reason for that is that we believe that if we don't bring inflation under control it will be very difficult for us to achieve Humphrey-Hawkins objectives. That is, we will have a recession and that recession will lead to rising unemployment and a rising Federal budget deficit.

With respect to the deficit we think that the \$29 billion is about right. I do not think it would be a good idea to try to balance the budget every year. I think there is no evidence that a balanced budget guarantees a healthy economy.

The budget should be viewed as the result of the economy as well as causing the economic activity. We should look at the relationship between the rising unemployment, for example, and the budget deficit as well as the effect of the deficit on inflation.

There is no necessary relationship between the budget deficit and inflation.

We don't believe—and my prepared statement goes into some detail on this—that there is much evidence of tightness of the labor market now that contributes to inflationary pressure. We rather believe that the inflationary pressures are caused by things outside of the labor market. But we do believe that we should use this opportunity and this occasion of a tight budget and within the budget constraints, to concentrate most of our resources on the people who need the most help.

I call your attention to the fact that that is what we are doing in the CETA system. Until the CETA reauthorization of 1978, in order to be eligible for the CETA programs, you had to be unemployed or disadvantaged. Now you must be unemployed and disadvantaged.

We believe that it is also important for us to improve the system not only by targeting but by concentrating more of our resources to try to develop linkages between the public employment training system and the regular economy.

So, in short, Congressman Mitchell, we believe that we can achieve those Humphrey-Hawkins objectives. We believe the evidence we have put together so far in reducing unemployment indicates the way that we can do that.

We believe that the mechanisms are outlined in the Humphrey-Hawkins bill it would make it possible for us to accomplish those objectives. We do believe that we have to concentrate much more in the next year or year and a half on containing inflation while we simultaneously reduce the differentials in unemployment rates.

I express that because, even though the overall unemployment rate will probably not go down, we can do a lot to cause the differentials to be reduced by concentrating most of our resources on the people and places with the highest levels of unemployment.

We believe that that will also help with the inflation fight because many of the sources of inflationary pressures in our economy originate during recessions. That is, the time that we don't invest in people through education and training. When we are operating at partial capacity that we don't get the investment in plant and equipment and a failure to get investment tends to be one of the factors responsible for declining productivity. All of those things show up as inflationary pressures when the economy improves.

I think that what we need to do on the inflation front is to improve the operation of the labor market, improve the training of people in our labor market information system, and improve the effectiveness of our program so that we use public resources as efficiently as possible. I think we need to concentrate on the sectors of the economy that tend to be most responsible for inflationary pressures—food, energy, health, and housing—and to do everything that we can to overcome the inflationary pressures that appear in those sectors of the economy. That is essentially the policy that we have developed.

Our overall wage-price standards are designed to concentrate public attention on above-average increases in wages and prices and then to try to hold down those wage and price increases to standards that we have established. We will take other measures to relieve shortages if shortages exist, to overcome market power that tends to make it possible for people to increase their wages and prices when there are no shortages, and to introduce as much stability as we can in the system. I believe that one of the main ways that we can reduce the inflationary pressures that tend to show up in the economy is to generate stability because a careful examination of those pressures indicates that many of them are due to instability.

Congressman Mitchell, I will end my testimony there.

I have a white paper that, with your permission, I would like to put into the record also that we prepared on the CETA system and its role in achieving the Humphrey-Hawkins objectives of both 4-percent unemployment and stable prices.

Representative MITCHELL. Without objection, your prepared statement and white paper will be entered into the record at this point.

[The prepared statement of Secretary Marshall and the white paper entitled "The New Comprehensive Employment and Training Program" follow:]

PREPARED STATEMENT OF HON. RAY MARSHALL

Good morning Mr. Chairman and members of the committee, I am pleased to be here to discuss the current economic situation before this Committee.

Last year substantial progress was made towards the Humphrey-Hawkins Act unemployment goal. Employment increased by 3.9 percent (3.6 million persons) between the fourth quarter of 1977 and the fourth quarter of 1978. Over the same period, the unemployment rate dropped from 6.6 percent to 5.8 percent. This decline is nearly twice as large as the average annual reduction needed to reach the 4.0 percent goal in 1983.

But the news on the price front was discouraging. The Consumer Price Index, for example, rose 9 percent between December 1977 and December 1978. In addition, the value of the dollar deteriorated sharply, largely as the result of faster growth here than abroad. These two adverse developments led to decisions to slow the rate of economic growth during the 1979-90 period to avoid the possibility of making inflation worse by overheating the economy.

During the period of slow growth it is especially important that we proceed with structural programs designed to reduce unemployment among those most in need since their prospects will not be improved over the next few years by overall economic growth. Furthermore, it is an important time to make progress with structural programs designed to reduce inflation. If these programs are successful, economic growth can be increased in subsequent years. The next two years should be viewed as a time when the impacts of structural programs are allowed to catch up with the impacts of past aggregate demand growth.

In addition, given the state of the art of economic forecasting, it is essential that we maintain the countercyclical capacity of public service employment as now

specified by Title VI of the Comprehensive Employment and Training Act, to protect workers if our forecasts are incorrect.

Role of aggregate demand

I want to emphasize that the Administration wants to moderate the growth of aggregate demand, not to stop it, much less to move the economy into recession.

We feel that a deficit of \$29 billion is the right deficit for the economy at this time. A higher deficit would increase by too much the risk of worsening inflation and a lower deficit would reduce by too much the prospects for economic growth at an acceptable level. The \$29 billion figure is consistent with our need to balance our dual objectives of lowering inflation and unemployment.

There are those who argue that we should be required to balance our budget at all times. I do not agree with this view. Balanced Federal budgets do not guarantee a healthy economy. The largest deficit of the last five years occurred in fiscal year 1976, a year in which the inflation rate was 5.9 percent; the lowest deficit was registered in a year in which the inflation rate was 11 percent. It is simply not true that the size of the deficit is proportional to the inflation rate. The appropriate deficit or surplus depends on the state of the rest of the economy.

The policy we have chosen for 1979 and 1980 is one of moderate growth. We feel unemployment rates are already at high enough levels to preclude the possibility of a surge in inflation because of labor shortages. In fact, there is a substantial margin between existing employment rates and rates that have been associated in the past with accelerating inflation.

It has become popular to quote the unemployment rate for prime-age males, men aged 25 through 54, as the rate most closely associated with inflation. This rate dropped from 3.9 percent during the fourth quarter of 1977 to 3.3 percent during the fourth quarter of last year, but it remained well above the 2.5 percent rate averaged in 1973 when inflationary pressures arose. Other demographic, geographic, occupational, and industrial measures of unemployment show similar patterns—substantial improvement over a year ago, but levels well above those that existed in 1973.

This thesis is also supported by observing where the greatest increases in prices occurred. Although the CPI increased 9 percent last year, the prices of goods, excluding food and the cost of mortgage interest payments, rose only 7.7 percent. Acceleration of food price inflation and mortgage interest costs cannot be attributed to labor market pressures. These factors tend to cause higher wage rates rather than to be caused by them. Import price increases, the widening of profit margins, and the reduction of productivity growth were all important sources of the increase in inflation in 1978. None of these were caused by wage pressures. The larger wage increases that did take place in 1978 were no higher than historical experience indicates should be expected when price inflation accelerates as it did during that year.

Unfortunately this exogenous inflation is projected to continue in 1979, and to be made worse by energy price problems which did not bother us a year ago.

The economy ended 1978 with considerable forward momentum—high sales, low inventories, high levels of business fixed investment—and with the prospect of a substantial personal and business income tax cut this year. This will maintain growth at a reasonable rate through the first part of the year. Later, however, growth may slow.

Since the only possible justification for slower growth is to reduce inflation, it is essential that we make progress during this period with our anti-inflation program. And, since an undeniable characteristic of slow growth is a lack of progress against unemployment, it is important we use this period to strengthen our structural programs so unemployment continues to fall among those most in need. Simultaneous progress against both inflation and unemployment requires successful structural programs addressed to both problems. These programs are linked to our overall economic policy through the Humphrey-Hawkins framework.

Reducing structural unemployment

Reducing structural unemployment is an integral part of Humphrey-Hawkins Act strategy.

Recent research indicates that increased employment of the hard-to-employ exerts little, if any, current inflationary pressure. In the long run we believe it reduces inflation, because it adds to the supply of skilled workers.

Employment and training programs conducted through the Labor Department have been and will continue to be more and more closely targeted toward those individuals whose chronic unemployment or underemployment is due to lack of adequate preparation for the labor market as reflected by their low incomes. Our progress in targeting these programs has been gratifying. Economically disadvan-

taged enrollees as a proportion of the total rose from 47 percent in fiscal year 1976 to 61 percent for fiscal year 1978 for programs conducted under Title II, from 44 percent to 80 percent under Title VI and from 76 percent to 80 percent under Title I.

The first results of the Continuous Longitudinal Manpower Survey are now in and they indicate that local CETA programs have in fact been effective in improving the labor force experience of enrollees. This survey is our basic source of data on program participants.

While gratifying, the Department of Labor views these results as only the beginning of progress that can be made. This year CETA programs will be expanded to meet a broader range of individual needs and will be even more carefully targeted to reach those in greatest need. Connections with the private sector will be strengthened, through private industry councils, implementation of the targeted employment tax credit, cooperation with non-profit agencies, and improvement of the Job Service. I am including for the record the Labor Department's White Paper on the new Comprehensive Employment and Training Program, which describes these changes in more detail.

Moreover, existing programs should do a better job this year. Partly this will result from strengthened management at the national and regional office levels, from a number of increased controls over abuse required by the CETA reauthorization, and from an entirely new program of management assistance for local program managers. In addition, it will result from the experience local program managers have themselves gained in working with economically disadvantaged persons and learning how best to produce the improvements in skills and experience required both for the needs of the sponsor and for the improved employability of the enrollee.

In summary, our structural employment programs will continue to support our overall objectives of reducing unemployment and inflation and of distributing the burden of unemployment more equitably among our citizens. We expect to make progress this year in improving the quality of these programs and in determining the quantitative links between these programs and the overall goals.

Structural programs to reduce inflation

The anti-inflation program announced by the President last October is off to a good start. The American public generally wants to break the wage-price spiral that began over ten years ago. Compliance is now the rule, noncompliance the exception. The program is expected to reduce this year's price inflation by three-quarters of a percentage point from what would otherwise have been the case.

Given anticipated food and energy price inflation during 1979, however, it is important that every avenue of potential price deceleration be explored. Compliance can be expected to continue if workers' real incomes are preserved, but not necessarily if they are eroded by price inflation. I would therefore like to discuss some of the areas where additional anti-inflationary initiatives have been taken.

Last April, the President called for the development of special programs to deal with individual sectors of the economy where government actions have the greatest potential for reducing inflation. He specifically named housing, medical care, food, transportation, energy, and primary metals as sectors to be investigated.

Some progress has been made. The Administration's hospital cost containment program is one example. Changes in airline regulations that produced dramatic improvements in productivity and reductions in fares are another.

On a smaller scale, the Department of Labor has organized tripartite committees, representing business, labor, and government for the purpose of increasing productivity in specific industries. In Chicago such committees are attempting to reduce seasonality in construction. In Massachusetts labor-management committees are acting to improve productivity of workers in municipal governments.

It is noteworthy that many CETA employees are reducing the demand for energy by weatherproofing low-income housing while learning their trades.

But clearly much more can be done. I would recommend the establishment of targets and time constraints to investigate special sectors demonstrating high inflation rates. We need to find specific solutions to specific problems, both large and small. Enlistment of microeconomists and program operators in helping to manage the battle against inflation may prove to be the decisive factor in the outcome.

Achieving Humphrey-Hawkins Act goals

The short and long terms goals described in the Economic Report of the President are achievable, though difficult. I have been asked to address the unemployment goals in particular.

Prospects of obtaining the economic growth required to hold the unemployment rate in the neighborhood of 6 percent during 1979 are good. Despite monetary stringency, the economy entered this year with forward momentum and with few dangerous imbalances; current growth also is receiving the stimulation produced by personal and business income tax reductions.

The improvement of growth and reduction of unemployment forecast for 1980, on the other hand, depends heavily on progress made this year in reducing inflation. If the President's wage and price guidelines are supplemented with significant structural efforts to reduce inflation in particular sectors, this progress can be made, and macroeconomic growth can proceed towards levels required to reach Humphrey-Hawkins Act goals.

Near-term uncertainty, however, means that it is necessary to preserve built-in stabilizing capacity within our economic system. These include the countercyclical capacity of Title VI of the Comprehensive Employment and Training Act. If the economy were to begin to slip into recession, some of the impact could be absorbed by the provision of title VI which provides authority for the President to request an increase in funding for public service employment when unemployment rises.

Beyond 1980, faster growth will be required—though not unusually fast by historical standards. The constraint beyond 1980 will not be our ability to grow, but our ability to avoid inflation. The unemployment reductions needed will not be as large as those we have experienced recently. In less than four years, the unemployment rate has fallen 3.3 percentage points. What remains is an additional 1.8 percentage points of decline to be accomplished in 4½ years. Even from 1980 on, what will be needed is a reduction of 2.2 points in three years, clearly not larger than our average progress over the last four years. The trick is to accomplish this growth without inflation. That is why our structural anti-inflation program is so important.

It will also be important to avoid a recession. As I discussed before this Committee last year, I believe that recessions may even raise inflation rates in the long run. Improvement must continue in the skills of the American labor force, partly as the result of training and public service employment programs, but largely the result of experience working in the private economy. Capital investment required between now and 1983 must also proceed on schedule if Humphrey-Hawkins goals are to be met. Nothing will reduce capital accumulation more than a recession.

In addition, international economic policy and immigration policy must be coordinated with manpower goals established under the Humphrey-Hawkins Act. Meeting these goals will be extremely difficult within the context of a world economy that has not yet recovered from recession. If the U.S. labor force had grown as it has, but our employment performance had paralleled that of Europe and Japan, the unemployment rate would be over 20 percent in the United States today. Not only has disparity between U.S. growth and growth abroad led to trade imbalances, and deterioration of the value of the dollar; it has also led to increased propensities to immigrate to the U.S. Under these conditions it will be necessary to look more carefully at the domestic impacts of both legal and illegal immigration.

Given sustained economic growth, I remain optimistic that the Humphrey-Hawkins goals can be met. Careful targeting and other measures such as the project approach are succeeding in reducing substitution connected with public service employment programs. Job experience, even in training programs, has been found to be an effective device for improving the employability of targeted workers. Studies of the impacts on inflation of reducing unemployment of various groups now point even more strongly to the probability that the unemployment rate of low-skill workers has little if any impact on wage inflation. This means our structural employment programs will support our anti-inflation effort and are an important ingredient in reducing unemployment in a non-inflationary way.

Thank you very much. I will be happy to answer any questions which you may have.

WHITE PAPER ON "THE NEW COMPREHENSIVE EMPLOYMENT AND TRAINING PROGRAM"¹

THE ROLE OF OUR EMPLOYMENT AND TRAINING SYSTEM

During the past several years employment and training programs have played an increasingly important role in strengthening the performance of the American economy and securing a more equitable distribution of its benefits. Employment and training programs contribute to the efficiency of our economic system in several ways. In times of strong economic growth they reduce inflationary pressures by

¹ Prepared by the U.S. Department of Labor, Office of the Secretary.

improving the performance of labor markets, increasing worker productivity, and expanding our supply of skilled workers. During economic downturns, by maintaining incomes, employment and skill levels and minimizing dependence on welfare and unemployment insurance, they set the stage for stable economic recovery. Employment and training programs also contribute importantly to the equity of our economic system by improving the access of all Americans to the opportunity to support themselves and their families.

Direct employment policies have now become an important and permanent tool of economic policy, strengthening the effectiveness of fiscal and monetary policies in promoting stable economic growth and reducing the adverse side effects of both economic expansion and contraction. Until recent years, however, employment and training programs were too small in scale to permit measurement of their potential effectiveness in this larger role.

Ten years ago employment and training programs were an insignificant item in the U.S. budget. This year over \$11.7 billion will be spent by the Federal Government for this purpose. The budget for Fiscal Year 1980 calls for expenditures of \$11.0 billion. The fundamental factor supporting this expansion is a growing national awareness that, even in periods of overall prosperity, sizeable investments must still be made to assist those disadvantaged in the labor market by background, location, or discrimination. But much of this immediate expansion has been in response to economic recessions. This was the case when President Carter took office while the country was enduring the high rate of unemployment which followed the 1973-74 recession. Since 1977, spending for Department of Labor jobs and training programs has increased by 73 percent. Much of this was due to the Economic Stimulus Package launched by this Administration. In contrast, there has been only a 14 percent increase in spending for other discretionary federal programs in this period. This fact, more than any other, provides a clear indication of the high priority placed on employment programs by the Carter Administration.

CETA'S RECORD OF PERFORMANCE

Despite this unprecedented growth there can be little question that our employment and training system has performed well. Aggregate statistics tell one part of the story. When President Carter took office, the unemployment rate was 7.8 percent. By December of 1978, it had fallen to 5.9 percent. A large part of this improvement can be attributed to the normal resilience of the economy in recovering from a downturn in the business cycle. But substantial credit should go to both macroeconomic policies of the Administration and the direct employment measures initiated as part of the Economic Stimulus Package. Along with the 7.2 million jobs created in the private sector, 1.3 million jobs and training opportunities were created during this period by the various components of the Comprehensive Employment and Training Act (CETA).

CETA has helped assure that the benefits of economic recovery are extended to all classes of workers including the most disadvantaged. For example, it is estimated that a third of the increase in black employment (6 percent) experienced during this period is directly attributable to the CETA job system. Employment gains for the most disadvantaged groups were particularly impressive. Employment of black teenagers had actually decreased during the preceding 8 years, but has increased by 27 percent since the start of this Administration. About 22 percent of all black teenagers employed in October 1978 were working in youth programs under the CETA system. During the Stimulus expansion, more than 86 percent of new CETA enrollees were economically disadvantaged. In the past, it had been less than half.

