THE 1980 MIDYEAR REVIEW OF THE ECONOMY

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

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JULY 23 AND AUGUST 1, 1980

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THE 1980 MIDYEAR REVIEW OF THE ECONOMY

WEDNESDAY, JULY 23, 1980

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

The committee met, pursuant to notice, at 10 a.m., in room 6226, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Present: Senators Bentsen, Sarbanes, and Javits; and Representative Brown.

Also present: John M. Albertine, executive director; Charles H. Bradford, minority counsel; Richard F. Kaufman, assistant director-general counsel; William R. Buechner and Mayanne Karmin, professional staff members; and Stephen J. Entin and Mark R. Policinski, minority professional staff members.

OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator BENTSEN. Mr. Schultze, we are going to start this hearing on time. I know you've got a tight schedule.

Let me say this is the first of two hearings to be held by the Joint Economic Committee on the Midyear Review of the Economy. We will also look at today's figures in the Consumer Price Index for June. Our witness this morning is the Honorable Charles L. Schultze, Chairman of the Council of Economic Advisers.

Mr. Schultze, this is an election year, and history shows that in election years most Presidents up for reelection tend to let economic policy be molded by political needs. So when you find a President who has made up his mind about the economy and what he wants to achieve, and then sticks to his plan regardless of what the polls or his opponents say, you have to admire the President whether or not you agree with every aspect of the plan.

I think President Carter ought to be commended for resolving not to play politics with our economy.

During the recent past, our economy has been wracked by an inflation that reached an 18-percent annual rate during the first 3 months of this year. President Carter decided on a program of fiscal and monetary restraint to fight that inflation, and he has stuck with that program. Now, whether or not that is good politics, we are not going to know until November. Whether or not it is good economics is a question we want to address today, particularly in light of the deepening recession.

One of my main concerns is the shortrun issues that may divert our attention from the important longrun aspects of economic policy. The tax cut issue, which has been injected into this campaign, is an excellent example.

For the past 2 years, the Joint Economic Committee has argued that an investment-oriented tax cut is needed in order to improve our productivity and to help reduce the underlying rate of inflation. That is the way you really get it down, by putting more goods on the shelf at a cheaper price, and by producing them more efficiently.

The most recent forecast by Data Resources, Inc., indicates that you are going to have a real investment decline in our economy of 11.9 percent during this recession. And that shows that investment stimulus is needed now more than ever.

Although President Carter opposes a tax cut, I believe our differences are more a matter of form than a matter of substance. I am not arguing for a tax cut that would stimulate the economy, because I don't believe that, at this late date, we can have a tax cut that is going to have any effect on the timing of this recession's end. What we do need, though, is a tax cut that will give us a much higher quality and a much less inflationary-prone recovery than the recovery from the 1974–75 recession.

I believe we can enact a tax cut this year. I think we should. Or we can wait until next year, as President Carter advocates. But in either case, at least half that cut ought to go for stimulating new investment and improving productivity. That is what this committee has being saying for a long time. And our recommendation still holds on that, Mr. Schultze, and we would like to hear your testimony now.

I would like to insert for Congressman Brown, ranking minority member, at his request, who will be along in a minute, his opening statement in the record at this point.

[The opening statement follows:]

Opening Statement of Representative Brown

We sit here today to perform a postmortem on the balanced budget of 1981. It was stillborn. Everyone outside the administration knew it would be. If the administration does not at long last learn something from this autopsy, if the administration does not take action, we shall soon be performing the last rites for the whole U.S. economy.

The great tragedy is that the inflation and the recession were both totally unnecessary. Economists outside the administration have warned against excessive spending and money creation in each year of the Carter administration. But we had the inflation anyway, because the administration blamed OPEC and American workers and businesses instead, and pretended its own policies were not involved.

Then we had quantum leaps in taxes and in regulations. Economists outside the administration warned that this was leading to recession, and that there was no hope of a balanced budget in a recession. But again the administration blamed OPEC, and the American people, and pretended its own policies were not involved, and pretended the budget would be in balance long after everyone knew better.

For 2 years the Joint Economic Committee has been warning against all of these excesses. The administration has ignored all of these warnings.

Any modest attempt to control Federal spending, by taking just 3 to 5 percent off each of the last three budgets, would have reduced spending and money growth enough to have avoided this inflation. And the $25–$30 billion in noninflationary supply side tax cuts recommended by Senator Bentsen and myself in a joint news conference more than a year ago, and urged by many leading economists, and by this committee, would have prevented this recession.

Tax cuts are not all alike. They are not all inflationary. There are many ways to cut individual taxes to encourage saving. Saving is anti-inflationary and pro-growth.