This dramatic expansion was done:

- On schedule;
- Without the creation of a large, new Federal bureaucracy;
- Without high administrative expenses;
- Without a significant degree of substitution of CETA workers for regular municipal employees; and

On a local basis. Bureaucrats sitting in Washington did not mandate what jobs CETA workers could hold or the type of work they needed to do. On a local level, thousands of innovative projects were launched such as park renovation in Boston, home health care in North Carolina, bike trail building in Atlanta, water quality monitoring in Wisconsin, river cleanup in Rochester, and weatherization of low income homes in many locales.

These kinds of results in so short a period were due to the concerted efforts of an enormous number of public and private institutions. The CETA system is made up of over 26,000 operating units. They include the national and regional offices of the Department of Labor and 460 State, county and local government units who, as the

CETA prime sponsors, subcontract with an estimated 25,000 non-profit and governmental organizations. There are also 54 State employment security agencies and 950 national CETA programs with hundreds of subcontractors. The roughly 1.3 million CETA job and training slots serve almost 4 million economically disadvantaged persons each year.

This experience has demonstrated that direct employment and training policies, as administered through our decentralized CETA system, are an effective tool of economic policy which can move rapidly and directly against the problem of unemployment. Recent analysis of CETA program experience confirms the findings of an earlier Congressional Budget Office study that CETA is the most efficient tool of the Federal Government to reduce unemployment. Additional dollars spent under the CETA program produces three times as many jobs as dollars spent elsewhere in the budget and with less inflationary pressure than more general stimulative policies.

THE NEED FOR A NEW STRATEGY

The range and diversity of our employment and training system is its greatest asset. No unitary system could respond as quickly or effectively to the great diversity in community needs, population characteristics and labor market conditions that exists throughout the country. CETA's connections to other governmental, community service and vocational organizations also enable local programs to build upon the management and training capabilities of existing public and private organizations, assure that public service employees perform useful community services and facilitate transition of participants to private sector employment.

While decentralization has many benefits, this complexity of structure, combined with the recent pressures of unparalleled growth has placed great strain on the employment and training system. In particular:

Faulty program design diluted resources available to meet the special needs of the most disadvantaged workers.

Not enough attention was given to building closer links between the private sector and employment program and training programs. While the percentage of CETA program graduates placed in the private sector has been steady, there has been no marked improvement.

There was inadequate attention paid to the development of management capability at each level of the system. Little has been done to identify, encourage and replicate successful programs.

Effective monitoring and control systems were either not created or have not kept pace with expanding system requirements. As a result, program abuse was not successfully controlled or corrected.

These deficiencies must be remedied promptly if the system is to maintain public confidence. Employment programs have generally benefited from strong public support. Even in the wake of Proposition 13 and other anti-tax initiatives, a detailed public opinion survey recently conducted for the Department of Labor showed strong public support for federal activities in direct employment and training. Seventy-six percent of respondents supported direct job creation particularly for priority groups such as low income persons and heads of families with children. Two sentiments underlie this public support—a firm belief that people should be able to work if they want to and that creating jobs is a cheaper way of assisting the unemployed than providing welfare or unemployment benefits. Most of the public also believes that public employment programs produce useful community services and they support local control over the kinds of jobs created. Nonetheless there is considerable public concern about abuses and inefficiencies in job program design and administration.

We must respond to this concern promptly and effectively. Many promising social programs have atrophied or been abandoned because management failures have resulted in public disillusionment. Budget restraint increases the urgency of responding to the legitimate concerns of citizens that their tax dollars are used effectively. This current mood provides us with a challenge to demonstrate that public programs can be useful, efficient and effective.

During the last year, the Department of Labor has been developing a coordinated plan for an improved employment and training system. Building upon important new legislation, a series of regulatory and management initiatives have been undertaken to develop a system which is responsive, comprehensive, accountable and manageable.

These initiatives, many of which are already being implemented, are described in the following sections under the four major areas of required improvement:

- (1) Improving service to those who most need assistance;
- (2) Strengthening connections with the Private Sector;

- (3) Improving program management; and
- (4) Controlling fraud and abuse.

IMPROVING SERVICE TO THOSE WHO MOST NEED ASSISTANCE

The CETA reauthorization legislation enacted last fall approaches this objective in two ways: (1) Providing a broader range of programs to meet varying needs of individuals; and (2) focusing government programs on those in greatest need. The strategy to provide more and better service to the poor has five program components. All of them share similar improvements in program design. These improvements are strict eligibility requirements, more emphasis on training, limits on wages and program duration and strengthened prohibitions against substitution of CETA employees for regular state and municipal workers.

Major program components to implement this strategy include the following:

General structural employment and training programs

The new Title II of the CETA reauthorization legislation establishes a permanent "structural" employment assistance program. It provides for a broad range of employment and training programs aimed at improving the skills of the disadvantaged in the labor market. The structural title of CETA is a permanent program of fixed size. For the first year it authorizes \$2 billion for training, job search assistance, outreach, and work orientation and \$3 billion for transitional Public Service Employment. In addition to the amounts allocated directly for training, at least 10 percent of all Public Service Employment funds must be used for associated training costs. This proportion will rise to 22 percent over time.

Eligibility will be restricted to the most disadvantaged. A person must be either receiving welfare or unemployed for 15 weeks of the last 20 weeks and come from a family with income less than 70 percent of the BLS low income standard during the last six months. To promote transition into regular economy employment and to avoid disruption of local labor markets, Public Service Employment wage levels are set at levels appropriate to relatively unskilled workers. No supplementation of wages by States or localities is allowed and all new jobs must be at the entry level.

The formula used to allocate funds among areas under the Public Service Employment section of Title II has been modified to channel funds to areas with concentrations of low income families and generally high levels of unemployment. Except for specific exceptions approved by the Secretary, no participant may remain in a public service job for more than 18 months. This limitation is intended to reduce the possibility of substituting CETA employees for regular state and municipal employees. It will also increase the number of people who can participate in these programs and emphasize the transitional nature of public service jobs.

The employment opportunity program: Welfare reform

A major emphasis of the Administration's new welfare reform proposal is to improve the opportunities and abilities of parents in low income families to provide a decent income for their families through their own work effort. The Employment Opportunity Program (EOP) component of the welfare reform package will be the major vehicle for achieving this objective. Like the new CETA Title II, this will be an employment and training program for disadvantaged workers. Many of the features of this program will be similar to CETA Title II programs. However, the Employment Opportunity Program moves beyond the current Title II in attempting to meet the *full* demand for employment and training assistance by primary earners in welfare eligible families with children. Although final program decisions have not been made, the Employment Opportunity Program could more than double the number of structural public service employment jobs.

As in Title II, emphasis is placed on skill acquisition, upgrading and transition to the private sector. However, the program also seeks to insure that the opportunity exists for such individuals to earn a basic income either through private sector work or a public service job, which, together with supplementary income assistance, will assure an above poverty line income.

A series of pilot projects, currently in the planning stage, in 15 geographically diverse sites throughout the country will provide a sound management basis for the orderly implementation of welfare reform. The projects will test and evaluate detailed organizational and programmatic models for meeting the varying needs of those who would be served by welfare reform. Those models which prove most successful will then be included in an intensive program of technical assistance, which will lead to the full implementation of the employment and training component of welfare reform.

Youth programs

A second major initiative are programs designed to meet the special needs of disadvantaged youth in making the frequently difficult transition from school into productive employment. In August of 1977, a major youth employment initiative was launched under the Youth Employment and Demonstration Projects Act (YEDPA). The Act created four new programs designed to increase youth employment and employability and to explore a number of innovative approaches for providing services to young people.

Youth incentive entitlement pilot projects (YIEPP).—The purpose of this program is to help economically disadvantaged youth complete high school. Sixteen to 19 year olds in selected geographic areas are guaranteed a year-round job if they agree to attend high school. Through a nationwide competition 17 eligible areas were selected. Jobs are guaranteed for an average of 20 hours a week during the school year and up to 40 hours in summer. About 30,000 jobs are to be provided during an 18-month period.

Youth community conservation and improvement projects (YCCIP).—This program is designed to develop the vocational potential of jobless youth through well-supervised work of tangible community benefit. YCCIP is for unemployed 16 to 19 year olds with preference given to those out-of-school with the most severe problems in finding jobs. Roughly 20,000 jobs are to be created in community-planned projects lasting up to one year with supervision by skilled workers.

Youth employment and training programs (YETP).—This program seeks to enhance job prospects and career preparation of low-income youths aged 14 through 21 who have the most severe problems in entering the labor market. Those eligible are youth from families whose incomes average about \$8,900 a year. Youths from families with lower incomes receive preference. About 170,000 job, training and service opportunities will be provided once the program is fully operational.

Young Adult Conservation Corps (YACC).—Patterned after the New Deal's Civilian Conservation Corps, the aim of YACC is to give young people experience in occupational skills through productive work on conservation and other projects on federal and non-federal lands and waters. Youth aged 16 through 23 who are unemployed and out of school are eligible. A capacity of about 25,500 openings was planned. YACC is operated cooperatively between the Departments of Labor, Agriculture, and Interior.

These programs have an estimated total job creation potential of about 200,000 slots. Under the CETA reauthorization, they will be continued as part of Titles IV and VIII of CETA along with the Job Corps which, by March of 1980 is scheduled to provide some 44,000 slots in residential work and training programs. Except for the Young Adult Conservation Corps, the programs authorized under the Youth Employment and Demonstration Projects Act will expire at the end of 1980. During this next year a full scale evaluation of these programs and demographic trends in the labor force will be completed. Such a review would enable us to seek a reauthorization of a youth employment program based on the experience of what has and has not worked.

Countercyclical unemployment programs

Title VI of the CETA reauthorization provides for PSE programs designed to alleviate countercyclical unemployment related to general downturns in the economic cycle. The needs of workers who are unemployed because of the general economy are somewhat different from the needs of the hard-core unemployed. As a result, there are some unique elements in this aspect of the program. Title VI is not a permanent program. The size of the program depends on how much above 4 percent the unemployment rate is. Under this title, less emphasis is placed on training and acquiring work experience. Less emphasis is placed upon reaching those who have the most serious long-term employment problems. However, the program is aimed at those with the greatest current need. To be eligible, a worker must be receiving welfare or be unemployed for 10 of the last 12 weeks and come from a family with income of less than 100 percent of the BLS low income standard over the last 3 months. Since Title VI is aimed at those who are unemployed because of the general state of the economy, skill levels will be higher than under structural Public Service Employment programs. As a result, supplementation of base salaries by states and localities will thus be allowed. However, supplementation will be limited to 10 percent of total wages.

Developing job linkages with other federally funded programs

The Department is trying to increase the use of CETA workers in other Federally funded programs such as low-income housing rehabilitation, energy conservation, rural transportation, community law enforcement, environmental clean-up and

monitoring, day care, services for the elderly, in-home health maintenance, education and cultural activities. Building bridges to other Federal programs improves the efficiency of Federal spending since employment goals are piggy-backed on other programs.

In August of 1978, Secretary Marshall wrote to each of the other Domestic Cabinet Officers enlisting the support of their agencies in using CETA resources to aid their programs. Since that time, a series of conferences and meetings on this subject have been held with representatives of these agencies. Some recently developed exemplary projects are part of the urban and rural initiatives programs directed by the White House Interagency Coordinating Council. These include a joint HUD/DOL project in Long Beach, California in which Urban Development Action Grant funds are being used to assist in development of a regional shopping center while CETA funds will be used for on-the-job training of disadvantaged workers in construction and permanent operation of the center. As part of the interagency rural water and sewer project, CETA supported workers will be given on-the-job and classroom training by EPA supplied supervisors in the operation and maintenance of expanded rural water and sewage projects.

Other special programs

To supplement the five basic program components in this section, the new CETA legislation also provides for an expanded set of employment and training programs to serve the special needs of certain other disadvantaged workers. These include programs for assisting older workers, handicapped workers, displaced homemakers, Vietnam-era veterans, Native Americans, migrant and seasonal farmworkers, workers hurt by foreign competition, and ex-offenders.

STRENGTHENING CONNECTIONS WITH THE PRIVATE SECTOR

The success of employment and training programs depends on whether they help participants to obtain permanent jobs at adequate wages in the regular economy. That is why it is important to include potential employers in the design and operation of these programs.

All of the initiatives in the preceding section strengthen the transitional nature of public employment and training programs. For this reason, long-term success requires us to work closely with the private sector. CETA program managers must gear their programs to meet the needs of private firms with the potential for providing permanent employment. Private employers must also be encouraged to hire hard-to-employ workers and to provide them with on-the-job training. New private sector initiatives will encourage both types of activity. Their success depends on the extent to which they influence the entire range of CETA programs, not just the private sector programs.

Private industry councils

The CETA reauthorization legislation includes a new \$400 million private sector initiative as Title VII of CETA. This program would establish an important new labor market intermediary—the Private Industry Council (PIC). These councils, which will be established in each prime sponsor area, will increase the involvement of local employers, community-based organizations, organized labor and other interested public agencies in the design of employment and training programs in their area. They will also encourage more on-the-job and classroom training in private industry. The first priority group to be served by the program consists of economically disadvantaged youth between the ages of 16 and 24. Other groups which may be served include Vietnam-era veterans and graduates of CETA training programs.

On-the-job training expansion

A closely related initiative will encourage expansion of on-the-job training by private employers by simplifying the administration and management of these programs for industry. The new CETA legislation provides more latitude to implement on-the-job training programs while insuring that adequate training is provided.

Employment tax credits

The Tax Reform Act of 1978 includes two provisions to encourage the private sector to hire hard-to-employ workers. The Targeted Jobs Tax Credit and the expanded WIN Tax Credit will allow private employers to claim credits against their corporate tax liability for 50 percent of the first \$6000 wages paid in the initial year of employment and 25 percent in the second year. The targeted tax credit extends eligibility to economically disadvantaged youths, Vietnam-era veterans, ex-convicts, welfare recipients, the handicapped or youths participating in cooperative education

programs. WIN tax credits are restricted to recipients of benefits under the Aid to Families with Dependent Children programs.

Use of non-profit agencies

The use of non-profit agencies can aid the transition of some disadvantaged workers into permanent employment. The Department has funded experimentation with a series of "Supported Work" projects hiring the hard-to-employ in work settings which provide intensive supervision, peer group support and transition to unsubsidized employment. In other cases, non-profit agencies have been established in local areas to provide training, supportive services and transitional employment in such areas as low-income housing rehabilitation, energy conservation and community revitalization. The advantage of these projects is that they can more closely duplicate working conditions in the regular economy.

Improving the job service

Recent performance.—The nationwide Job Service operates through Employment Security Agencies in 54 States and jurisdictions with about 2,500 local offices. In fiscal year 1978, the Job Service assisted over 15 million people. Over 9.1 million non-agricultural job openings were received from employers and 4.6 million individuals were placed in jobs, both of these record levels for the 1970's. Many special target groups experienced substantial placement gains including a 13.6 percent placement increase for all economically disadvantaged persons served, 14.5 percent for all minorities, 14.8 percent for minority youth and 16.7 percent for disabled veterans.

Wagner Peyser legislation.—Planned legislative and administrative improvements will further strengthen these gains. In February, the Secretary will submit to Congress a report setting forth suggested amendments to the Wagner-Peyser Act, the basic authorization for the Job Service. Recommendations will seek to strengthen coordination between the Job Service and other state and local agencies, particularly CETA prime sponsors; emphasize the provisions of intensive services to disadvantaged applicants; and strengthen the role of state governors in overall management of state agencies and the coordination of their labor market intermediary functions with state economic development plans.

IMPROVING PROGRAM MANAGEMENT

Effective program management involves much more than adequate cost and accounting controls. Ways must be found to identify, reward and replicate those programs which improve participants' ability to obtain and hold adequate paying jobs in the regular economy. The CETA system abounds with local examples of successful programs. It is the job of management to extend those programs nationwide.

At the same time, it is essential that efforts to improve system control do not, as a result, impose undesirable uniformity on local program design or stifle local initiative. A strong and successful employment and training system must be responsive to the environment in which it operates. It must adjust to the differing needs of its clientele, the perceptions of its programs by the larger community, the structure and capabilities of other public and private institutions, and the problems and requirements of local employers. Accountability must operate in both directions. Improving the flow of information to national policymakers and managers is essential to evaluating program success and correcting program failures. But at the same time, guidance and assistance must be provided in a timely and responsive manner to meet the needs of local programs.

We have several initiatives aimed at improving program management at all levels of government:

Improving Federal management

The Department of Labor is currently reorganizing the national and regional offices of the Employment and Training Administration. In addition, we also are trying to improve overall system management, monitoring and evaluation. Important elements in this program include:

- Changing and strengthening top level management;
- Improving the communication of policy directions through regional field offices;
- Establishing an ombudsman in the Office of Legislation and Intergovernmental Relations to assure that important problems which cannot be solved by established mechanisms receive high-level attention;
- Implementing civil service reforms that require new pay and performance evaluation systems for executives and managers be related to organizational performance;

Establishing a Department-wide Management Improvement Program. Each organization is required to review its structure, internal management systems and allocation of staff; and

Establishing a Regulatory Review Program to simplify program regulations.

Management assistance program

The new CETA legislation authorized the creation of an Office of Management Assistance to improve overall management of the CETA program. A major function of this new office, to be established in the Employment and Training Administration, will be to design an improved program of training and technical assistance for local program managers. This effort will emphasize helping local program operators learn from each other by identifying successful programs and encouraging widespread adoption of them.

A related effort is the development of more useful measures of program performance to identify program success. Frequently used indicators such as the number of enrollees, the number of placements or cost per placement may actually impede the development of high quality job and training programs by encouraging selection of the best applicants and placement in high turnover occupations.

Management Information System development

The Department of Labor is undertaking a program to improve the management capabilities of the CETA prime sponsors through the development and installation of automated Management Information Systems (MIS).

The automated MIS will for the first time, on a timely and routine basis, provide a detailed profile of program participants, track the progress of participants through the programs, and measure the impact of the program on participants' subsequent job experience and income.

At the present time, the great majority of basic management information systems used by prime sponsors to collect and report information are of a manual nature. Most are incapable of meeting either the management system needs or the full reporting requirements in the new CETA legislation.

The new system will provide local and Federal program managers with the necessary information to effectively plan, control and evaluate the CETA programs. For example, it will show whether prime sponsors are meeting the needs of particular categories of the disadvantaged, and identify which program components are the most successful in enabling participants to move to private sector employment.

Strengthening local program management

The new CETA legislation and regulations establish several positive approaches for effective management by CETA prime sponsors. Included in the regulations are new requirements for overall management systems to monitor programs, handle complaints, and determine and verify the eligibility of individuals seeking entry into CETA programs.

Monitoring/program assessment.—To encourage stronger management controls, an independent monitoring unit is now to be established by each prime sponsor to monitor compliance with the regulations and recommend corrective action when warranted. Prime sponsors are also to extend management information efforts to the monitoring of subgrantees. Besides simply policing activities, the monitoring unit is to determine the effectiveness of programs.

Verification.—Previous ineffective management techniques have resulted in many ineligible individuals receiving CETA services. To combat this, the Act now requires prime sponsors to establish a system to verify the eligibility of participants.

Performance goals.—Prime sponsors will be required to establish quantifiable goals and objectives for each program activity and service. Included will be information on the number and quality of placements with sufficient follow-up to determine the long-term labor market experience of participants.

CONTROLLING FRAUD AND ABUSE

During the last year, the Department of Labor has greatly expanded and strengthened its efforts to insure that scarce program resources are used as effectively and honestly as possible. Several major initiatives have been launched.

Establishment of the Office of the Inspector General

Responsibility for fraud and abuse detection and control in all DOL agencies was consolidated in a single office reporting directly to the Secretary of Labor. This office has a considerably expanded staff. Program abuse consists of noncriminal activities such as failing to observe regulations, keeping inadequate records or hiring ineligible workers to criminal cases of fraud. Since January 1978, 67 indict-

ments and 24 convictions have resulted from the Department's investigation of CETA and workers compensation programs.

Fraud and abuse prevention survey

Another major new effort to eliminate fraud and administrative abuses in Labor Department programs has recently been inaugurated.

Using a new Fraud and Abuse Prevention Survey (FAPS), DOL's Office of Inspector General will seek to identify and correct administrative weaknesses in CETA and other Departmental programs before fraud and abuse can occur.

Up to now, investigative efforts of the Labor Department and most other federal agencies have been passive with most investigations triggered by specific complaints. The new program will emphasize prevention, while our efforts to respond to complaints will continue.

Under FAPS, three-persons teams (an investigator, an auditor and a program analyst) will be dispatched to examine DOL programs and grantees, monitor their management systems, seek out weaknesses and, if necessary, direct them to change their procedures.

Grantees will have 60 days to respond to a FAPS report. Follow-up investigations will assure that changes are carried out and that, if needed, program regulations are modified to forestall further abuse.

FAPS assessments, each requiring approximately one month to complete, will supplement the Department's regular program investigations. While FAPS teams will be searching for conditions which make fraud possible, actual cases of fraud will be referred for investigation and prosecution when warranted.

The first two FAPS surveys (the Mobile, Alabama prime sponsor and the Cherokee Nation grantee from the Office of National Programs) have already been completed. Current plans are to conduct eight to 12 surveys during this fiscal year and 20 to 40 surveys each year thereafter.

Legislative and regulatory restrictions

Numerous provisions pertain to the prevention and control of program abuse at the local level. These include:

Conflict of Interest: No member of any prime sponsor council may vote on any matter which has a direct benefit to him/her or any organization he/she represents.

Kickbacks: No officer, employee or agent associated with the prime sponsor may solicit or accept gratuities, favors or anything of monetary value from any subgrantee, contractor or supplier.

Ineligible CETA workers. Knowingly hiring an ineligible individual for a CETA Public Service Employment job is now a criminal offense.

Charging of Fees. No CETA funds may be used for the payment of a fee charged to an individual for placement into a CETA activity.

Nepotism. No prime sponsor, subgrantee or employing agency may hire a person in a CETA funded position if another member of the same family is in an administrative position for that agency.

Political Patronage. No prime sponsor or subgrantee may select, reject or promote a participant, subgrantee or contractor based on political affiliation.

Political Activities. No programs may involve political activities.

Lobbying Activities. No CETA funds may be used to attempt to influence members of Congress, State or local legislators.

Sectarian Activities. No CETA funds may be used in support of any religious activity.

Unionization and Antiunionization Activities. No CETA funds may be used to either promote or oppose unionization.

Theft or Embezzlement; Improper Inducement; Obstruction of Investigation. The criminal provisions of 18 U.S.C. 665 shall apply for any individual who embezzles, steals, obstructs an investigation or induces any persons to give up any money or anything of value.

Representative MITCHELL. Let the Chair thank both of the witnesses for very comprehensive and quite expert testimony.

Before I ask questions, I will make a brief statement. Mr. Marshall, I just don't share your optimism about achieving the goals for the Hawkins-Humphrey bill. Certainly I can not be as optimistic as you when the present policy propounded by the administration is one which anticipates an increase in unemployment in the name of fighting inflation.

Second, I don't share your optimism primarily because I think you misread that 6-percent unemployment figure. We have heard witnesses testify that perhaps as much as 1 percent of the present 6 percent is structural. Though I am quite sympathetic, I just don't see how your approach, which is primarily structural, is going to help us achieve the goals.

Though I know you want to comment on that later, I am just not quite as optimistic as you are.

Secretary MARSHALL. I don't mean to appear either optimistic or euphoric. My statement was that I believe we can do it, and I believe we put together the evidence from the last 2 years to date that we can do it.

Representative MITCHELL. My response is based on present policies, I don't think you can. However, we can come back to that.

Secretary MARSHALL. We are also continuing the present policy that caused that decline although we are shifting the emphasis to the structural.

In our program, because part of the unemployment that we now have is cyclical, we are going to concentrate a larger proportion of an increased amount. For example, in 1976, in our program, \$3 billion got spent on the disadvantaged. In 1980, it will be \$9 billion, which is 300 percent of the 1976 base and that is a significant increase in the resources that would concentrate on the structural unemployment problem.

Representative MITCHELL. I want to comment a little later on my interpretation of this. First, let me discuss an issue with the Secretary for a moment, if I may.

I know you are under significant time constraints as you indicated in your testimony. Let me ask about three issues and ask you to respond to all three.

You indicated in your testimony that you are not very optimistic about our prospects for trade with China, that certainly the normalizations will not be of significant impact in the near future.

The question remains, however, how will China pay for its imports? Am I receiving some indication from you, about oil or other natural resources, that China might have to pay for their imports?

The second issue is that some of our colleagues, Senator Ribicoff and Senator Roth, have proposed the establishment of a Department of International Trade.

Also, it is my understanding that Senator Byrd is thinking more that we need it. In your opinion, do we need a separate Department of Trade to be internationally competitive?

My last issue is just a little nice statement and question.

Yesterday, I had the pleasure of escorting 22 minority businessmen to the Embassy of the People's Republic of China to explore whether the minority business sector can enter into trade relationships with the People's Republic of China.

I had to do this, and I regret that I had to take the responsibility, because apparently in the trade mission to Japan there were no minority businesses included. And, as I recall, there were no small businesses included.

In the meetings that you have had with the Ambassador and the President, and meetings others have had with the Ambassador at the White House, there has always been an exclusion of minority

businesses. I don't want to take that responsibility to include minority businesses, which is a State Department-Commerce Department function, but I have to do it because there appears to be a pattern of exclusion of small businesses and minority businesses from the possibilities resulting from the normalization of the People's Republic of China.

Those are the three issues I ask you to address very briefly.

Secretary KREPS. Congressman, regarding first the matter of China trade, you asked two questions; the volume of trade expected, and how the Chinese will pay for it.

I did not mean to seem pessimistic in my prepared statement. I think that there is potentially, a very big market with China. I meant primarily to put a timeframe on it that I thought was realistic. We expect over the next 6 years, say, up until 1985, that our trade with China will increase very significantly.

We are talking about \$2 billion a year, and in a 5-year period, perhaps, as much as \$12 billion plus. We would expect that figure to be heavily in our favor with a heavy export surplus so that this is not a small amount.

We have a number of problems to work out in order for that trade to take place. We have to work out all the problems that Secretary Blumenthal has been working on in payments and assets.

We have to resolve questions of the most favored nation treatment, those kinds of things. All of those, I think, can be solved.

With respect to how China will pay for the very large volume of imports that she expects to have, not just from us, but from the world, they expect to pay by expanding their exports to the world, including the United States, although, clearly, they cannot export enough to pay the volume that they are discussing of imports.

Largely, at least in the beginning, China will have to pay for her imports with credits.

These credits will come from both public and private sectors. China's credit rating is very good. I suspect a great deal of the borrowing will come from private lenders.

As to the second question on the Department of Trade, I do think we need better coordination of our trade-related activities.

We have a great many players and the activities related to export matters are widely fragmented.

I suggest that we pull those together in a much more coherent package. I think that it is perhaps not necessary to have a new Department of Trade but to have far better coordination.

I have been working with the Office of Management and Budget on some proposals for pulling together the trade-related activities throughout the Federal Government and, although it is too soon to see what direction those will take, I suspect that the OMB proposals will reach the President fairly soon. We could then discuss the proposals with the Congress in terms of their own wishes.

Regarding the involvement of minority businesses in Japanese trade and in the preparations for trade with China, I regret that there has not been greater involvement. We have begun to do a number of things; not all of them will show up in any particular company's endeavor.

We took, as you know, 137 business people on the trade mission to Japan. We solicited small- and medium-sized firms to go on that mission because it did not seem necessary for us to spearhead a trade drive for the major multinationals and they were very lightly represented in that mission.

I shall check again. It is my impression that we did, indeed, invite minority firms, but for very good reasons—the time involved, the expense involved, their views of the prospects of trade that might grow out of that trip—we did not get any to go with us.

Let me just indicate to you, however, that the Department of Commerce has been involving minority firms in our industry sector meetings—we have had five of now in the last few months—and we have invited minority firms to participate in those very small industry sector group meetings—meetings which go all afternoon and all evening, meetings designed to discuss the industry sectors, their particular problems, the issues they would like to have before the Federal Government.

I think we now have a better involvement with minority firms and indeed with small firms we have better involvement than our Department has ever had.

In the case of China, I will be going in early May to work on the trade agreement. It can be a very complicated trip. We will probably not be taking business firms of any sort on the trade mission but I can assure you that we will be happy to work with small firms and minority firms, particularly to arrange trade missions for them as the China prospects open up.

I don't know if that has been sufficiently responsive.

Representative MITCHELL. My 5 minutes has long since expired. Let me just indicate that I will probably come back to this because the information I have, concerning the Japanese trade mission, differs from that you have just testified to.

Ordinarily, we would recognize Congressman Brown next but instead, we recognize Senator Javits because of his problems of monitoring the Senate floor debate on Taiwan.

Senator JAVITS. I will just ask Ms. Kreps one thing. What has happened to the President's widely advertised Export Advisory Council?

Secretary KREPS. I too, have been disappointed that we could not announce the President's Export Advisory Council sooner.

We are ready to do so, I think. We have had a Chairman for quite some time. The only holdup has been in hearing the name of a very large group of people but I expect that to come forward very soon.

Senator JAVITS. How soon?

Secretary KREPS. Well, I would hope within the next week or so but I had hoped so before.

Senator JAVITS. Congressman Mitchell, I ask unanimous consent to ask certain written questions of both witnesses and that the answers may be incorporated in the record within 1 week.

Representative MITCHELL. Without objection.

Senator JAVITS. I thank the Chair and I thank Congressman Brown.

Representative MITCHELL. Congressman Brown, you are recognized.

Representative BROWN. Ms. Kreps, it is also good to see you and I want to ask a couple of specific questions about the table which appears in your testimony.

I am concerned about two items in particular that seem to me to have strong negative possibilities as a result of the Iranian situation.

First, the negative factors about fuel imports and the special category, military goods. My question is with the change in Iran and that change now seems to be ongoing since Khomeini, according to the news, has a little problem this morning with the new regime. Do you have any statistics or have there been any model runs on the cost of our price controls, given the breaking of the OPEC cartel and the corresponding oil price increases?

What is going to happen to that minus 38.4 figure in the next year or what has happened to it in the first month or two of the nonproduction in Iran?

Secretary KREPS. We don't have any numbers quite yet. We hope to have them in a few days and we will be glad to give you our estimates. We know, of course, that the spot price of oil has risen sharply. So far, we have been gratified that Saudi Arabia, in particular, has held the line on the oil prices.

Representative BROWN. I wish you would explain that to the chairman of the Foreign Relations Committee of the Senate that we are gratified as a nation that that has occurred.

He seems to think it is time to get tough with the Saudis. It seems to me that we ought to take a Saudi to lunch if we could. [Laughter.]

Secretary KREPS. Perhaps I should say that I am gratified.

Representative BROWN. So am I. Maybe we both ought to talk to the Senator, but help yourself.

Secretary KREPS. Let me emphasize that there are additional problems involved, of course, in the Iranian disruption. It is not just that the oil has been cut off since we were relying on them for about 500,000 barrels a day but it is the impact of their total oil exports to the world and the price impact you suggest.

At the same time we have to worry about the discontinuance of our exports to Iran.

Representative BROWN. And that is why I asked about the military category because they seem to have been a pretty good customer of ours and now there does not seem to be much in the way of a customer there for our military goods.

Secretary KREPS. Our numbers look like this. In 1978, our exports to Iran totaled \$3.7 billion, \$1.2 billion of which was military hardware, \$0.4 billion of civilian aircraft and parts, \$0.3 billion agricultural products. These exports had increased very sharply in the last 5 years. With the discontinuance of our ongoing trade with Iran, it looks as though we will suffer significant drops in our exports. I don't know that my colleague, Mr. Cox, has a number on that but it will be quite serious.

Representative BROWN. Yes; help yourself.

Mr. Cox. Congressman Brown, I don't have much elaboration on that. The cancellations that have been reported through the month of January, for which we have data, were fairly minimal according to the Census Bureau. Since that time there have been further

cancellations, but many of those will not affect our trade balance in 1979 but rather in the future years.

Representative BROWN. I wonder if you could answer two questions for me for the record, if you would, Ms. Kreps. First, any model results that you may have on what the impact with reference to our outpayments might be for the first quarter and the first month of this year as a result of the price increases.

Then, the second thing is whether or not there would be any particular American firms that might be adversely impacted by the situation as it evolved in Iran, such as Lockheed, any of those companies where we have had some passed commitments made, that might be in trouble because of the situation.

I want to ask just one other question, if I can, and, if you will, have both respond—I don't want to ignore the Secretary of Labor. In the recent upturn in the economy since the last bottoming out of recession, we have had two notable, one positive and one negative, occurrences.

One is, we had a sharp increase in employment and the other one is that we have had relatively little increase for the upturn after a recession in capital investment for capitalization and modern improvement.

Now, we have a tax system which requires you to take appreciation rates at historic rates and does not allow for the replacement costs.

We have a major industry in this country where if you net out what they would have to spend to replace their equipment, they would be operating over the last decade or more at a net loss.

The steel industry is one I have in mind.

Now, is that increase in employment combined with the relatively little investment in capital goods which might tend to modernize plants and to have reduced that employment increase, is that good news or bad news taken in the aggregates for our economy?

Do you understand my question? Should we have had a little bit more money invested in capital goods and modernization and a little bit less, perhaps, in additional employment?

Are we moving toward a hand-labor society and not keeping up with our competition internationally?

Secretary KREPS. Let me just begin and I am sure Secretary Marshall would like to respond.

There is not any way I can imagine that we would see a good result from any reduction in investment and planning equipment. That has always been a stimulus for improved productivity and rising standards of living in this country and I don't think anything has changed in that regard.

The only thing I would add to that is the fact that very recently we do see some upturn in investment and it is too soon to make a trend out of that but we are somewhat encouraged by that.

The gist of your question is whether this dual development is good for the economy, one can applaud the increase in employment and does so but if that is not accompanied by an increase in real wages and standards of living, it can hardly be a net gain.

Secretary MARSHALL. One of the problems that we faced with investment in plant equipment has been the recession that we have

been coming out of. I think that is one of the factors involved and I think there are many specific problems in industries.

In the steel industry, for example, there was the uncertainty about imports and the impact of those investments on imports on any investment that you had made in the steel industry. Since we have introduced the trigger price mechanism to give some stability in this field, both employment and investment have gone up and so have profits and sales and plant capacity but I think one of the problems arising from the recession is that when you are operating at partial capacity, there is not much incentive to make capital investment.

Since the economy has been expanding, in capital investment, expenditures have been going up.

The figure is now above 10 percent of GNP, which shows that they are responding to improved economic conditions. I think that is a very important thing to try to accomplish.

Representative BROWN. My time is up. I wish you would review the questions, Congressman Mitchell, and have the Secretary try to answer the question that I asked because I don't think she quite did hit it but I don't want to pursue the answer and take the time of the members.

Representative MITCHELL. The Chair is going to recognize members in sequence. I think that is the only fair way.

Senator Jepsen.

Senator JEPSEN. Thank you, Congressman Mitchell.

Ms. Kreps, you say that trade with the People's Republic of China will double this year and continue to grow. While I realize that such trade is not expected to reach a high level for some time, do you have any estimate of what products are expected to be in primary demand by the Chinese and I, of course, being from Iowa, am especially interested in agricultural products.

Secretary KREPS. Senator Jepsen, the increase in our sales to China in the past year has been due to an increased demand for our foodstuffs. In 1978, there was a tremendous increase in their purchases of food from us.

With respect to the future, it is clear that the Chinese demand for our agricultural products will continue to be high. In addition, the process of industrialization which they have sketched out for themselves will clearly call for an import from the United States of fairly advanced industrial products and technology, oil drilling equipment, steel industrial products generally, and hotel capabilities.

In general, I think that the shift in the composition of their demand will be in the direction of industrial manufactured goods but there will continue to be a very large demand for agricultural commodities.