The same thing applies to business tax cuts. This committee heard from the Chairman of the SEC and the Chairman of the Financial Accounting Standard Board that inflation has drastically increased business taxes, crippled depreciation, and strangled investment. This has been known for years. And for 2 years the Congress has been ready to do something about depreciation, only to be blocked by the administration. The administration has nit-picked every congressional depreciation proposal to death.

The administration has had 3½ years to come up with a savings and depreciation proposal of its own. I am tired of this dog-in-the-manger attitude. There is something much, much worse than a slightly-less-than-perfect depreciation bill—and that is no depreciation bill at all.

The administration has addressed the issue of progrowth, anti-inflationary personal and corporate tax reduction with all the vigor and flexibility of advanced rigor mortis.

If this administration is defeated in November, it will be because it has understood nothing, learned nothing, admitted nothing, and done nothing about the economy of this country.

Senator BENTSEN. Please proceed, Mr. Schultze.

STATEMENT OF HON. CHARLES L. SCHULTZE, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY DAVID MUNRO, SENIOR STAFF ECONOMIST

Mr. SCHULTZE. Thank you, Mr. Chairman, and thank you for those remarks. I guess, given those remarks, I am pretty close together with you on your remarks as you are pretty close together with us on policy. And where we differ is, I think, a matter of technical judgment.

I also welcome the emphasis which you placed, Mr. Chairman, and I think properly placed, and which your committee has placed for some time, on looking at our problems in the longer run perspective. In fact, if I may, I'd like to put my testimony in that context. While this Mid-Session Budget Review that the President has sent to the Congress is an occasion to review the short-term economic outlook, and I will do that for the committee, I'd like to put that in the context of a longer term review, and very briefly do so by looking backward at it through the decade of the 1970's and maybe forward to the decade of the 1980's.

Looking backward, Mr. Chairman, I think there is only one word you could probably use to describe the economic history of the 1970's. Maybe many words, but the most appropriate would probably be "terrible." Oil: The price of oil rose tenfold. The cost of imported oil to the United States during that decade rose thirtyfold, and this year will exceed $85 billion. And for the oil-consuming countries of the world, the oil bill in 1 year alone will be over $300 billion.

And this didn't happen smoothly and gradually. It happened in two huge and disruptive surges, in 1974 and again in 1975, with two highly disruptive effects on the United States and on the world economy. On the one hand, recessionary effects: Oil price hikes have siphoned off massive amounts of purchasing power from consumers and other users. Second, inflationary effects: It gave to all of the economies of the oil-consuming world a real impetus toward inflation.

So inflation itself, during the decade of the 1970's in the United States and in other industrial countries, taken on an average, inflation for those 10 years averaged 7½ percent. We ended up the decade in double-digit inflation. We ended up the decade with inflationary expectations having become endemic; that is, unlike 20 years ago or

15 years ago, people view a future in which inflation is a way of life, and that is dangerous.

Recession in the mid-1970's. We had the worst recession in 40 years, kicked off by that massive oil price increase. We are now again in a fairly steep recession, again triggered by that huge jump in oil prices. The CEA has made some rough calculations, for example, that if you compare what is actually taking place with respect to world oil prices, with the world in which the real oil price has been unchanged or oil has moved up only in line with inflation, by the fourth quarter of 1980 that difference added about 1¼ percent to the rate of unemployment; and by the end of 1981 it will add 1¾ to 2 percent to the rate of unemployment.

By the end of 1981, that development, we think, will have set in motion recessionary tendencies worth about 5 percent in the level of our gross national product and cost consumers, by the end of 1981, about $150 billion.

Oil, inflation, recession, and finally, Mr. Chairman, productivity. In the United States and around the world, but perhaps more so in the United States than elsewhere, the annual rate of productivity growth has fallen off from about 2¾ to perhaps 3 percent in the 1960's to something like 1 percent or maybe a little under, by the last half by the 1970's. It was actually negative in 1979.

As a consequence of this, Mr. Chairman, I think that the chore, the economic challenge facing us in the decade of the 1980's, will be to restore reasonable growth and upward employment while at the same time dealing with these four legacies of the 1970's—dealing with the problems of energy, of inflation, of productivity, and of periodic recession.

If I may, let me turn to the problem of inflation. Since they are all very closely connected, if I begin to deal with that I think I can bring them all in.

The immediate objective of the United States and of every other major oil consuming country in the world over the past year, Mr. Chairman, has been the same: To quarantine, to isolate, to contain that massive oil-induced inflation so it didn't spread to the rest of the economy and become a semipermanent double-digit wage-price spiral. What we had to worry about was everyone in the economy, businessmen and labor, trying to push up wages, salaries and other money incomes to keep up with that oil-induced inflation and not being successful, but turning a temporary oil-induced inflation, as I said, into a semipermanent, or at least long-perpetuated, double-digit wage and price spiral.