Senator JEPSEN. It is ironic someone said, I believe, yesterday, that a 6,000-year-old country is now turning to a 200-year-old baby and asking for quality and technology advancement.

It is good testimony of our country.

Secretary Marshall, I heard all through your remarks that you said \$29 billion is about right for the deficit. I would be interested in a one-liner on that and I don't mean this in any way but constructively.

I don't know what is right but I would be interested in how you arrived at "that is about right."

You also indicated that there is no necessary relationship between deficit and inflation. It has a lot of debate going on, we will hear a lot more about it.

I would like to hear why you as Secretary of Labor feel there is no necessary relationship between deficit financing and inflation. I will end up by adding too that you did directly say that the sectors that caused inflation are the areas of crude energy, health and housing, I believe.

Could you just remark on those general areas for me?

Secretary MARSHALL. Yes, sir. With respect to the first point, I am going to say that \$29 billion is about right now. I mean, if you tried to reduce it by more than that now, I think you would be putting too much deflationary pressure on the productive economic activity in the system; that is to say, you would generate more of a dampening effect on the economy than would be good for the economy right now.

I think we ought to move toward budget balance but the best way to do that is through improving economic activity and reducing unemployment rather than simply trying to reduce the budget for its own sake.

In other words, let the budget deficit be reduced by people paying more taxes rather than trying to do it all through our reducing the expenditures. We estimate roughly that a 1-percent increase in unemployment, for example, would increase the budget deficit by about \$18 billion so that you will get rising budget deficits if we are unable to continue to get unemployment down and to keep it down.

Now, the reason that there is no necessary relationship between inflation and deficits is that it depends what is happening elsewhere in the economy.

It is true that the budget deficit can be an inflationary pressure in the economy. It is not necessarily a relationship because a good bit depends on whether you are using that budget deficit to stimulate productivity and growth, as we did, for example, when we reduced unemployment or whether you simply use it to pay income maintenance or other activities that do not simultaneously lead to an increase in productivity and output.

The key, of course, is that inflation has a relationship between money and goods. If you can spend most funds in such a way as to increase the productivity of the whole system, that is not inflationary.

Senator JEPSEN. The Feds are financing to crank up the money machine and you get more money in creating an artificial demand for goods and services. It seems to me that creates a factor for inflation.

Secretary MARSHALL. Let's take another scenario.

Suppose we spend money that puts people to work doing useful things that society needs. They spend that money on the steel industry that is operating at 60-percent capacity, expand capacity utilization in the steel industry to 100 percent.

The industry becomes a lot more productive and the total output of goods and services increases by more than the expenditure be-

cause you are able to make better utilization of the plant equipment that you already have.

Senator JEPSEN. Is my time up? I have 1 minute.

Representative MITCHELL. Another 30 seconds.

Senator JEPSEN. Another 30 seconds.

I appreciate everything you say, Mr. Secretary. I, sometime, would like to pursue this further with regard to who do you think ought to put people to work, the Government or the private sector?

Secretary MARSHALL. I believe in the private sector and in getting people employed in the private sector. That is our objective now and one of the main new initiatives that we have on the way is the private sector initiative program.

We try to do everything we can to get people employed. Most of the jobs in our economy are in the private sector and most of the expansion in employment that we had in the last 2 years has been in the private sector. But there will be people who have difficulty for one reason or another getting absorbed in the private sector; some who need training or work experience; and some who need temporary jobs to make it possible for them to work until regular employment comes on.

Senator JEPSEN. I have some more questions, but I will wait.

Representative MITCHELL. Before calling on Senator Sarbanes, let me comment very briefly. In my interpretation, you said that the Feds are just shoving money out of reality at the present time.

The Federal Reserve has reduced the money supply to just below 1.5 percent. That is frightening to me because if that course is pursued, it certainly is going to steer us into a recession.

That undersupply of money policy has been pursued by the Federal Reserve in the last couple of months and that, too, has its very damaging impact on the economy.

Senator Sarbanes.

Senator SARBANES. Thank you, Congressman Mitchell.

First of all, let me say that I am very pleased to have been appointed to the committee and I look forward to participating in the work of the Joint Economic Committee.

It is a committee whose work product I have had great respect for over the years. I am pleased to have the chance to join the committee.

Madam Secretary, I was interested in just that short exchange that you and Congressman Brown had over Saudi oil production.

What is the volume of Iranian exports that were lost internationally, about 5 to 6 billion barrels a day?

Secretary KREPS. Five to six million.

Senator SARBANES. Five to six million barrels a day. Did the Saudis, increase production or did they not as they had planned to do, or what combination of that?

Secretary KREPS. I am sorry, I missed the first part of your question.

Senator SARBANES. The Saudis, did they increase production or did they not cut back as they had perhaps been planning to do?

Secretary KREPS. They initially increased quite substantially their monthly production to somewhat over 10 million barrels a day from late October through December. Since the beginning of the year they have been producing about 9½ million barrels a day.

Senator SARBANES. I guess I am asking, what is the addition that you think they are providing. If we are going to take them to lunch, we ought to figure out what kind of lunch we are going to give them before we get there.

Secretary KREPS. They have gone up substantially on the average in this period at times up to almost 2 million barrels a day.

Senator SARBANES. Two million?

Secretary KREPS. Yes.

Senator SARBANES. I understood the figure was 1 million, from 8½ to 9 million.

Secretary KREPS. For a while there they were at about 10½. That has gone back down some, but I think it is still over a million a day; yes.

Senator SARBANES. A million.

What could they produce? What is their capacity?

I mean, we have lost 5 to 6 million and we are getting 1 million. That is 20 percent or less. What could they do? Is 9½ million the limit, or what they can do? Practically speaking.

Secretary KREPS. Our best estimate would be that they could increase their oil production perhaps to 11½ million a day.

Senator SARBANES. Instead of 9½?

Secretary KREPS. But not much more than that; no.

Senator SARBANES. A total of 11½ instead of 9½?

Well, I appreciate that. I think that ought to enter into the judgment as to whether you take them to lunch, and if you take them, what kind of lunch you ought to buy them.

Mr. Secretary, I am interested in this 6.2 percent unemployment figure. Is it related to the \$29 billion deficit figure?

Secretary MARSHALL. Yes; it is.

Senator SARBANES. In other words, your assumption is that with unemployment rising to 6.2 percent, you are still going to be able to hold the deficit down to \$29 billion?

Secretary MARSHALL. Yes.

Senator SARBANES. And that the additional \$18 to \$20 billion increase in the deficit as a consequence of each point in the rise in unemployment is above and beyond the 6.2 percent figure?

Secretary MARSHALL. That is correct. Above and beyond that projection, you would get that increase in the deficit because of the rising unemployment unless you do something to counteract that unemployment.

Senator SARBANES. What do you figure the deficit would be if the unemployment went down to, let's say, 5.5 percent?

Secretary MARSHALL. Well, it depends on what causes the deficit to go down.

Representative MITCHELL. Unemployment.

Secretary MARSHALL. If, because of reducing unemployment, we have reduced the deficit, I think our proportionate amount—by \$14 million are the numbers you gave—

Senator SARBANES. Well, on the analogy of the answer you gave to Senator Jepsen and I must say I subscribe to that analysis, why didn't we have a fiscal policy designed to drive down the unemployment rate which would result in a lower deficit, not a higher deficit?

Secretary MARSHALL. That is what our objective is. That is the reason we want to move toward that 4-percent unemployment rate we have in the Humphrey-Hawkins bill because it is very possible—

Senator SARBANES. But you are letting the unemployment rate go up.

Secretary MARSHALL. Well, the main problem we got into—

Senator SARBANES. And you don't have at this time labor markets, by your own statement.

Secretary MARSHALL. That is right.

Senator SARBANES. So, you are not trading it off on inflation, or probably not?

Secretary MARSHALL. What you would do if you increased the expenditures, if you had as fast growth during the last or this coming year as you did in the past 2 years, is increase the inflationary pressures in the economy, not necessarily in the labor market but in product markets. What appears to be happening now is that there are shortages of materials long before you get to shortages of labor.

Senator SARBANES. I see my time is up.

I am interested in these tripartite committees that you referred to. They strike me as a very constructive idea and if I could get some greater detail from you about them, I would appreciate that.

Secretary MARSHALL. We would be happy to give you that for the record. I think that they are doing a lot of very useful things and we would be happy to share that information with you.

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

JOINT LABOR-MANAGEMENT COMMITTEES, APRIL 1979¹

A basic premise of the voluntary cooperative approach is that some complex problems of the workplace and industry can be more readily handled through joint consultation than across the bargaining table. Labor-management committees are intended to supplement collective bargaining and to provide a mechanism for drawing more fully on the ideas of workers and unions to improve productive efficiency and to enhance working conditions and the work environment. The concept is applicable to the public as well as the private sector.

BACKGROUND

The idea of labor-management cooperation has been discussed for over 50 years. Considerable interest was aroused in the 1920's when the Baltimore and Ohio Railroad and the machinist union established joint committees operated in manufacturing plants and shipyards. Few, however, survived. One of the most successful applications of the concept is the Union-Management Cooperative Committee system of the TVA which has been operating since the 1940's with strong support from both sides.

Since 1971, there has been growing interest and several significant new developments have taken place. The term now encompasses a broad diversity of situations and types of relationships. Over 240 examples have been identified but data on the total number of joint committees in operation are not available.

Some labor-management committees have been organized on the industry level; some at the community level; some at the plant level, each type addressed to different and appropriate sets of problems. A few examples illustrate these different approaches.

¹ Prepared by the U.S. Department of Labor, Office of the Secretary.

INDUSTRYWIDE JOINT COMMITTEES

In a few industries, the parties to collective bargaining have set up industrywide joint committees to deal with mutual problems that cannot be handled effectively on an individual company basis. Some problems arise out of the impacts of imports, government regulation and other developments affecting the climate of negotiations. The Labor Department has helped to organize a tripartite committee in the steel industry to discuss such issues as trade, taxes and regulation. In the airline industry, the unions and companies, with the Department's involvement as a third party, have met to discuss the impact of deregulation, energy shortages and other mutual problems that may affect job security.

Some joint industry committees receive support from Federal agencies for specific projects covered by existing programs; others have been aided by FMCS mediators. Among these joint industry committees are the following:

The Amalgamated Clothing and Textile Workers and the Clothing Manufacturers' Association jointly developed in 1978 an agenda of research, education and training to improve the competitiveness of the fragmented men's clothing industry. Job Training and Research Inc., a non-profit agency created by the two parties, has been granted \$1.7 million by Labor Department under CETA to train new entrants; \$0.5 million from Commerce for management training and marketing research; and funds from the National Science Foundation for technological research, development, and testing.

In the railroad industry, a joint labor-management committee of industry leaders has been operating for a number of years to deal with common problems such as rail safety, terminal efficiency and government regulation. Joint task forces of union and management experts have been working on improvements in terminal operations in St. Louis, Chicago and Houston, with grants from the Federal Railroad Administration. Their main objective is to reduce time of cars in terminals by changing labor and management practices.

In the retail food industry, a joint Labor-Management Committee, organized in 1974 in connection with the termination of controls, has concentrated on improving collective bargaining between the food chains and three unions—The Teamsters, Retail clerks and Meatcutters. It has also dealt with problems of technological change and health and safety. The entire project has been wholly financed by the companies and unions in the retail food industry.

In addition to these established joint efforts, the UMWA-Industry Development Committee has just been created under the 1978 coal collective bargaining agreement to consider ways of improving training, health and safety and productivity.

COMMUNITYWIDE JOINT COMMITTEES

A second approach involves representatives from unions and business in a particular locality or city forming a committee to promote their common interest in the economic health of their community. About 24 localities, including Cumberland Maryland, Jamestown, New York and other older industrialized cities and towns, mainly in the Northeast and Midwest, have such community-based joint committees. They are concerned with improving the local collective bargaining atmosphere, reducing work stoppages, upgrading the skills of supervisors and workers, and promoting retention of firms and jobs in the locality.

Many area wide committees that have been organized in the past few years follow the model of Jamestown, New York and encourage and assist the parties to form joint committees at the plant level to deal with productivity improvement and other workplace problems. Typically, these area councils have a small staff to coordinate activities with community colleges and assist plant committees. Several government agencies have helped to fund their activities as part of existing programs for economic development.

JOINT COMMITTEES IN CONSTRUCTION

A variation of the community approach is the industry wide joint committee in a locality. Several examples of this type are found in the construction industry. The Chicago Construction Coordinating Committee, involving the various trades, contractor associations and government procurement agencies, was established in 1973, with Department of Labor funding for staff support, to help improve productivity by reducing seasonality, better training and wider exchange of information about government policies. Similar coordinating committees have been established in San Francisco and Kansas City. Also, construction unions and contractor associations in six areas (St. Louis, Indianapolis, Boston, Columbus, Nevada and Colorado) have established under their collective bargaining agreements local joint labor-manage-

ment councils to deal with work practices and other problems affecting their productivity and competitiveness. The government is not involved in these situations.

PLANT COMMITTEES

The third type—plant committees—is the most numerous form. These joint committees of workers, union officials, supervisors and managers take up specific problems at the workplace that are not usually covered by the collective bargaining agreement. They may concentrate on particular troublesome issues such as absenteeism, production bottlenecks, excessive scrap, energy conservation and other types of operating problems.

Joint committees are found in the steel, auto, food and paper industries. Many labor management councils are active in agencies in the public sector at the federal, state and local levels. The Labor Department is assisting the Massachusetts Quality of Working Life Center in its efforts to bring together unions and management in local government agencies in three towns to deal with organizational improvements.

A few joint committees have recently expanded into new and previously uncharted areas, such as bidding on new work, organizing the layout of machinery and equipment in a new plant, and helping to select key supervisors. In the auto industry, UAW-General Motors QWL Committees plan and oversee quality of working life programs. Also, a few hundred plants have adopted the Scanlon Plan that combines worker participation in improving efficiency through joint committees with an incentive system based on a formula for measuring the plant's productivity and sharing any gains with all employees on a periodic basis.

Some labor-management committees have been assisted, at the start, by mediators of the Federal Mediation and Conciliation Service. A few have been guided by third parties who have acted as facilitators and teachers. In some experimental quality of working life demonstration projects, government agencies have supported outside consultants to assist the parties and study the process.

EVALUATION AND OUTLOOK

In reviewing experience with labor-management committees, we find, as in other collective bargaining arrangements, examples of noteworthy success and disappointing failures. Joint efforts often provide opportunities for a dialogue about mutual problems, which lead to broader understanding of the need for productivity growth, job security and a better working environment. They help create a favorable climate for industrial peace and technological change.

Cooperative endeavors, however, are highly fragile, especially in the context of historically adversarial relationships. They require commitment, mutual trust and a problem solving attitude which few seem to be able to make. The challenges of competition, history of past relationships, and economic condition—all influence the outcome. In only a few of the many thousands of possible cases has this type of formal cooperation been adopted.

The Government can only facilitate wider acceptance of labor-management cooperative endeavors in a limited way. It can encourage the parties to consider various approaches, provide objective data, and support technical assistance to those who request it. It cannot mandate labor-management committees through law or regulation. Federal leadership can and help the parties understand more fully the benefits and problems of this constructive approach.

The enactment of the Labor-Management Cooperation Act of 1978 (CETA Amendments of 1978) could help in spreading the concept more widely. The Act authorizes \$10 million for the Federal Mediation and Conciliation Service to encourage and assist the formation of labor-management committees at the plant, area, and industry levels. Funds have not yet been budgeted or appropriated for the Act.

Programs to encourage labor-management cooperation have already been established in several states, with Federal and State assistance. Typically, these programs of information, technical assistance and research are being conducted at State universities such as the Center for Productivity and Quality of Working Life at the University of Maryland's College of Business and Management and the Center for the Quality of Working Life at Pennsylvania State University. These Centers disseminate information about the benefits and problems of labor-management cooperation and help both parties in various industries adapt the idea to their individual circumstances.

Senator **SARBANES**. Congressman Mitchell, I am going to have to leave and I may not be able to return to hear Mr. Brown's state-

ment on behalf of the Full Employment Action Council, but I would be remiss if I didn't say that I am happy he is here today.

The Council, under Mrs. King and Mr. Yeoman, worked in putting the Humphrey-Hawkins statute on the books. Mrs. King promised at the signing ceremony that they were going to continue day in and day out watching all of us, and I am pleased to see that they are doing exactly that here today, I apologize to Mr. Brown for not being here when he testifies. I have read his statement, which is a very forthright and strong exposition, I think, of a very important position.

Representative MITCHELL. Madam Secretary, it is now 11:17 and 25 seconds. You wanted to leave at 11:15. Can you stay with us a moment longer to have some questions by Congressman Wylie and Senator McGovern?

Secretary KREPS. Yes, Congressman Mitchell, with the understanding that they will be easy questions.

Senator SARBANES. They tell me they are short but not easy.

Representative WYLIE. This is a very easy question, Madam Secretary: What are the specific reasons for our terrible productivity performance?

We are at the bottom of the heap in the ranking of the major industrial countries right now in terms of the growth of productivity. I just saw a report in the Wall Street Journal that our productivity is rising about one-tenth as fast as Japan's.

What should we do to turn that around?

Secretary KREPS. Well, the explanation of why our productivity has been declining I skipped over in my oral statement. We are not absolutely sure we know the answer to that, but insofar as we have some sort of general categories, we will accept those rather than specific ones. We do think that we had a long-term, rapidly rising productivity because of the shift of workers out of agriculture into industry where the productivity per hour was much higher and we have now lost that and that is no longer occurring.

On a much shorter term basis, we think—and I suspect Secretary Marshall would confirm this—that part of what is happening in the last decade or so has been a shift in the age composition of the work force toward the younger workers who have less skills and whose productivity reflects that.

Finally, there are a series of other governmental, largely governmentally imposed actions which influence productivity as we now measure it.

That is to say, if you have heavy expenditures for cleaning the air or providing safety in the workplace, one counts the cost of those, but the gains in benefits are in many instances, I think, not adequately reflected in the GNP accounts.

Therefore, there may be, to some extent, a measurement problem in addition to the demographic factors in the long-term shift from agriculture into industry that is at work here.

I regret that I cannot be more precise.

With respect to what you should do about it, it does seem to me that some of it will be self-correcting. The age composition of the work force will change in time.

We are beginning to see, I think, somewhat of an upturn in the volume of investment in industry which will also be helpful.

I do think that we have a lot of problems in the innovation area, in the composition of the investment and we have some important questions to consider with respect to the rate at which we would spend for external considerations, important consideration of how we plan to take those.

Representative WYLIE. In your prepared statement, you suggest that, in a general fashion to account for declining productivity, a possible factor is the end of migration out of the low productivity farming sectors.

Would you expand on that just a little bit?

Secretary KREPS. The big increases in productivity that we have had historically in this country have been a rapid improvement in our capacity to produce agricultural commodities, thereby transferring people off the farm where they were not very productive into manufacturing, which was highly productive because those industries had heavy investments, were highly mechanized, and so on. But this shift has pretty well taken place now and indeed shifts now are occurring from manufacturing into services very heavily.

By and large, the service industries are less productive per man-hour than manufacturing and that gets reflected in the figures one is talking about here in long-run returns, about the state of the economic development of the economy. We are at that watershed which is both good and bad.

It is good in the sense that it signifies the higher and higher standard of living. It is bad in the sense that the momentum occasional raises in productivity, are not necessarily any longer there.

Representative WYLIE. Secretary Marshall, in your prepared statement you seem to say that it is simply not true that the size of the deficit is proportionate to the rate of inflation in any given year, and I am inclined to agree with you that the size of the deficit may not be proportional to the inflation rate of any particular year since there is some lag time between a deficit and the resulting inflation.

However, I submit to you that the \$60 billion plus deficits in 1976 and 1977 are really the main reason for our roaring inflation now.

Would you disagree with that?

Secretary MARSHALL. Yes; I would.

I think that the reason for the deficits in 1976 and 1977 was that unemployment was 8 percent or over. Therefore, we had a lot of expenditures in transfer payments and people were not paying taxes so the collections went down.

I think the main sources of the recent inflation have a lot more to do with external shots with the economy. That is to say, the quadrupling of the OPEC oil prices in the seventies, the fact that we had some bad crop years and significant increases in agricultural prices throughout the world.

I think that one aspect of the deficit which was inflationary, was that we financed the Vietnam war by spending rather than by taxing to pay for it. If we had not done that, then you would not have generated a lot of those pressures.

The point that I would make is that these deficits can be inflationary but they are not necessarily inflationary. It depends on the effect that they have on the overall economy and that you won't

necessarily get rid of the inflationary pressure by balancing the budget we could have balanced our budget and still the OPEC oil countries would have quadrupled the energy prices. We could have had a balanced budget and still have had crop years and have gotten significant increases in agricultural prices.

I think that some of the prices that have been increasing have more to do with the market power of the health industry than, say, with Government expenditures. I think those are partly related, though, partly not because of the budget itself but because of the way we spent the money. That is to say, by increasing the incidence of third-party payments in the health industry, we have not created an environment that would tend to keep those costs down and therefore I think those are much more of a problem.

In other words, I believe that the big budget deficits were more consequences of rising unemployment at that time than—

Representative WYLIE. I would agree with you that there are other factors but I think it is nonsense to say that the budget deficits in the area of \$120 billion in 2 years were not a deciding factor in increasing our inflationary rate immediately thereafter.

The Federal Government had to go to the private sector to finance the public debt and there was a crowding out in the process which created an excess demand for high-cost money and the money just was not available.

If the Federal Government had not created the money the price of oil would not have gone up as high as it did, then perhaps the price of oil would not have been the deciding factor it was.

The point I want to make here is that during this time of expansion in the money supply to finance and manage the public debt there was an impact which may not have been in proportion to the inflation situation in that particular year, but I think there was a ripple effect that we are seeing now. Technically, I think this is called an Almon distributed lag, at least conceptually.

Representative MITCHELL. Would the gentleman yield for just a moment?

Representative WYLIE. Yes.

Representative MITCHELL. We will put a strain on the Secretary and I think Senator McGovern has one question that he wants to raise.

Representative WYLIE. You have been very generous. Thank you very much.

Senator MCGOVERN. Just one question, Madam Secretary.

I noticed in your prepared statement you make the observation that in order to offset the rising deficit for oil and to continue reducing our overall trade deficit, our surplus in manufactured goods must increase much further.

What policies are we pursuing toward that end in increasing our manufactured exports?

Secretary KREPS. The only longrun way that we can improve our export competitiveness in manufactured goods, of course, is to increase our productivity and make those goods price competitive. In the long run, what we have to concentrate on are those measures which increase the investment in industry that will enable us to expand its output and keep its costs down.

That involves a number of considerations such as tax considerations, depreciation allowances, and things of that sort.

It also involves considerations of how fast we can make governmental regulation more efficient or to put it positively, how much deregulation we can bring about, how much we can decrease the paperwork burden on industry and therefore reduce the costs.

In the much shorter run, of course, what we are trying to do is stimulate exports by bringing into the export market firms that have never been there before, firms medium and small sized that have traditionally viewed the American market as all they needed.

We have in that regard, of course, asked for and received some additional funds for export promotion. The additional funds will be spent primarily in getting better information and developing a computerized system of available demand from abroad, which we can then feed to small- and medium-sized firms across the country.

I do think that one should not be too pessimistic about our situation vis-a-vis the other industrialized countries in exporting because one of the factors that has been working against us is the cyclical factor.

We have recovered from the recession faster than many of our competitors. Therefore, we were buying, in 1977-78, much more heavily from abroad in manufactured goods, among other things, much more rapidly than they were buying from us.

This balance is shifting some now in part because of the depreciation of the value of the dollar. In addition, we are now growing more slowly, they are growing faster.

We expect this to continue to improve the trade balance by increasing their demand for our goods.

Senator MCGOVERN. Thank you, Madam Secretary. That is all I have for you.

Secretary MARSHALL. I—

Representative MITCHELL. Senator, would you yield to me for just a moment? I notice you are getting ready to leave, and, Madam Secretary, we do thank you for appearing before us.

A few of the members of the committee have questions that we wanted to ask you. We will submit those, requesting a prompt reply.

Secretary KREPS. Thank you, sir. I will be glad to respond.

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF HON. JUANITA M. KREPS TO ADDITIONAL WRITTEN QUESTIONS POSED
BY REPRESENTATIVES MITCHELL AND BROWN

Question 1. Provide an explanation as to the exact numbers of small and minority businesses who were invited to join the mission to Japan last Fall.

Answer. Because much of the recruitment was done indirectly through organizations such as trade associations, we cannot provide a compilation of the firms contacted as to their character. Approximately 68 percent of the members of the Japan Export Development Missions were small and medium sized firms. The attached "Profile of the U.S. Export Development Missions to Japan," shows the breakout by size of the firms.

No known minority firms took part in the Missions. Efforts to recruit minority firms included contacts through the following two minority associations.

(1) National Association of Black Manufacturers, Mr. Ron Lewis, Vice President, 1625 I Street, Washington, D.C. 20006, 785-5133.

(2) National Business League, Mr. Waymon Wright, Executive Director, 4324 Georgia Avenue, N.W., Washington, D.C. 20011, 726-6200.

These organizations were provided full details and complete solicitation kits.

Other recruitment efforts were made through 18 trade associations which were invited to attend a meeting on May 5, 1978 held at the Commerce building to discuss the upcoming missions to Japan. The 18 trade associations have a membership of approximately 6,000, of which 367 are minorities. The associations advised that as the majority of member companies are publically owned, neither the associations nor the companies themselves can be sure of the degree of minority ownership.

Also, notification of the Missions was made through a Press Release dated June 28, 1978 asking interested potential participants to contact the Industry and Trade Administration for further information.

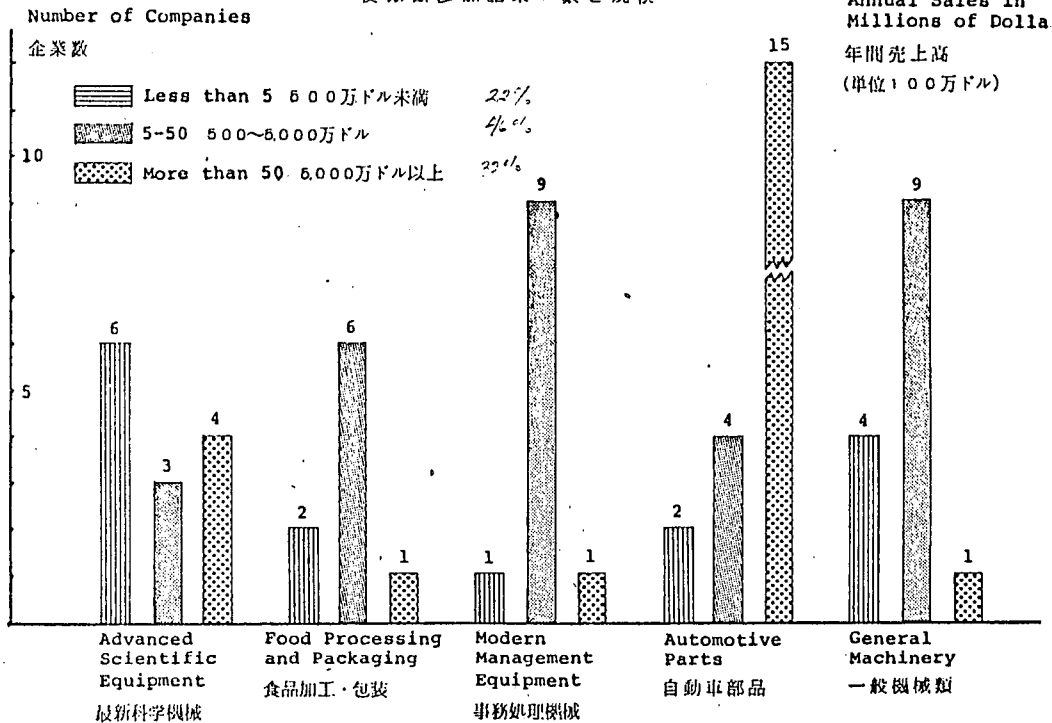
A PROFILE OF
THE U.S. EXPORT DEVELOPMENT MISSIONS
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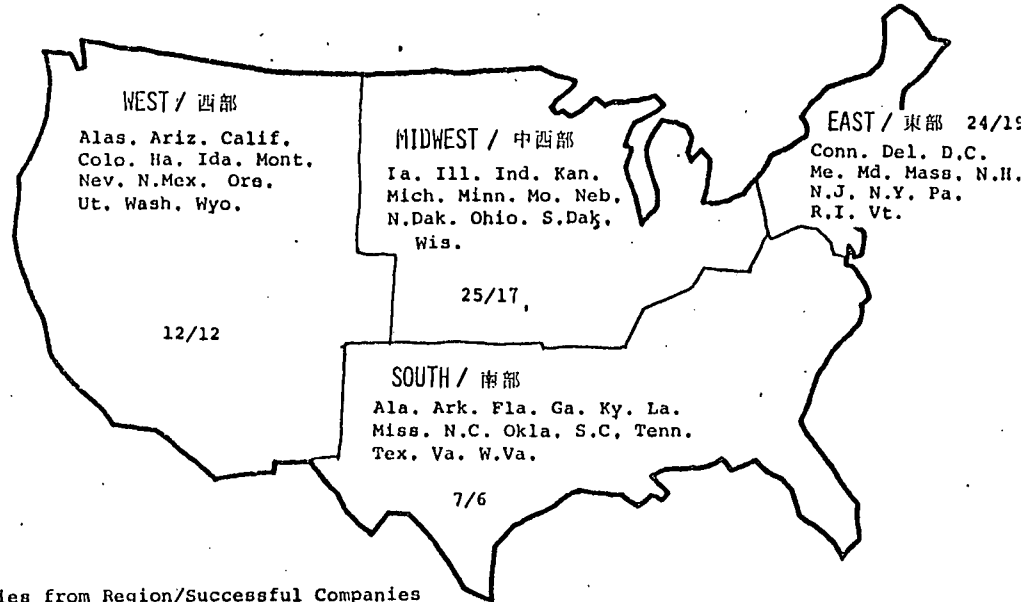
NUMBER AND SIZE OF EXPORT DEVELOPMENT MISSIONS' MEMBER COMPANIES

使節団参加企業の数と規模



GEOGRAPHICAL DISTRIBUTION OF
EXPORT DEVELOPMENT MISSIONS' MEMBER COMPANIES

参加企業の地理的分布



Companies from Region/Successful Companies

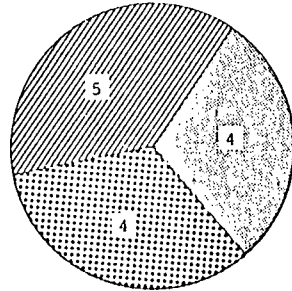
各地域からの企業数/契約成立企業数

PROSPECTS FOR SALES OF ALL COMPANIES

全企業の販売見通し

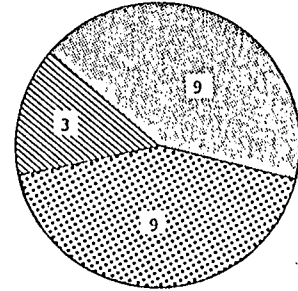
Advanced Scientific Equipment


最新科学機械 (13社)





Automotive Parts

自動車部品 (21社)



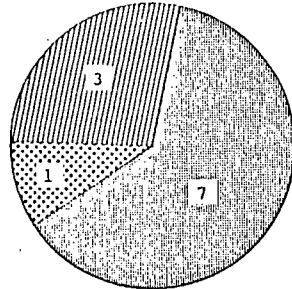
 Definite Prospects
or Concluded Contracts
成立した契約または成立の見込み

 Good Prospects
for Future Sales
今後の販売の良好な見通し

 Few or No Prospects
ほとんどまたは全く見込みなし

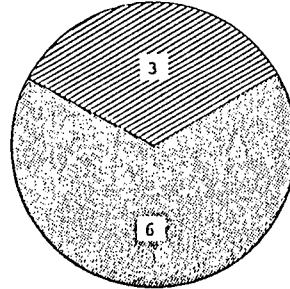
Modern Management Equipment

事務処理機械 (11社)



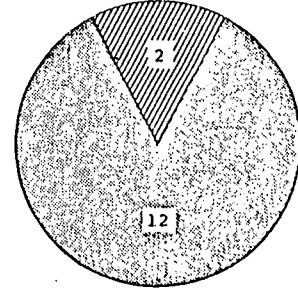
Food Processing and Packaging

食品加工・包装 (9社)



General Machinery

一般機械類 (14社)

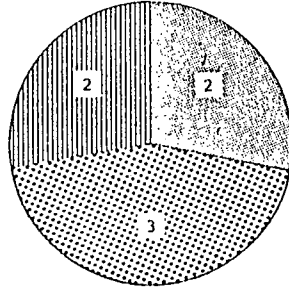


PROSPECTS FOR SALES OF COMPANIES NEW TO MARKET

日本進出企業の販売見通し

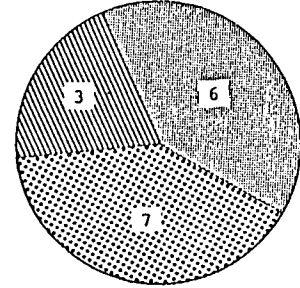
Advanced Scientific Equipment

最新科学機械 (7社)



Automotive Parts

自動車部品 (16社)



Definite Prospects or Concluded Contracts
成立した契約または成立の見込み



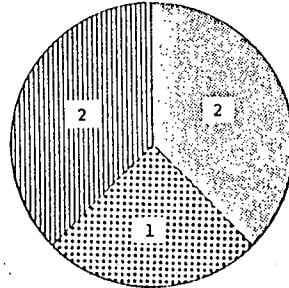
Good Prospects for Future Sales
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ほとんどまたは全く見込みなし

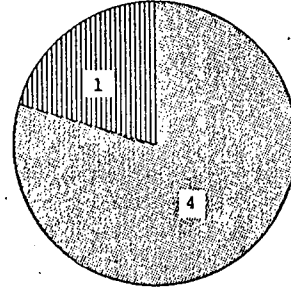
Modern Management Equipment

事務処理機械 (5社)



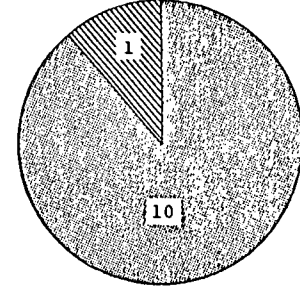
Food Processing and Packaging

食品加工・包装 (5社)

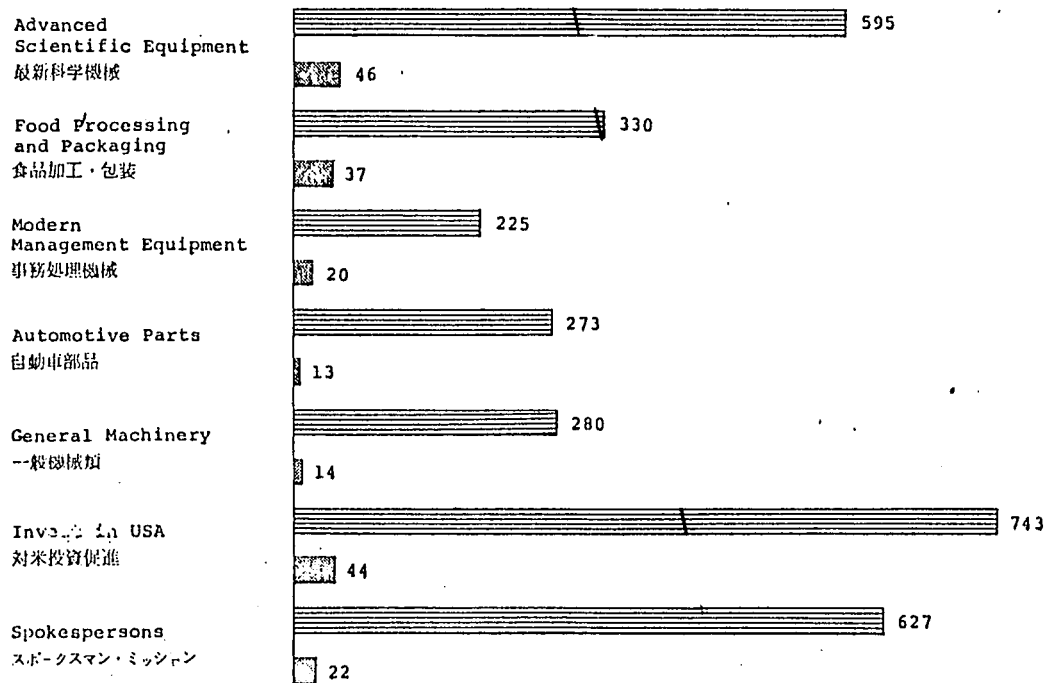


General Machinery

一般機械類 (11社)



NUMBER OF CONTACTS PER MISSION
 AVERAGE NUMBER OF CONTACTS PER MISSION MEMBER
 ミッションごとの接触数、ミッション・メンバーごとの平均接触数



Question 2a. Provide information on any model results showing the impact of Iran's decrease in purchasing U.S. exports and their reduction in the production of petroleum on our out-payments for the first quarter and the first month of this year?