During most of 1979 that objective was met. Consumer prices did rise by 13 percent, but almost all of the increased inflation came from two sources: Energy, and the associated increase in mortgage interest rates which, as you know, has a highly exaggerated effect on the Consumer Price Index. Outside of those areas the Consumer Price Index rose at about 7½ percent during 1979; that is, the oil price inflation was contained in 1979.

But at the end of 1979 and early in 1980, the first 3 months of 1980, that strategy, that objective, was seriously threatened. Inflation jumped to an 18- to 20-percent rate; and while a good bit of that, again, was oil and mortgage interest rates, we began to notice the rate of inflation outside of those two areas accelerate.

Wage increases, which had not accelerated in 1979, began to accelerate at the very end of the year and into early 1980. Inflationary expectations, for which, of course, we have no statitistical measure, but inflationary expectations by even casual observations had leaped forward. And associated with all of this was a massive increase in interest rates.

As a consequence, vigorous action was necessary; and the President, the Congress, and the Federal Reserve took vigorous action in the form of budget reductions, selective credit controls, with the Federal Reserve moving under its traditional power also to deal with this very dangerous situation threatening the strategy which we, as I say, along with all the other countries of the world had been pursuing in the first stage of this problem of dealing with inflation.

These actions had a major effect even more quickly than anticipated. Inflation has slowed from 18 to 20 percent to a 10- to 11-percent rate so far. In June the Consumer Price Index did rise—at least this morning—did rise at a 12.4-percent annual rate. That's more an artifact than anything else. What it does is reflect the mortgage interest rate increases of several months ago. There is a big lag between the time that mortgage interest rate increases actually occurred and the time they showed up in the CPI.

Senator BENTSEN. When is that going to play out?

Mr. SCHULTZE. It starts down next Monday, Mr. Chairman. This is the last, he said confidently, the last month of those lagging interest rates. The CPI picks up take-down mortgage rates, that is, not the commitment, but the rate at which it is taken down.

The June rate is not completely, but importantly influenced by data collected in the first 5 days of May. What you are getting in the June index, reported in July, are commitment rates—increases that occurred in March and April. This is the last month of those.

X that mortgage, finance, tax and insurance line in the CPI, the rate of increase in the CPI this month was a 7.3-percent annual rate. If you look at the CPI X energy and mortgage interest rates the last 3 months, it's been in the 7½-percent range—actually 7.6 percent—compared to the 12-percent range only 3 months earlier. So that, yes, June did show a jump up again, but it was solely due to those mortgage interest rates. And in July we will pick up not an increase, but a decrease in mortgage interest rates in the CPI.

I have to say, as a matter of fact, in the next 2 to 3 months, that the CPI is undoubtedly going to show—strike undoubtedly; nothing in this world is ever undoubtedly—but very likely to show a very substantial decline and rates of increase below the kind of underlying core rate of inflation, just the way mortgage interest rates kind of overweighted the CPI in the other earlier periods.

In any event, Mr. Chairman, looked at carefully, the rate of inflation has indeed slowed down very substantially since the first 3 months of this year. The CPI, as I indicated, may fall significantly further in the next several months, although, as I point out, the core rate of inflation probably stays somewhere in the 9-percent, 9½-percent range—you can get an argument as to exactly where it is, but it is in the 9- to 10-percent range.

Interest rates, as you know, have fallen dramatically. Very shortly after the March 14 set of announcements by the President and the Federal Reserve, short-term interest rates are less than half of what they were. Short-term market rates and long rates have fallen substantially.

While again we have no measure, it's clear that inflationary expectations, while far from eliminated, have calmed substantially from the fevered rate at which they were going along in the early part of the year

Mr. Chairman, while, therefore, there has been a major improvement in inflation and in interest rates, the economy has simultaneously entered into a very steep recession. The unemployment rate rose from 6 percent, the rate at which it was characterized during most of 1979 into early 1980, to 7¾ percent in May and June. Employment from February to June fell by 1.4 million persons. There were large declines in automobile and housing sales. And in the second quarter the GNP declined by an annual rate of 9.1 percent, a rate of quarterly decline which had been equaled once before but never exceeded.

Interestingly, Mr. Chairman, 90 percent of that drop in the GNP in the second quarter was autos and housing; 90 percent. If you look at the employment statistics, it was also clear that the big declines in employment were concentrated in construction, motor vehicles, and closely associated industries like lumber, primary metals, stone, and plate glass.

In June, the nature of the recession changed somewhat. Autos and housing bottomed out. The recession spread on a more moderate basis to a wider range of industries. As you are beginning to get some inventory corrections the evidence has begun to accumulate that the worst of the decline—well, let me say it another way. The evidence has begun to accumulate that the rate of decline, the rate of recession, is moderating. And some harbingers of a later upturn have already begun to appear.

Auto sales kicked up in early July, although again I hesitate to make much out of a one 10-day figure; but I think you can clearly say they bottomed out. There is some sign they are picking up.

Real personal consumption expenditures for goods outside of autos rose in June by almost 1 percent. Housing starts rose 30 percent. Initial claims for unemployment insurance, seasonally adjusted, in the first 2 weeks of July dropped substantially below the June level. And again 2 weeks literally can be only a harbinger. It is not yet confirming evidence. But I think it is fair to say that the evidence has begun to pile up pretty heavily that the rate of recession is slowing and that an upturn is not immediately around the corner, but in sight.

It is a fair question to ask, Mr. Chairman, to what extent the recession that we are having was brought on by the anti-inflationary actions taken last March; and to what extent these actions were necessary. It is probably true that failure to act last March by the President and the Fed might have postponed the decline in the economy. It may be the recession could have been avoided for the time by the continuation of credit expansion at the kind of rapid rate it was going and inflationary expectations would have continued and people would have been buying ahead to beat inflation for a while.

But to have avoided action in the face of rising inflation and accelerating expectations would have lead to a longer period of exceedingly high interest rates, would have threatened another rise in the hard to eliminate underlying rate of inflation, and in the long run would have produced a much worse fall in employment and output. So even from hindsight, Mr. Chairman, those actions in my judgment were necessary.

Let me turn to the short-term outlook. Two of the major factors causing this recession are now in the process of correcting themselves. First, the rapid increase in prices relative to the increase in wages has been sharply eroding consumer purchasing power. That, in fact, is the way in which the big oil price increase tended to set in motion recessionary tendencies. And the actual and prospective further decline in inflation is shortly going to slow that erosion of purchasing power and remove one of the major factors causing recession.

Similarly, the economic decline can be traced back to the surging interest rates that accompanied the rise in actual and expected inflation, having impacts not only on housing but throughout the economy. And the recent declines in interest rates clearly are reversing that cause of recession, and we're seeing the results in the housing area already.

A third favorable factor which has been mentioned very often, and I needn't dwell on it, is the fact that as we went into this recession, unlike the 1974-75 recession, it had not been preceded by a massive speculative accumulation of inventory. Businessmen, compared to any other time I know, have been amazingly prompt in keeping their production related to their sales. And so as sales bottom out, we do not have large—we do have a little, but we don't have a large—inventory overhang to get rid of. There'll be some of this, but compared to the 1974-75 recession, in particular, we do not have much, and that's a favorable factor.

There are two major questions about the outcome, however, and we have not yet got answers. First, with respect to consumers. Early this year there was some probability that consumers were buying ahead to beat inflation. Query: Will they return to normal buying habits or will they go beyond that and run for the storm cellers, as they see layoffs, their neighbors perhaps being out of work? Will they pull in their horns for security reasons? Decrease their spending very sharply?

I don't have the full answer to that, Mr. Chairman, but the evidence is beginning to come in that this is not happening. In particular, the June retail sales, just 1 month, but the June retail sales seemed to indicate this was not occurring.

Senator BENTSEN. Which was not occurring?

Mr. SCHULTZE. Consumers pulling their horns in, sharply reducing their spending. Auto sales have fallen sharply, but we do not have any evidence that the consumer savings rate is going to explode up, and the consumer spending rate is going to drop very radically. We do not have any evidence of that.

It is, as I say, a question mark.

Senator BENTSEN. It's kind of a mixed bag, isn't it?

Mr. SCHULTZE. That's right, it is. But what we have not seen is literally consumers doing what happened in 1974 and running for the storm cellar. But I have to say that all the evidence isn't in yet. We similarly don't have all the evidence in yet on what's happening to business investment during this recession.

The first thing we note is that in every past recession, businessmen have cut back their spending. The question is how much? In some cases it's been very mild. In other cases, it's been quite dramatic. Again, the evidence to date, the surveys, indicate that, yes, in this recession, like all others, businessmen are going to cut back. So far the evidence seems to be it's a moderate cutback.

As you may recall, Mr. Chairman, this is the most widely advertised recession in history. In fact, it was predicted for a long time and didn't show up. And very probably the plans that businessmen had been making already reflected the probability of some recession. And, therefore, unlike other occasions in the past. there may be much less watering.

Again the answers are not yet in. The outlook will depend on how those do come in, but so far it seems to be favorable disposed toward a moderation of recession and a turnaround this year.

On balance, I think if we put all this together—and forecasting is as difficult as it always was—it does appear that the pace of the recession has slowed; that the trough of the recession may be be reached at or before the end of the year; and that 1981 should see a rather slow recovery. Since the larger rundown in inventories which often accompanies a recession doesn't appear in prospect for this recession, as I indicated earlier, the subsequent boost to recovery occasioned by a sharp turnaround in inventory investment will also be absent. Table 1 in my prepared statement summarizes some of the major aspects of the economic outlook. We project gross national product in real terms to decline 3.1 percent over the four quarters of 1980, but conversely, it will recover in a moderate way, by 2.6 percent in 1981. It's not shown on the table, but the size of the peak to trough decline in the economy from the first quarter of 1980 to the fourth quarter of 1980 we have at 3.4 percent.