Answer. The situation in Iran and in world petroleum markets is still evolving. There are many factors associated with this situation which need to be carefully analyzed, and a reasonable forecast of the effect on U.S. trade is simply not possible at this time. There are, however, a number of factors that can be identified that will have an impact on our trade balance.

U.S. exports to Iran are likely to be smaller than they otherwise would have been. Staff estimates of this reduction have been in the \$2 billion range—from a potential level of over \$4 billion.

Another factor is the accelerated rise in petroleum prices made possible by the shortfall in world oil production. (We should have a better indication of future oil prices after the March 26th OPEC meeting.) Higher oil prices will, of course, add to our already enormous oil import bill. Also, to the extent that higher oil prices and supply shortages reduce economic growth abroad, our export growth to non-OPEC nations would be reduced.

Offsetting these factors are several forces that will tend to reduce our trade deficit. The most important is implementation of steps by the large oil importing nations to reduce oil consumption. We have agreed to reduce our oil consumption by roughly one million barrels per day. If we are completely successful, this would significantly offset the higher price of oil imports.

Added revenues, furthermore, would tend to increase OPEC import demand, and consequently U.S. exports, to those nations. Finally, to the extent that supply shortages and higher oil prices constrain U.S. economic growth, this would reduce U.S. imports of non-oil products.

There are also other possible effects, but the ones I have mentioned are the major factors which will influence our trade account. I am optimistic the adverse effects of the Iranian crisis on U.S. trade can be minimized and that we will see significant improvement in the trade and current account balances over the course of the year.

Question 2b. What information do you have as to the adverse effects of the Iranian situation on U.S. companies which have had a special interest in that country?

Answer. We have only a very general idea of the extent of the damage suffered by U.S. commercial interests as a result of the recent upheaval in Iran. There have been significant adverse effects of an immediate nature, but the loss of future earning potential of U.S. firms in Iran could prove far costlier in the long run.

(1) *Property damage:* The offices of many American companies in Tehran and other cities suffered physical damage as a result of the rioting of the past several months. There also was a substantial loss of personal and household effects caused by looting of houses and apartments hastily vacated by departing employees of American firms.

(2) *Payments problems:* U.S. Creditors were adversely affected by the shut-down of the Central Bank of Iran during the past three months. Many engineering and other service companies have not received payments since October. U.S. merchandise exporters likewise suffered as a result of cessation of all funds transfers through the Iranian banking system. The strike at the Central Bank is now ended, but it may still be several months before the backlogged transactions have been processed.

(3) *Loss of export sales:* Census Bureau data show that U.S. exports to Iran in January were \$218 million below the January 1978 total—a drop of more than 70 percent. Recovery of exports, particularly in the capital goods area, is expected to be slow under the best of circumstances.

(4) *Contract cancellations:* Last month the Provisional Revolutionary Government of Iran cancelled \$7 billion in Foreign Military Sales (FMS) contracts with the Department of Defense, and indicated that the remaining FMS contracts (totaling some \$4.5 billion) would be carefully reviewed in light of Iran's reduced defense posture. In addition to the FMS contracts, the Iranian Armed Forces have large contracts directly with U.S. suppliers. For example, the \$700 million Chah Bahar naval base contract held by Brown & Root will be substantially scaled back, if not cancelled outright. In most instances, U.S. suppliers of defense material will be able to recover direct contract termination expenses, since such contracts call for adequate cash advances.

Civilian public-sector projects in Iran represent another area in which American firms are heavily involved. Here, too, major cutbacks are expected, although nothing specific has been announced. Meanwhile, with American and other expatriate

staffs having been pulled out of Iran, firms such as AT&T, GTE, Morrison-Knudsen, Kaiser Engineering and Ralph M. Parsons have adopted a wait-and-see posture with respect to their Iranian projects.

In the petroleum sector, the National Iranian Oil Company has announced it would no longer contract for oil field services with the consortium of western oil companies. This means that the many American subcontractors which until recently had been active in the Iranian oil fields, will have to negotiate new contracts directly with NIOC at such time as it is safe to bring back expatriate technicians.

We estimate that U.S. companies in 1979 could lose as much as a half a billion dollars in profits as a result of Iranian contracts already cancelled or liable to be cancelled with the next month or two.

(5) *Future of American joint ventures*: A sizable number of U.S. firms are engaged in manufacturing joint ventures in Iran. The book value of these types of direct U.S. investments exceeds \$200 million, and until last year the figure was growing steadily. Thus far the Government of Iran has made no move to expropriate these assets, but the loss of earnings suffered by these joint ventures as a result of the political turmoil in Iran has been substantial.

Representative MITCHELL. I'm sorry, Senator. Please continue.

Senator McGOVERN. Members of the Agriculture Committee have just finished a review of the USDA budget which, as you know, includes the food stamp program.

When we attempted to reform that program 2 years ago, we projected food inflation at a figure that was based on the estimates from both the Congress and the Budget Office and also from the administration and, on the basis of that, we set a "cap" on food stamp spending at \$6.2 billion.

Now, it turns out we were way off in our estimates and came up against the "cap" on food stamps about 2 years before we had anticipated. On that basis, on a 9 to 8 vote, the Agriculture Committee voted this week to go along with the administration's request to lift the "cap" on food stamps.

The alternative would have been to knock the benefits down by 15 or 20 percent. I am wondering what assurance we have now that the projected inflation and unemployment figures are any more reliable than they were 2 years ago.

If they are not reliable, then presumably the whole game plan is out of kilter.

Secretary MARSHALL. I think that that is the case and that is the danger in forecasting. I think we can be a little more accurate on the unemployment side than we are on the inflation side in making forecasts.

Our employment performance has been better than many people had forecast. On the price side, we really have had a serious problem because of external shocks—you know we don't have control over the things that will cause the increases in food prices.

It seems to me that what we ought to do with our planning which is to have contingency plans to have standbys, and we ought to monitor the process and monitor our forecasts very carefully. When we see that we are going off course, we should do whatever we can to take corrective action.

In my area, the employment area, I think, it is extremely important to maintain that countercyclical concept so that if unemployment does rise more than we expect it to, we can rapidly move in to compensate for it by more jobs.

I think we can do that in other areas of the economy also. I think it is particularly important, since you are talking about the food stamps, that we not shift the cost of either inflation or rising

unemployment unnecessarily and inordinately to low-income people who tend to suffer from both more than most people in the economy.

Senator McGOVERN. Is it your feeling, Mr. Secretary, that the most serious inflation now is in the basic necessity sectors, in food, in energy, housing, health?

Secretary MARSHALL. Those are very important sources of inflation. I think that it is serious in the sense that those prices are increasing faster than prices overall. It is also serious in the sense that they have a greater impact on low-income groups than the general price—

Senator McGOVERN. In those areas, do you think that we ought to consider standby price and wage controls?

Secretary MARSHALL. I think that we ought to consider anything we can do to deal with the pressures.

I think that there are many things that can be done. We don't know all of those yet. I think that we need to concentrate, get ourselves organized, and understand as much as we can about the sources of pressure—and they will be different in different sectors.

Some inflationary pressures come about because of market power that sellers have in those markets, not because of a real shortage. We ought to determine that, and, if it is because of market power, then I think we ought to do whatever we can, through deregulation or antitrust laws or whatever, to try to counteract that market power.

The other side of it is that if you have a shortage, a real shortage, the only way to relieve that is by increasing output, and one way to do it is to use your resources more productively. I think we can do a lot to increase productivity or to increase supply. Careful examination, industry by industry is required.

Sometimes it is useful to let the price go ahead and rise in order to correct the imbalance. It would be hard to generalize that across the board. One of the problems I have with wage and price controls is that you do not make the distinction of what caused the price increase and therefore you cannot take the appropriate action.

If you tried control the increase in prices where you have a real shortage you would not solve the problem. You might solve the problem if it is market power that you are worried about, wage and price controls in that situation might do a lot to correct that imbalance, but it is important, I think, to examine these sectors case by case and try to do whatever we can to overcome those pressures.

Senator McGOVERN. Thank you, Mr. Secretary.

Representative MITCHELL. Gentlemen, our other witness has been waiting patiently back there for some time. The Chair would like to suggest that we attempt to put the next witness on by quarter of twelve.

Secretary MARSHALL. I would also be glad to respond in writing to any questions you may have.

Representative MITCHELL. The Chair does have additional questions but I will defer to the other members because of the time constraints.

Senator Jepsen.

Senator JEPSSEN. Yes. Thank you, Congressman Mitchell.

Concerning unemployment, Mr. Secretary, and I won't go into the definition of how you measure unemployment, I think that you could start categorizing the voluntarily unemployed as the voluntarily unemployed and you will find quite a philosophical, tangible, and real problem that we ought to attack in this country.

That partially solves some of our problems but I keep hearing you say that if we really get in trouble, the things that you have been doing by way of creating public sector jobs under the Humphrey-Hawkins bill are going to help solve many of our problems including inflation.

The public service programs you talk about have been created and initiated by an important concern. I think primarily the efforts to help the hard-core unemployed, the structurally unemployed, has been well intentioned but unfortunately they are not well received by the public generally, and particularly and ironically by those who have much to gain from it.

Specifically, I don't believe that the disadvantaged Americans, the minorities, women, youth, the elderly, are either greatly impressed or satisfied with the public works programs that have been initiated by the Labor Department and I will tell you why.

I believe the people who are the hard-core unemployed or desperately want real jobs, not public short-term jobs. These people want longevity in their employment.

What are the goals and the objectives for securing real jobs for the hard-core unemployed?

Secretary MARSHALL. While there might be dissatisfaction with the system, all the evidence that we get from polls taken by independent organizations indicates great support among the people for a jobs program to deal with these problems.

I agree with you that we cannot solve the problem of the hard-core unemployed by public employment and training activities alone—we should not try to do that.—That is the reason that the President has made the proposal of the private sector initiative of \$400 million.

Senator JEPSEN. I commend you.

Secretary MARSHALL. We have to improve the strength of this. We also believe the targeted job tax credit, which is an inducement for the private sector to employ and train the disadvantaged, will do a lot.

We have looked at those programs not just to put them to work in the private sector but also to help us improve the operation of the public employment training system because we want them to incline more toward each other.

We want to get the private sector more involved and we are. All of the major business groups in this country and unions and private community-based organizations are helping us with that system. We think that is the missing link in the system right now.

We are also trying to do everything we can to improve the public employment training system. I think we have made some significant strides in that direction in the CETA review authorization. The program that we have now is really significantly different from the program we had, say, 3 or 4 years ago, and I think its problems are understandable because it is a relatively young program.

It is less than 6 years old; it has been going through a shakedown and we believe that will continue. It will continue to evolve until we get a system that relates not only to the private sector, but to the educational system.

The last point I would make is what we are trying to do is shift not only into the private sector but to target more and to pay more attention to training and work experience as a component.

I do believe, however, that the evidence will show that the things that people have been doing in the public sector jobs have been very significant and important things. We have got many of those in your State. The green thumb program, for example, that we have puts older Americans to work in rural areas and is a very constructive program. We have a program for young people to work rehabilitating the homes of the low-income people. That's not make-work that traps those young people. This new idea not only gets people trained but it also improves housing, saves our energy, and cuts down on our public assistance payments and the like.

We think if you do get meaningless work done, it is simply because the local prime sponsors who run the system have not managed it right and we intend to see that they manage it right.

Senator JEPSEN. I am pleased to hear this. You will have my 1,000-percent support for this. I hope you put some real emphasis on this.

Secretary MARSHALL. Thank you.

Representative MITCHELL. Congressman Wylie.

Representative WYLIE. I just have one question. Do you think that we will reach the 4-percent unemployment rate goal by 1983?

As I read further from what you have just been saying here, it seems to me as if you may have said that you are against corporate tax cuts, you are against inflation cost depreciation, tax writeoffs, the youth benefit; you are against first-year writeoffs for R. & D., you are against writeoffs for environmental protection equipment and you say the way to get to this 4-percent unemployment figure is to encourage the growth of demand.

I say, what about increasing the rate of the aggregate supply—I think we could do it if we did some of these things that I just mentioned you say you are against.

Secretary MARSHALL. I didn't say I was against any of those.

The only one that you mentioned—and I listened carefully—is the youth differential on the minimum wage. I think that there are real problems with the youth differential.

Let me make this point, though: I don't believe that we are going to solve any of our problems by any one technique because different kinds of things fit different industries and different situations.

That is the reason that we believe that a combination of monetary and fiscal and selective activities have to be undertaken. If your problem is that you don't have enough capital capacity, for example, then obviously you need to do things that will tend to stimulate investment in capital capacity.

I believe that in the long run, the best way to deal with the inflation problem is increasing productivity, and I believe that is the best way to get to full employment because you won't get to full employment if you don't do away with the inflationary pressure before you get there.

May I add one other point in connection with your question to Secretary Kreps?

I think it is important to distinguish between the average level of productivity—in which we are still leading the world—and changes in productivity. There are a lot of people who think that our productivity levels are lower today in this country than in other days, but that is not the case. We have had lower increases in productivity, but since the first quarter of 1978. But I think you are right that we need to concentrate on improving shortages.

That is our fundamental problem improving the productivity. The margin for reducing inflation will depend really on how much we increase productivity.

I think investment in persons and capital can do a lot with that, but I think that we have some inefficiencies built into the economy that we have to correct as well.

Representative WYLIE. I thank you very much.

Representative MITCHELL. Thank you, Mr. Secretary.

I have one last question and I don't want you to answer it now; you may phone me on this.

You talked about the \$400 million that would be used as an incentive for the private sector.

Secretary MARSHALL. Yes.

Representative MITCHELL. There is conversation in the Halls of Congress concerning your inability to fill all of your slots in CETA. Therefore, why should we appropriate the \$400 million? If you have money that you didn't use because of failure to fill slots, why not take that money and use it toward your \$400 million?

Please don't answer now, just supply it for the record.

Secretary MARSHALL. That is an important question and let me answer a part of it now. The system required to implement the private sector initiatives program is a somewhat different system than the one already in place. While you would not change the total amount of spending if you reallocated that fund, you could cause disruptions and instability in the system. We think it is better to make those adjustments in 1980, than to try to make them now.

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

The Department does not have the authority to use PSE funds for the private sector initiatives program. Such an action would require congressional concurrence, and there is some question as to whether or not it would be appropriate to begin this activity under continuing resolution authority. More importantly, however, this action would be extremely disruptive to the prime sponsor system, in that it would require the development of new allocations for the title II-D and VI programs and extensive modifications to the prime sponsor plans to reflect the new operating levels. Such an action could impact only in a highly negative way on the system. Therefore, it is important that the \$400 million supplemental be maintained on a separate track and the excess PSE funds issue be dealt with in terms of fiscal year 1980 availability.

Representative MITCHELL. Thank you.

You have been very, very kind in staying with us and we will submit additional questions to you.

Secretary MARSHALL. Thank you.

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF HON. RAY MARSHALL TO ADDITIONAL WRITTEN QUESTIONS POSED BY
SENATOR JAVITS

Question 1. What is the Department of Labor doing to promote a more aggressive export stance among labor?

Answer. Department officials have discussed the importance of export efforts, particularly in respect to the MTN, with trade union representatives on numerous occasions, stressing the potential increases in employment that may flow from increased exports.

The Department participated in the interagency work that led to the announcement last September of the President's National Export Policy. We are also taking part in the follow-up work to the President's directive. We co-chair with the Commerce Department the Trade and Employment Subgroup of the Task Force on Export Disincentives.

Question 2. Does the Department of Labor agree that the only way to meet the protectionist cries for import barriers is to demonstrate the positive effect exports have on U.S. employment?

Answer. The issue raised by the phrasing of the question is complex. If we enjoyed full employment and import competition reflected fair trading practices among countries, pressures for import barriers would certainly diminish or disappear. To the extent that exports generate increased employment and produce a trade surplus, the outlook for a liberal trade policy would be improved. Both sides of the trade equation must be looked at. The nature of trading practices among nations and the government's response to unfair trade practices of competitive countries are important factors in shaping attitudes towards liberal or protectionist trade policies.

Representative MITCHELL. Mr. Brown, please come forward.

Our next witness is Mr. Ronald Brown, the vice president of the National Urban League, who is going to give testimony on behalf of the Full Employment Action Council.

I would certainly be remiss if I did not indicate to the witness the extent and the degree of my pleasure working with him throughout the years. We have fought small battles and large battles against unemployment which seems to linger in our economy year after year, particularly for minorities and even more particularly for blacks.

Mr. Brown, we welcome you. We have a copy of your statement so if you care to read it, that is fine. If you care to summarize it, fine.