The unemployment rate, given these developments in the economy, we estimate to rise to 8.5 percent by the end of 1980, to increase just a bit further in early 1981, and then to end up 1981 also at 8.5 percent. The Consumer Price Index we estimate to grow by 12 percent over the four quarters of 1980. The worst of that is behind us. Our forecasts imply, given what's already happened, an 8 to 8½ increase in the CPI in the second half of the year. In 1981, we have a 9¾-percent increase in the CPI, but a half of a percent of it is due to the fact that the President is renewing his request to the Congress for a 10-cent gasoline tax. There's about half a percent of that 9.8 in that account. So it would be 9.3 ex that gasoline tax.

The budget consequences of this outlook are shown in the Mid-Session Review. I can simply summarize them very quickly. Economic conditions, a combination of economic conditions and the fact that the Congress in effect repealed the President's import fee on gasoline, gives us lower revenues below the March estimate that we sent to the Congress of about $15 billion lower revenues in 1980 and $24 billion lower in 1982.

Conversely, a steeper recession raises expenditures, principally unemployment compensation—not solely but principally—by $7 billion in 1980 and $11 billion in 1981. Defense spending out of existing budget authority will be somewhat higher. This and a few much more minor changes will raise the deficit to a $61 billion estimated deficit in fiscal 1980 and $30 billion in fiscal 1981.

As I indicated, something like 85 percent of this change in both years is due to a combination of the repeal of the gasoline fee and economic conditions, most of the rest for defense, a little bit for a few things like disaster expenses, and a few other things.

Senator Bentsen. As I understand it, you're saying that he has put back in the assumption of a 10-cent gasoline tax; is that right?

Mr. SCHULTZE. What we had before, was a 10-cent gasoline tax only in——

Senator BENTSEN. I remember it very well, because I was one of the very few that voted for it. I had to take some time to answer my mail.

Mr. SCHULTZE. I appreciate—I was about to say we feel lonely together.

Senator BENTSEN. Are you going to give me that opportunity again?

Mr. SCHULTZE. That's right. Not for awhile, however. The President has looked at the situation and we decided yes, we will ask the Congress to enact and we'll submit it in January, and we'll assume enactment in the spring of next year. We don't have it there in the budget through the remainder of 1980 and a little bit of 1981 because of that.

And that loses us revenue as compared to the March forecast, but I welcome your support.

Senator BENTSEN. Thanks a lot.

Mr. SCHULTZE. Mr. Chairman, the economic forecast I presented foresees the end of the recession before the end of 1980, followed by a slow recovery. The President and his administration consider that this outlook is not satisfactory. While recovery will occur, it will proceed at a pace insufficient to reduce unemployment significantly, although inflation is going to slow, it's going to remain far too high. The administration, therefore, will work with the Congress to develop a longrun economic program aimed at improving the prospects for noninflationary, hence, sustained recovery.

To echo your opening remarks, Mr. Chairman, in designing programs to assist economic recovery, it's absolutely vital that we do so in ways which attack fundamental structural problems and not merely inject a traditional antirecession stimulus into the economy. I'd like to drive that point home, Mr. Chairman, if I might, by calling your attention to tables 2 and 3 in my prepared statement.

If you look at table 2, which compares the job-creating performance of the United States to other countries over the past 3 years before this recession began, the 1976 fourth quarter to 1979 fourth quarter—a period chosen at random, Mr. Chairman—as well as over the much longer decade of the 1970's, there is absolutely no question that the United States far outperformed any other major country in providing additional jobs. In this 3 years, for example, employment—this is total nonfarm employment—grew by 12 percent in the United States compared to either decreases or very small increases elsewhere in the major countries. And if you look at the whole decade of the 1970's, you can see what a massive difference there was.

I don't have the table here, but if you look at manufacturing employment, it turns out that over either of these two periods the United States is the only major country in which manufacturing employment wasn't decreasing. It was increasing. It was decreasing in most other countries, not everywhere, but all the big ones.

Now part of this is indeed because of sluggish productivity performance.

But if you look at table 3, Mr. Chairman, you can see it's not just that by any means. I don't think most people realize it, but in terms of industrial production, increases in industrial production over the past 3 years and over the decade of the 1970's as a whole—and it's been a difficult decade for the United States—the United States has outperformed every other big country in the world, except Japan, and we're not that far behind Japan. If you look at the last 3 years, we're 15 percent, the Germans, 11, the French, 6, the Big Four European countries put together, the United Kingdom, France, Germany, and Italy are 9.

I won't read off the numbers, but you look at the decade of the 1970's and it's equally impressive.

What's the point of these statistics, Mr. Chairman—except, at least to me, they were surprising—that the United States has done so well with respect to output and incredibly well in terms of providing jobs, massive increases in jobs? The implications, however, when you think about it, conforms very closely to your opening remarks. The problems of the United States, whatever they are, are not an inability to generate increases in jobs and production. The record shows that in a very difficult decade, we not only did an absolutely good job, we did a very good job compared to other countries.

Obviously, that's interrupted by the recession. But the recession is temporary. Our ability is there. It's proven. It's demonstrated as recently as the past few years. Rather, the problem is to improve the increase in jobs and output in ways consistent with long-term reductions in inflation and increases in productivity. That's the problem. It is not simply to get sales and output up.

Quite frankly, we know how to do that. The problem is, how do we get it up, steadily, constantly in ways which also permit this 9–10 percent core rate of inflation to come down gradually? How do we do it in ways consistent with improving the productivity and the competitiveness of our economy? That is, and must not just focus on generating output and jobs—terribly important—but also on generating them in a way which increases efficiency, increases productivity, lowers cost increases, increases competitiveness, and lowers inflation.

That's our problem. That's our job.

In that context, Mr. Chairman, I might take a few minutes longer to discuss briefly with you some of the considerations that ought to go into the design of a longrun policy aimed preceisely at that combined set of objectives. While the rate of inflation has been brought down substantially from the 13 percent of 1979 and the 18 to 20 percent of early this year, as I've said several times already, the core or underlying rate probably now runs at a 9, perhaps 9½, conceivably even 10 percent rate. The most important task of economic policy, therefore, will have to be encouraging a healthy growth in jobs and output during the economic recovery, while at the same time unwinding that core rate of inflation, which remains far too high.

And meeting this very challenging objective will require two approaches, Mr. Chairman. First, longrun monetary and fiscal policy to control the growth of the spending, to keep reasonable restraint on the growth of aggregate demand in the economy and so help to bring about a gradual slowdown in the growth of hourly wages, salaries, and other costs.

Second, supply and structural policies designed to raise productivity and efficiency. To increase the rate to which output and employment can increase without setting in motion inflationary pressures. Mr. Chairman, in other words we need to have both demand policies and supply policies. Neither one alone is going to do the job.

All right. We start with demand policies.

CONTROLLING THE GROWTH OF DEMAND THROUGH MONETARY AND FISCAL POLICY

If inflation is to be reduced in the long run, monetary and fiscal policies have to be geared toward reducing the growth of total public and private spending combined. That is, over time we must reduce the growth of nominal GNP, GNP measured in current dollars.

Now in one sense this is simply a truism, it's arithmetic. The rate of growth of nominal GNP is simply equal to the rate of growth of output, plus the rate of growth of inflation. If, for example, real output grows by 3 percent and inflation is 10 percent, then the money value of the GNP, or nominal GNP, is going to grow by 13 percent.

Given a fairly steady advance in real output, a long-term reduction in inflation necessarily requires a decline in the growth of total spending measured in dollar terms. That is, it requires a decline in the growth of nominal GNP, but it's more than a truism. There's a momentum to inherited inflation as prices and wages chase each other, influenced by expectations about inflation in the future. Unless some force actively works against that inherited inflation, it tends to keep going unabated. The longrun reduction of the underlying rate of inflation requires that economic policy aim on the average to produce restraint on the growth of spending and thus a decline in the annual growth of nominal GNP.

This need for long-term restraint in monetary and fiscal policy doesn't imply that policies can't respond to changes in economic conditions, but, on the average, more restraint and greater caution will be required over the years than would have been warranted or required, were we in a period of price stability.

In that context, long-term supply and structural policies take on a new meaning. Supply-side economics is not an alternative to demand restraint, but it is a complement. To the extent that supply and structural policies can speed up productivity, reduce the growth of costs and increase the competitiveness and flexibility of the economy, they thereby reduce inflationary momentum. The long-term demand restraint that's necessary to lower inflation becomes more and more compatible with the sizable growth in output and employment. Or, to say it another way, to the extent we can speed up the growth of supply and increase the flexibility of the economy, the needed slowdown in nominal GNP can result in quicker reductions in inflation and faster growth in output.

Similarly, the long-term anti-inflation requirement for demand restraint has important implications for any tax measures which might be adopted to help speed recovery. In particular, it is not enough to pay attention to the immediate year's budgetary consequences of a proposed tax reduction. It's essential that the longer term revenue losses be carefully evaluated in terms of budget prospects over a number of years in the future.