STATEMENT OF RONALD H. BROWN, VICE PRESIDENT, NATIONAL URBAN LEAGUE, ON BEHALF OF THE FULL EMPLOYMENT ACTION COUNCIL

Mr. BROWN. Thank you, Congressman Mitchell. It is always a pleasure to appear before any hearing which you chair and I also appreciate appearing before the other members of this committee this morning.

INTRODUCTION

I am very pleased to have the opportunity to appear this morning on behalf of the Full Employment Action Council with respect to our Nation's economic policy.

Next week we will be submitting additional material that is a detailed account of the Full Employment Action Council's views. That is material which would be published within the next week or so and relies upon the studies of the Conference on Economic Progress, which is directed by Leon Keyserling, the Chairman of the Council of Economic Advisers under President Truman.

I come before you this morning with a slightly different perspective from most of the witnesses whom you have heard during these hearings. I am a lawyer, I am not an economist. I am not a public official. Rather, I am here to convey the deep concerns of a broad coalition of American citizens, members of the trade union movement, civil rights organizations, the religious community, women's, student, senior citizen, and other public interest organizations. Our members, organized some 5 years ago under the leadership of Murray H. Finley and Coretta Scott King, are united in our commitment to the achievement of a genuine, full employment economy.

We believe that this Nation took an essential step forward on the road to social justice last October when it enacted the Humphrey-Hawkins Full Employment and Balanced Growth Act. As you know, that landmark legislation affirms in law the basic human right of every American "to full opportunities for useful paid employment at fair rates of compensation." It provides our Government with specific numerical goals and timetables for reducing unemployment, 3 percent adult and 4 percent overall by 1983, and requires a process of policy coordination among the President, the Congress, and the Federal Reserve Board in order to reach these goals. It is, indeed, an economic Magna Carta.

Having worked for years to achieve this important first step, however, we are deeply disturbed about the direction of economic policy today. We fear that recent moves in the area of fiscal and monetary policy as well as deep cuts in Federal jobs programs and other social programs which are now being considered, could undermine the commitments which are the centerpiece of Humphrey-Hawkins. We oppose any strategy which relies on austerity, low growth, tight money, and rising joblessness to combat inflation. Such a strategy will fail to control inflation effectively, will unfairly impose the greatest burden on the most vulnerable members of our society and is in violation of the principles of the Humphrey-Hawkins Full Employment and Balanced Growth Act.

We recognize the significance of this committee's deliberations. The Joint Economic Committee has been given a central role in insuring that the Humphrey-Hawkins Act's provisions are implemented. Your committee's review of the President's Economic Report and recommendations to the Budget Committee this month will represent Congress' first statement on economic policy under the act. With that responsibility in mind, we have a number of concerns to share with you.

UNEMPLOYMENT: AN URGENT SOCIAL PROBLEM

The progress the Nation has made during the last few years ought not to signal an end to the fight against joblessness. We know that there are still too many of us who are eager to work, but who are unable to enter the economic mainstream of society. Just last month, Washington, D.C., witnessed a scene which has become common in city after city across this Nation whenever a few jobs are advertised.

With the District's transportation system paralyzed by a blizzard, the city made an announcement over the media asking for help in

cleaning the subway tracks. Literally hundreds of individuals turned out at 4 in the morning to vie for those jobs. As usual, many more responded than could actually be hired. How desperate our people must be to make their own livelihood when on a few hours' notice they compete for the backbreaking work of digging their city out of a snowstorm.

I need only remind you of a few statistics to put this problem in perspective.

Today there are still some 6 million Americans out of work and many more too discouraged to look for work. The burden continues to fall most heavily on women, minorities, teenagers, blue-collar workers, and young veterans; 7.8 percent of women who head families cannot find jobs to provide for themselves or their children.

For black America there has been no end to the recession—nearly 12 percent of black Americans are jobless; among minority teens, the official jobless figures are hitting at depression levels of over 30 percent. In some city neighborhoods, one out of every two young adults is unemployed, without a feeling of self-worth or a stake in society. These individuals don't know when they will earn their next paycheck, how they will be able to meet the mortgage payment due on the house, or if they will be able to pay for medical care when an illness strikes the family. To condemn these and other citizens to longer stretches of joblessness is not only cruel to them but harmful to us as a society. We waste human potential and resources and divide society into two camps, one contributing and employed; the other nonproductive and idle.

COSTS OF UNEMPLOYMENT

There are many ways to calculate the costs that unemployment imposes on all of us, those working as well as those without a job. In dollar terms, it is estimated that each 1 percent rise in the jobless rate costs our Government \$20 billion—\$15 billion in decreased Federal tax revenues and \$5 billion in increased Federal spending. As the Conference on Economic Progress has documented, during the last 25 years our economy's failure to operate at full employment has meant a loss of from \$4 to \$6 trillion—in 1977 dollars—worth of total national production and over \$1 trillion in public revenues. The reality is that no factor is contributing more to Federal budget deficits and the national debt than persistent high unemployment.

But the economic costs are not the only price we pay. How do we calculate the costs of a generation of minority youth who cannot obtain work and grow accustomed to a life of dependency and idleness? How do we calculate the lost hopes and ambition and the ravages of despair? How do we calculate the terrible price inflicted on millions of Americans in the form of increased mental strain, alcoholism and drug abuse, family breakup and community strife?

We are convinced that full employment is sound economics. But even more, we know that a society which relies on massive unemployment to balance its economy is morally bankrupt and in grave social danger. Failure to respond to the needs of the jobless represents a social callousness and neglect which we ought not tolerate.

As a society, we must not accept the notion that some will have jobs and income while others are told to wait a few years and to subsist on welfare in the interim.

Our democratic form of government cannot long survive with two separate societies—one working, one jobless; one hopeful, one despairing.

UNEMPLOYMENT GOALS AND TIMETABLES

Therefore, the progress which this administration and the Congress have made in reducing unemployment among Americans during the last several months should not divert us from the critical task of devising long-term policies and effective programs to insure full employment. Instead, it should spur us on to even greater efforts. Now is the time to carry on the work necessary to comply with the targets and timetables established in the Humphrey-Hawkins bill.

For this reason, we are deeply disappointed that the President's Economic Report projects a short-term goal of higher unemployment, a 6.2 rate, over the next 2 years. Setting a goal of 6.2 percent unemployment for 1979 and 1980, a rise of one-half of 1 percent above the current level, is unconscionable in view of the goals and timetables outlined in Humphrey-Hawkins on American citizens. The goals of 4-percent overall and 3 percent adult unemployment for 1983 were established after lengthy negotiation between the bill's sponsors and the administration and extensive debate within the Congress. They became the law of the land only after the most intense public scrutiny.

Flexibility was given to the administration and Congress in choosing methods to reach these mandated goals. However, the act makes clear that that flexibility to devise a mix of programs does not include the right to ignore the goals nor to delay the work necessary to achieve them. Moreover, the act and the legislative history make clear that the fight against inflation, while important, must not postpone action to achieve the full employment goals.

The act stipulates that the methods chosen for reducing unemployment and inflation simultaneously be "mutually reinforcing" sec. 5(b). The prohibition against fighting inflation with the jobs of the American people is clearly stated in sec. 4(b)(2):

* * * policies and programs for reducing the rate of inflation shall be designed so as not to impede achievement of the goals and timetables * * * for the reduction of unemployment.

Can anyone reading the act miss this direct repudiation of the discredited "tradeoff theory"? In writing Humphrey-Hawkins into law, Congress recognized the lessons we have learned from the performance of the American economy during the last three decades. We have learned that a properly balanced expanding economy will both produce jobs and limit inflation. A severe program of economic restraint leads to both high unemployment and high inflation. The Full Employment Action Council refuses to accept a course of action which will result in "stagflation" and recession.

When our coalition decided to support this vital legislation, some argued that we accepted too high a goal or too long a timetable.

Some argued that we were being sold empty symbols and that the commitment Government had made was really a "cruel hoax." We did not believe that then and we don't believe that now.

We agree with this committee's March 15, 1978, analysis of the significance of Humphrey-Hawkins: "A blueprint for economic progress that sets larger objectives, provides for their implementation through a coordinated approach, and places the responsibility on policymakers for failure to achieve its targets."

Now is the time for America's leaders to demonstrate that they intend to live up to their commitment. The American people know that things do not get better by making them worse. Raising the unemployment goal to 6.2 percent for 2 years does not chart a sensible course for achievement of a full employment goal of 4 percent within 5 years. Delaying actions and attempting to accomplish in only 3 years what will be a challenging task even in 5 years does not demonstrate good judgement.

Drawing distinctions between the 1979 and 1980 goals—which are "forecasts"—and the 1983 goals—which are "not forecasts"—hardly instills confidence in the American people that their nation's leaders intend to fulfill their promises. We urge the JEC to recommend to the Budget Committee's short-term goals that reflect at least a modest reduction from the fourth quarter 1978 rate of 5.8 percent and which demonstrate steady progress toward achievement of the 1983 goals.

SCAPEGOAT MENTALITY

At this point let me address what I consider to be a reprehensible attempt by our opponents to place the blame for unemployment on its chief victims. These opponents argue that the greater participation of black Americans, Hispanic citizens, women and young people in the labor force has so altered its composition that the traditional definition of full employment no longer applies. This is not a new attack.

You and other Members of Congress heard it during consideration of Humphrey-Hawkins and you wisely rejected it. You recognized that these so-called "new entrants" often have been delayed by decades of racial and sexual discrimination and that they enter the job market in most cases to provide essential income to support themselves and their families. Instead of redefining full employment as 5 or 6 or 7 percent to explain the failure of economic policy, Humphrey-Hawkins calls for efforts to make these "new entrants" as productive as possible. The forced idleness of one of our most precious resources—our own people—leads to lower, not greater rates of productivity. Any discussion of excluding these groups from participating in the economy would be callous, convey a message of racism, sexism, and agism, and be contrary to the dictates of the Full Employment and Balanced Growth Act.

STRUCTURAL UNEMPLOYMENT

We urge the JEC to consider "employment objectives for certain significant subgroups of the labor force, including youth, women, minorities, handicapped persons, veterans and middle-aged and older persons" as specified in section 3B(3) of the act.

In addition to lowering the overall unemployment rate, Humphrey-Hawkins is specific about the need for every effort to be made to reduce and then remove the gap between the unemployment rates of such groups and the overall unemployment rate. Our coalition is pleased to note the interest which the committee and the chairman have taken in the problem of structural unemployment. As the President's Economic Report indicates, policies and programs aimed at providing training and experience to our least skilled citizens are essential to achieving full employment with price stability.

But the structurally unemployed are not the only ones in need of assistance. Close scrutiny of unemployment figures shows that targeting alone will not alleviate most of the country's unemployment problem. There are three times as many adults unemployed as youth, three times as many whites unemployed as blacks, and as many adult males unemployed as females. Adequate provision must be made for programs to deal with all the unemployed.

ECONOMIC OUTLOOK

I am not an economist. I do not have an econometric model or a crystal ball to present you with an economic forecast. However, if I have heard those economists who are on the President's Council of Economic Advisers, at the Congressional Budget Office, on the Full Employment Action Council, and in the private sector correctly, we can expect the number and needs of the jobless to be even greater in 1979 and 1980 than in 1978.

The administration has predicted a rise in unemployment to 6.2 percent. CBO's estimates are more pessimistic: Joblessness may rise to 7.2 percent by the end of 1979 and remain in the 6 to 7 percent range through 1980. There are private forecasters who are convinced that we will indeed be in a recession in a matter of months. These are sobering projections which have significant implications for our policymakers.

THE FEDERAL BUDGET

Economic stimulus and employment and training programs have played and must continue to play an important element in the strategy to reach full employment. Labor Secretary Ray Marshall's statement of February 1 certainly bears this out:

As you know, the unemployment rate began its steady decline in 1977 as soon as funds from President Carter's economic stimulus package were translated into jobs in communities across the country. I believe that it is fair to say that without CETA and the other job creation measures, the unemployment rate today would still be over 7 percent.

These programs will be at least as, if not more, essential in the year ahead. If the administration's estimate is correct, at least 500,000 more citizens will join the ranks of the unemployed. If CBO's projections are correct, we could see 1 million more jobless. Those numbers could go much higher.

An increase of one-half or 1 percent in the unemployment rate will dramatically affect us all, but especially those groups already suffering disproportionately—the "last hired, first fired." We

cannot allow the gains which have been made to be eroded for lack of planning or will.

Unfortunately, the administration proposes not increases but cut-backs in essential social programs. According to estimates by the Office of Management and Budget and the U.S. Conference of Mayors, outlays for employment and training programs would be cut 14 percent, while outlays for youth employment programs would be slashed 12 percent. More than 400,000 jobs now provided under the countercyclical public service employment program would be eliminated, a cut of some 58 percent.

Redirecting some \$75 million to CETA title IId for the structurally unemployed does not camouflage the stark fact that it is only a minute fraction of the funds—\$610 million—which would be cut from title VI. Moreover, while we support private sector initiatives, relying on news, as yet untested programs—such as private sector initiatives program and target jobs tax credit program—to make up for these cuts does not insure an adequate response to the needs of the jobless.

The Full Employment Action Council opposes attempts to reduce the number of public service jobs, summer youth employment slots, and other vital social programs. Equipping our citizens with the skills and opportunity to contribute to society is productive, not inflationary. As Federal Reserve Board Chairman G. William Miller stated before the House Banking Committee on February 21, money spent on programs to deal with the problem of structural unemployment is money well invested. In fact, he suggested that even within the constraints of lowering the budget deficit, more funds ought to be allocated for such programs.

These programs enjoy the overwhelming support of the American people. According to the February 8, 1979, ABC News-Harris survey, 78 percent of the American people oppose a major cutback in Federal Government spending for help for the elderly, handicapped, and poor. Moreover, that poll found that the American people, by a margin of 2 to 1, support increased spending for jobs even if it increases the deficit \$8 billion. A CBS News-New York Times study reported similar support for jobs programs.

A BALANCED BUDGET IS NOT THE ANSWER

Why then are many of these programs in danger of being drastically cut? They are being sacrificed in what we believe is a misguided attempt to balance the budget and fight inflation. While Humphrey-Hawkins recognizes the desirability of balancing the budget, it rejects any such efforts which are inconsistent with the unemployment goals of the act. Reducing the budget deficit will become impossible anyway if pursued in such a way that unemployment rises and we are faced with a recession. Each 1-percent rise in unemployment will add \$20 billion to the deficit.

In addition, while reducing the size of the deficit is being touted as a solution to the problem of inflation, its actual impact on prices will probably be negligible. The Congressional Budget Office estimates that each \$10 billion cut will reduce the rate of inflation by only one-tenth of 1 percent. As CBO Director Alice Rivlin explained to the House Education and Labor's Subcommittee on Em-

ployment Opportunities on February 13, 1979, these cuts will have little initial effect on inflation, but an immediate negative impact on unemployment.

These are not people on white horses that are going to solve the problems of America by, in fact, cutting services to those people who need them the most.

The Congressional Budget Office estimates that the administration's proposed spending cuts will mean 350,000 fewer jobs in 1980 and 350,000 fewer jobs in 1981 and a rise of 0.4 percent in the unemployment rate by fourth quarter 1981. We would urge this Congress not to adopt a budget which raises unemployment even further at a time when economic indicators suggest a substantial increase in the number of jobless. It is clear that these cuts would take us further away from, not closer to, the achievement of full employment.

Section 6 of the Humphrey-Hawkins Act outlines national priorities which this Government ought to address as part of a full employment economy. We know that we have unmet social needs in health care, housing, the environment, education, energy, transportation, and all the areas listed. And we know that meeting those needs makes economic as well as social sense. For example, increasing the supply of housing would not only provide decent shelter and jobs for our people, but help to alleviate the severe inflation that we are finding in the housing sector. We know that the process of designing a Federal budget consistent with these needs requires effort, but we know that such an effort can and must be made.

The Conference on Economic Progress, through considerable study over the years, has developed a "model" Federal budget. You will find a copy in the material which I will be submitting next week. That "model" Federal budget is an example of what this Nation can accomplish if it only has the will.

Humphrey-Hawkins mandates that the expenditures and revenue elements of the President's budget be developed to promote the purposes, policies and goals of the Full Employment and Balanced Growth Act of 1978. This year's budget must be based not on a magic formula or arbitrary deficit target, but on meeting the needs of the American people. JEC's report to the Budget Committees should recommend that the budget be measured against the standard of the 4-percent unemployment goal for 1983 as agreed upon in law and not against a goal of a \$29 billion deficit, a figure plucked out of the air.

MONETARY POLICY IS TOO RESTRICTIVE

The policy of tight money and rising interest rates has been a substantial factor in the five periods of stagnation and recession since 1953. A national economic policy which encourages a continuation of this monetary policy is inequitable. It enlarges the incomes of those who need help the least and cuts into the living standards of the average American family, encouraging dangerous reliance on credit. The present policy monetary contraction chokes off investments necessary for home and school construction and the exploration of new sources of energy, all areas experiencing above-

average rates of inflation. Moreover, extraordinarily high interest rates themselves further fuel inflation. We urge the Federal Reserve Board to shift to a more expansionary monetary policy.

A CONSTRUCTIVE INFLATION PROGRAM.

Humphrey-Hawkins sets goals for the reduction of inflation—3-percent rate for 1983, 0 percent for 1988—provided that these goals not interfere with achievement of the full employment goals. I remind you of the language I have already cited from section 4(b)(2) of the act:

* * * *Provided*, That policies and programs for reducing the rate of inflation shall be designed so as not to impede achievement of the goals and timetables * * * for the reduction of unemployment.

In addition, the legislative history makes this point even more clearly. During Senate debate on the bill, one after another of those who offered the amendment establishing the inflation goals took to the floor to explain that these goals do not have equal weight with the unemployment goals:

The goal of low unemployment takes precedence over any other goal in the bill. Everybody that has been associated with this on both sides of the aisle, the Republicans and the Democrats, including the Senator from Indiana, Mr. Lugar, who spoke on it the other day in our conference, have all agreed that the unemployment goal takes precedence over any other goal, and that we tell the President, "You do not—you do not—adopt any policy that puts the inflation goal ahead of the unemployment goal" * * *. The language of the bill makes it clear that the unemployment goal takes precedence over any other goal in here. So if at any time it appears that it is necessary to do something about unemployment and sacrifice some of the inflation goals, that is what happens, not vice versa.