You have to bend over backward to assure that the out-year revenue losses from any proposed tax reduction are consistent with long-term fiscal and budgetary restraint. Otherwise, immediate gains in output and employment from such a cut may be dissipated in later years by renewed inflationary pressures.

Let me spend just a moment on supply and structural policy. A substantial and a durable increase in the flexibility of the American economy and the growth of its productivity will require a number of supply and structural measures over the years ahead. Among these will be policies, some of which have already been enacted, to adjust our economy to higher energy prices and reduce its vulnerability to supply and price decisions made abroad.

Improving long-term economic performance also demands a continuation of deregulation and regulatory reform efforts already underway. Mr. Chairman, it will most assuredly require us to take steps to increase the Nation's capital formulation. We do not know all the reasons for the recent decline in the growth of American productivity, but we do know that reversing that trend will demand significant increases in the share of the Nation's output devoted to investment. That investment shore will have to grow in the 1980's for a number of reasons. There will be substantial new needs for direct investment in alternative energy sources. The adjustment to higher energy prices will also levy substantial investment requirements on the economy indirectly, as the Nation replaces large parts of its capital stock made obsolete by higher energy prices. Environmental and related objects will continue to require significant investment.

In addition to all of these requirements, we have to speed up the increase in capital stock per worker as a prerequisite to an increase in the growth of productivity.

It is not likely that the requisite investment will be forthcoming without tax measures aimed at increasing investment incentives. Restraint in Federal spending, if steadfastly pursued, will free national resources for such use through tax reductions to increase investment.

Mr. Chairman, we have to recognize that supply-side economics cannot provide a quick and painless way to cure inflation and speed growth. We cannot raise Federal revenues by cutting taxes. Federal revenues do indeed tend to rise year after year as nominal incomes grow. In the year after a typical tax cut, revenues will usually continue to rise since tax cuts are seldom large enough to offset the effect of income growth.

Senator BENTSEN. Mr. Schultze, this committee at no time has said that supply-side economics is going to bring us a quick and painless way to cure inflation and speed up growth. We didn't get into this mess overnight, and we're not going to get out of it overnight. It's going to take some time, and it's going to take some very targeted tax cuts to go on that path. We've got to look beyond this next election to the years ahead.

It will not be a dramatic turnaround. Unfortunately, there's just no quick fix that anyone's been able to find.

Mr. SCHULTZE. Mr. Chairman, I couldn't agree more, and I am sure you are aware that I know enough about what this committee has done that these remarks were not addressed to this committee.

But on the other hand, I think you're also aware that there have been a number of claims made with respect of pulling oneself up by one's bootstraps, free lunches, and the like.

Senator BENTSEN. Well, this is an election year.

Mr. SCHULTZE. Mr. Chairman, those who do say that a tax reduction will increase GNP by such a large amount as to eliminate the revenue loss simply haven't looked at the arithmetic, if I may spend one more paragraph on this. I'm speaking to the converted, I realize.

Roughly speaking, an additional dollar of GNP will produce about 20 to 25 cents of additional revenue. That is, the relationship is about 1 to 4 or 5. So a $40 billion tax cut must generate $160 to $200 billion of additional GNP to provide enough additional income so that the initial tax loss is wiped out, and, of course, it doesn't do any good to produce hundreds of billions in additional spending unless it is matched by hundred of billions of additional supply. Otherwise, we will simply get inflation. There's absolutely no body of evidence which suggests that for $1 of tax cuts, however carefully designed, we can expect $4 to $5 of increase in the GNP supplied to the economy.

Mr. Chairman, as I said earlier, this administration is deeply concerned by the economic prospects that face the Nation. The prospective rise in unemployment and the fact that it fails to decrease in 1981, is highly troubling because of the human suffering it entails, the social dangers it poses, and the debilitating effect of prolonged slow growth on investment and productivity. The rate of inflation that we foresee for 1981 and future years will also be too high in the absence of further policies to correct the situation. We intend, therefore, Mr. Chairman, to work closely with Congress toward the development of policies on both the demand and supply side of our economy to meet the problems I have outlined.

With respect specifically to taxes, Mr. Chairman, the administration believes that a tax cut may turn out to be appropriate and desirable in 1981. But by waiting to make a final decision we gain several important advantages.

First, we will have a better picture of the economic situation on which to base judgments about the magnitude and pattern of a tax program.

Second, before deciding on the magnitude of a tax reduction we ought to make sure that the spending restraints proposed by the President last March and contained in the first concurrent resolution of the Congress are actually being achieved.

Finally, and most importantly, we think we will get a much better tax cut by taking the time for responsible action. The tax cut we want must be a carefully designed part of a long-range economic improvement program, not simply a traditional antirecession fix. As I have been at pains to point out, we need to pay close attention to both demand-side and supply-side economic and to make sure that any tax reduction does not have excessive "out year" costs.