This was from Senator Gaylord Nelson's debate in the Senate floor on October 13, 1978:

We understand the first priority is employment. It has to be the first priority. We understand that jobs are the first priority * * *. Those in the labor force who are opposed to perhaps one amendment should read it very carefully; because we made it very clear in the inflation amendment that it was secondary to meeting certain obligations in unemployment, trying to help the unemployment picture.

This was from Senator Robert Dole's debate on the Senate floor on October 13, 1978.

Given the specificity of Humphrey-Hawkins on this point, we cannot understand why the President's Economic Report (page 123) stated:

The most difficult obstacle to achieving the 1983 goals for unemployment arises from the potential inconsistency between the objectives for growth and unemployment and the need to reduce inflation.

The inconsistency which we find is between the administration's assumption and the law.

The Full Employment Action Council will wholeheartedly support efforts to achieve price stability if those efforts are guided by an understanding of the root causes of inflation and are not erroneously based on the discredited "tradeoff theory." Inflation rises when unemployment and other underutilized production resources are high, and is lowest when the opposite is the case.

As Barry Bosworth, Director of the Council on Wage and Price Stability, told this committee on February 23, 1979, slowing aggregate demand will not solve inflation in the food sector.

And it is in those "necessity areas"—food, shelter, health care, and energy—that much of our inflation is fueled. Inflation in the "necessities" ran almost 70 percent ahead of "non-necessities" in 1978 according to a study by the National Center for Economic Alternatives. When one considers that 70 percent of the budgets of four out of five American families goes to buy these necessities, one senses the severity of the situation. We know that throwing Americans out of work is not an answer to inflation caused by changes in the weather or decisions made by OPEC. Likewise, we know that condemning a generation of American youth to forced idleness does not increase our rate of productivity.

Section 8 of the Humphrey-Hawkins Act offers a more constructive and sensible approach to dealing with inflation. The strategies include: Coordinated fiscal and monetary policies; an effective information system to monitor and analyze inflationary trends; programs and policies for alleviating shortages of goods, services, labor, and capital with particular emphasis on food, energy and critical industrial materials; establishment of stockpiles of agricultural commodities and other critical materials; encouragement to labor and management to increase productivity; recommendations to increase competition in the private sector and to improve the economic climate for the creation and growth of smaller businesses, including recommendations to strengthen and enforce the antitrust laws, the patent laws, and the internal revenue laws and regulations; removal or proper modification of such Government restrictions and regulations as add unnecessarily to inflationary costs; increasing exports and improving the international competitive position of agriculture, business, and industry; and such other administrative actions and recommendations for legislation as the President deems desirable, to promote reasonable price stability.

We urge JEC's report to recommend that the fight against inflation be waged according to the specific strategies outlined in Humphrey-Hawkins and not along lines which will fail to control prices at the same time that they increase unemployment.

CONCLUSION

In conclusion, Congressman Mitchell and members of the committee, I know that the issue of full employment is not new to you. Since the Employment Act of 1946, the Joint Economic Committee has played an important role in developing the Nation's economic policies. You have conducted numerous hearings and studies into the problem of unemployment. It was as JEC chairman that Senator Hubert Humphrey designed the Full Employment and Balanced Growth Act with Congressman Gus Hawkins. He knew that effort would be required to achieve the goals. Were Hubert with us today, I am sure that he would demonstrate, as Gus Hawkins is, the determination and hard work necessary to implement the act.

Our coalition of national and local groups can do no less. We call on the administration and Congress to comply with the mandate of the Humphrey-Hawkins Act. We come to you not begging and emptyhanded, but carrying out the law of the land. Can the American people have any confidence in their leaders if they renege on their promises just 5 months after making them?

We will not accept anything less than delivery on the pledges this Government has made to its people. We will work in Washington and in cities across this Nation for as long as it takes to insure that every American who wants to work has an opportunity to do so. Just as this committee stated last year, Humphrey-Hawkins places the responsibility on policymakers for failure to achieve its targets.

Less than 1 year into the act, let us not focus on failure, but be advised, should our policymakers fail, the American people will most surely hold them accountable.

We call on JEC to help chart a sensible and humane economic course for this Nation, following the blueprint provided by Humphrey-Hawkins. At a minimum, FEAC urges JEC's report to the Budget Committees to:

One. Set short-term—1979 and 1980—unemployment goals which reflect at least a modest reduction from the fourth quarter 1978 rate of 5.8 percent, and which demonstrate steady progress toward reaching the 1983 goals of 3 percent adult and 4 percent overall unemployment.

Two. Set employment objectives for certain subgroups of the labor force and recommend efforts to reduce and then remove the gap between the unemployment levels of those groups and the overall rate.

In this regard, Congressman Mitchell, I think it should be on the record that the unemployment in minorities, specifically among black Americans, is 2½ times the white unemployment in this Nation today. That is the highest the differential has been in recent history. The National Urban League has developed what we call a hidden unemployment index which we think is a more accurate measure of unemployment in this Nation than the Bureau of Labor Statistics has. In fact, what we use in developing that index is not figures that we have gotten out of thin air, but the unpublished data on the Bureau of Labor Statistics. As you know, the Bureau of Labor Statistics does not include when they publish statistics each month those millions of Americans who have grown tired of beating their heads and hearts and hands against the closed employment doors and have simply dropped out of the labor market, nor do they include the millions of Americans who are working part time, but who need full-time employment in order to adequately feed and house and clothe their families.

When you include just those two groups in the unemployment data, you find that unemployment, in fact, in this Nation is double what the Bureau of Labor Statistics said. So it is not 6 million, but 12 million Americans who are unemployed and some economists and viewers of statistics believe that even that estimate is low.

According to the National Urban League's data based on unpublished data, one-fourth of the black workers in this Nation are unemployed today, 25 percent. One-third of the black children growing up in this Nation are now growing up in homes where the head of the household is unemployed. This is certainly unacceptable and must be unacceptable to all Americans and should give us the kind of impetus and the kind of motivation to be able to achieve full employment.

Three. We would further recommend a budget based on meeting the economic and social needs of the Nation as outlined in Humphrey-Hawkins, not on meeting an arbitrary goal for reduction of the budget deficit. The standard for measuring the budget ought to be on the ability to achieve 4-percent unemployment by 1983, not a \$29 billion deficit, a figure plucked out of the air.

Four. You should also recommend that the Federal Reserve Board follow a more expansionary monetary policy, as the remarks of the chairman of this Joint Economic Committee suggested earlier.

Five. We feel you should also recommend an inflation program based on the strategies contained in the Humphrey-Hawkins Act, not on the discredited "tradeoff theory."

We appreciate, Congressman Mitchell, the opportunity for the Full Employment Action Council to make this presentation before the Joint Economic Committee this morning and we certainly hope that you will take heed of our recommendations.

Thank you very much.

Representative MITCHELL. Thank you, Mr. Brown, for a very cogent and I think very powerful statement, one that I wholeheartedly subscribe to, including all the recommendations.

I would be less than honest with you if I didn't say that I don't think we are going to do those things. In acknowledging the present mood of the Congress and the majority of Americans, I just don't think we shall be able to do those things.

This does not mean that some of us on this committee and in the Congress, will not try to accomplish exactly what you propose. I just have a growing concern that the status of black unemployed is going to remain at an unacceptable level, for at least this Congress, because propaganda has been circulated depicting black unemployment in tradeoff with inflation.

I hope that I am incorrect. I hope that when your statement is published, Members will read it and perhaps realize the awesome damage they are doing in this Nation by pursuing policies which perpetuate black unemployment rates.

I am always glad to see you. What you had to say, which is true, is sad and I am further saddened because I don't think the response from this Congress is what you or I will want. Senator Jepsen asked that I extend his personal apologies. He had a vote on the Armed Services Committee that he had to make.

Congressman Wylie.

Representative WYLIE. Thank you, Congressman Mitchell.

I want to compliment you, Mr. Brown, for what I regard as a very scholarly and most impressive statement. I might say that I would be remiss if I didn't indicate that I have a somewhat different view, and maybe a somewhat different view than Congressman Mitchell, on how we can solve the problem.

I would like to commence by asking you: Why is there so much unemployment among black youth? I saw the statistics just recently which indicate it might be as high as 40 percent.

Mr. BROWN. I think there are several factors for that. First, I think there is continuing racism and discrimination in the employment market notwithstanding the Civil Rights Act of 1964, notwithstanding some of the major legislative achievements that came

about in the 1960's, and notwithstanding certain kinds of rhetorical commitments that have been made.

The fact is that discrimination still abounds in the job market.

I think, quite frankly, the other major factor is lack of preparation and training. Most minority group individuals are in our public school systems around the country—a public school system which is of deteriorating quality.

Most of us feel that unless that problem is dealt with immediately we will not have people coming out of inner-city schools who are able to compete effectively for jobs.

I think the joint problems of continuing discrimination and lack of adequate preparation is clearly not the fault of young people but the fault of the society in which we live and lack of commitment.

The goals of equality and equal justice and equal treatment are not being met and until we make the kind of commitment that it is going to take to overcome that, I think there will be that continuing problem and the continuing differential between minority and white unemployment rates.

Representative WYLIE. I agree that one of the basic problems is the matter of training and education and I don't necessarily think that is just related to the black youth, and I have been very much in favor of the training programs within the past 94th and 95th Congresses.

You spoke of differential. Are you in favor of the youth differential?

Mr. BROWN. I am not.

Representative WYLIE. You heard Secretary Marshall say that he is not in favor of it.

Mr. BROWN. That is the only point he said he had his opinion accurately defined on. He did indicate he is against it.

I know the administration has taken a strong position against it.

There are all kinds of problems. I think it is a simple matter where you would not have a problem of facing the problem of substituting youth for middle age or older workers who were receiving the minimum wage.

We might be for it. We are for most reasonable efforts to employ young people, but I think we cannot employ young people either at substandard wages or in a system which encourages the displacement of those already working in the economy, who also have families to support.

Representative WYLIE. What do you think about a work-sharing concept for youth?

It was suggested by a witness who appeared before our committee from the Committee for Economic Development that perhaps some youth might share their full-time job so that they would have more time for recreation, education, even time to look for a better job. Could we work out some sort of a program whereby one job would be shared by two youths?

Mr. BROWN. I think there are a number of innovative approaches that could be used.

I think work sharing is certainly worth investigation. We have investigated that during times of high unemployment when, unfortunately, the minority people were getting a disproportionate share of the unemployment.

It would behoove us to look that work sharing to combat the youth employment problem.

I do think that there are some other creative kinds of approaches. I think we need to look at the relationship between the educational system and the world of work, and doing a better job of preparing those people for the world of work.

Some have suggested that there might be opportunities for young people to have jobs and be in school at the same time so that they don't have to become school dropouts in order to get a job, that programs can be initiated where there might even be education at the employment site.

I think we need to look at the whole public education system anew and see whether it is meeting the needs of our young people and our society.

One of the ways it has clearly failed is in the relationship between it and the world of work.

Representative WYLIE. I am very serious when I say to you that I am trying to find some of the answers for a solution to this problem, because I recognize it as a serious problem facing the Nation.

You suggest that we should have Humphrey-Hawkins full employment, that we should have more youth in the public service jobs and summer jobs for youth program.

Aren't those only temporary and just exacerbate the problem at the end of the summer?

Mr. BROWN. I don't think so, Mr. Wylie.

First of all, I don't just suggest that we have Humphrey-Hawkins. It happens to be the law that this Congress passed and it was signed by the President so it is a matter of national policy.

Representative WYLIE. It is different from the Humphrey-Hawkins—

Mr. BROWN. I would be glad at this point just following the present Humphrey-Hawkins bill than what has been followed thus far.

There is some criticism for short-term jobs. For many people these are people who never had any job experience, never had the opportunity to get up at 7 o'clock in the morning and work a full day and get paid.

There is a very valuable learning experience in that, a very valuable preparation experience for longer term employment which would be more meaningful and which would have greater positive consequences for future years.

I do not think we ought to eliminate short-term job programs just because they are short-term job programs. I do think that we ought to make sure that the people who can most benefit from those opportunities are the ones who receive those short-term jobs.

In too many instances local prime sponsors and others who are involved in administering programs have seen to it that friends of friends or children of friends have gotten a job rather than the low-income people who the jobs were really meant for.

I think if low-income people, many of whom have little experience in the job market, get those jobs, they will, I think, provide a useful experience which would benefit them in the years ahead.

Representative WYLIE. That is the solution. Some type of a specific structural program, and I have in mind that we would be better

off if we put more youths into on-the-job training programs in the private sector by creating private-sector jobs rather than just giving youth jobs part time for the summer.

To be sure, it is a good job and a meaningful job for that summer, but I am thinking of more education, more training, more on-the-job training in the private sector which would extend beyond the summer employment period.

Mr. BROWN. Certainly, Congressman Wylie, a choice between those two would be to take the longer term private sector job. Unfortunately, in the past we have not had that choice.

The private sector has not shown an inclination to absorb young workers, hard-core employees, those people who we are talking about.

I think if the private sector had demonstrated more good faith in the past, I would have more faith in them today.

They have not shown an inclination to solve the unemployment problems of this nation unless there is some real incentive.

I am for incentive if that is what it takes.

I think there should be some incentives today. As a matter of fact, for almost all of our 7-year history, we have participated in on-the-job training programs, some of them funded through the Labor Department, where we subsidize employers to hire and train workers who are classified as hard-core unemployed, and put them in meaningful long-term jobs so we certainly support that approach.

There has not been given enough money so we can really make it unemployment but given a choice between those two, I would certainly side with you and would favor an approach which would be of a more long-term nature.

Representative WYLIE. I think that there is not a demand in the private sector right now because the Government is messing up our economy.

We have had deficit budgets now in the neighborhood of \$60 billion for 1976 and 1977, and there has been a consequent crowding out of private capital for capital expansion in the private sector market and I think that is the real culprit.

It seems to me that we fly in the face of history when we don't recognize that we have had these cyclical changes in our economy from inflation, through recession and unemployment and back to inflation.

I think we are in a peak of an expansion like that right now with a very bad inflationary situation.

Mr. BROWN. Well, sir, we certainly support economic expansion as one of the principal ways to overcome high unemployment, one of the principal ways to solve our problem and we certainly agree that we do have a cyclical economy.

Our problem with a cyclical nature of that economy is that the same people do all the suffering when we are in an economic downturn, when we are in a valley rather than on a hill.

Those are minority group people, disproportionate black people. While we are waiting to get uphill, we ought to impose some kind of measures in order to assure that there is some equalization of the sufferer.

There has not been a willingness or the inclination on the part of our society to equalize that suffering. Although I would hope that we could find a way where we would always be on a hill, that seems improbable.

I would think that if we are clearly interested in some kind of economic justice that while we are trying to wait for us to get to that hill, we should at least impose some kind of system where there is sharing of the burden and sharing of the weight.

Representative WYLIE. So, we agree that the past programs of the Government to stimulate the economy through Government intervention have not worked, and perhaps we ought to look to the expansion of the private sector.

Mr. BROWN. Just as Secretary Marshall, I would not agree with that statement. I do not think it is.

I think that they have not met the expectations that many of us have.

Representative WYLIE. You just said that the same people were unemployed all the time through inflation and expansion.

Mr. BROWN. If you look just at this administration's programs, many of which we have problems with, there has been an impact on unemployment because of that program. There has not been as much of an impact on the problem that black workers face as we would like, but I think to call them a failure and unsuccessful would be unfair.

I think that is one of the things that has been said of some of the programs in the 1960's. I think that is not a fair characterization of any analysis of them.

I would say that there has not been a long enough and deep enough commitment to them. I would say there has not been the kind of resources devoted to them that we really need.

I would say that it was fair to characterize some of them as band-aid programs and unfortunately, because of a lack of commitment that was all that many in our leadership intended them to be.

I think once we as a nation make the commitment to overcome some of these problems and to do a real analysis—and I think we are in favor of a real analysis of what works and what does not—what works ought to be replicated and expanded.

What the problem has been in many cases is that things that work have been discarded along with the things that have not worked.

I think we need to do a fair and accurate analysis of what does work and I don't think it is fair to characterize all of those efforts as failures.

Representative WYLIE. You have been an excellent witness and very generous with your time, and you, with your time, Congressman Mitchell.

I just think that there is a real need toward expansion of the private sector if we are going to avoid these so-called boom-and-bust cycles which we have experienced in the past.

Mr. BROWN. I would agree with that.

As you know, all the analysis of the progress made by particular minorities has been at times of great economic expansion so we would be in favor of that position.

Representative WYLIE. Thank you.

Representative MITCHELL. I just want to commend my good friend, Congressman Wylie, over there on the process that we used to—were you not on the Budget Committee in the House at one time?

Representative WYLIE. No, sir.

Representative MITCHELL. What we did was projected a chairman's mark, which in effect set Government spending.

Before that was put into place he would call in the private sector to inquire as to the rate of spending. I was on that committee 4 years and each time we started developing a budget, he took testimony from the private sector, the institutions and so forth, to see whether or not the rate of Federal spending would indeed be equal in the private sector.

I can only refer you to those testimonies that were submitted by the private sector which would say, no, this date we will not promise that.

I think in all fairness that ought to be a part of the record here.

Representative WYLIE. Maybe I ought to take a look at that.

We are searching for the right answer.

Representative MITCHELL. Right.

Representative WYLIE. I will look at that to see if it will help me.

Representative MITCHELL. Mr. Brown, thank you very much.

You were a most articulate and persuasive witness. I am sure that Representative Wylie is sympathetic; in fact, I know he is sympathetic with the factors that you and I are seeking to achieve.

Mr. BROWN. Thank you very much, Congressman Mitchell.

Thank you, Mr. Wylie.

The committee stands adjourned.

[Whereupon, at 12:23 p.m., the committee adjourned, subject to the call of the Chair.]