Otherwise, by violating the demand-side conditions of economic policy, that tax cut will lead to inflation. Tax burdens are rising and will need to be reduced. But it is absolutely essential in the long run, however, that when tax burdens are reduced, we put additional dollars back into the private economy in a way which accomplishes long-term structural objectives.

Mr. Chairman, I'll take your questions.

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

[The prepared statement of Mr. Schultze follows:]

PREPARED STATEMENT OF HON. CHARLES L. SCHULTZE

The Mid-Session Review of the Budget offers a time to review the economic outlook and to take stock of where our economy is. I will of course set forth the immediate economic outlook and prospects facing our country, but I would like to put those economic problems and challenges in a longer term context by looking backward at the developments of the 1970's and forward to the challenges for policy in the 1980's. Indeed as I will demonstrate, unless we deal with our immediate economic problems in a longer term context, we are likely to make little sustained progress.

In many ways the 1970's was a decade of great economic difficulty for the United States and for the entire world economy. Four major developments made this true:

First, oil. The world oil price rose more than tenfold during the decade. The U.S. oil import bill expanded almost thirtyfold and in 1980 we will be paying over \$85 billion for our oil imports. And for the world as a whole, the oil import bill will exceed \$300 billion. These increases in oil prices and import costs occurred not gradually but in two huge and highly disruptive surges, which simultaneously damaged our economy in two quite different ways: they siphoned off large amounts of purchasing power from consumers and created substantial recessionary forces; they also gave a sharp upward push to the price level and set in motion two new rounds of inflation.

Second, inflation, ~~which had already~~ gained a foothold in the United States during the Vietnam War, rose sharply at home and abroad during the decade of the 1970's. Both here and around the world, inflation averaged about 7½ percent a year over the decade. Last year for the second time in the decade inflation moved into double digits and as this year began was rising in most of the countries of the world. Inflationary expectations became endemic. By the end of the decade people had come to expect relatively high rates of inflation to be a way of life.

Third, recession. In the mid-1970's the world economy experienced the worst recession in 40 years. In 1980 recession began in the United States and economic growth slowed sharply ~~elsewhere,~~ triggered by the sharp runup in oil prices.

Fourth, productivity. Throughout most industrial countries productivity growth slowed sharply during the 1970's, perhaps nowhere more so than in the United States. During most of the 1960's, U.S. productivity growth averaged over 2½ percent a year. By the second half of the 1970's productivity growth had fallen to about 1 percent a year, and in 1979 productivity actually declined.

The problem that faces our country as we enter the 1980's is to restore a healthy growth in output and employment after the current recession while dealing effectively with the three major legacies left by the decade of the 1970's:

Inflation: We must contain the dangerous oil price component of inflation and reduce the remaining and far too high underlying inflation rate.

Energy: We must adjust our economy to a world of sharply-higher energy prices and reduce our vulnerability to OPEC supply and price decisions.

Productivity: We must take major steps to improve the efficiency, productivity and competitiveness of the American economy.

THE RECENT PAST

Over the past year, in the United States and around the world, the most pressing economic objective has been to isolate, to quarantine, and to contain the surge of inflation initiated by the 125 percent increase in world oil prices. Every country, the United States included, has sought to make sure that this large inflationary shock did not spill over and infect the rest of the economy. If wages, salaries, and other money incomes were to rise sharply in an effort to keep up with the higher consumer prices for energy, then business costs would rise dramatically, inducing rapid price increases and threatening a self-sustaining wage-price spiral at double-digit levels. Monetary and fiscal policy have had to be aimed at creating an overall economic environment in which it was hard to raise money incomes excessively. The wage-price standards aimed at wage and price moderation more directly.

During most of 1979 this "containment" objective was met. Inflation, as measured by the consumer price index did increase at a 13 precent rate. However, most of that increase stemmed from two sources: the huge rise in energy prices themselves and the associated increase in interest rates, particularly mortgage intrest rates, whose impact on the cost of living is significantly exaggerated in the consumer price index. Outside of these two areas, the rate of inflation in consumer prices during the first ten months of 1979 was about 7½ percent, varying from time to time because of fluctuations in food prices. And despite the sharp overall rise in the consumer price index, wage increases did not accelerate and remained relatively moderate throughout most of 1979.

At the very end of 1979, and more strongly in early 1980, successful containment of the oil price bulge was threatened by a number of developments. Overall, prices began to rise at an 18 to 20 percent annual rate. Although much of this additional acceleration was directly attributable to further large increases in energy prices and mortgage interest rates, and to the indirect effect of energy prices on industrial costs, the rate of increase in other prices accelerated. Inflationary expectations clearly took a leap upward. Since the Federal Reserve, quite properly, refused to accommodate this large additional jump in inflation by increasing the growth in the money supply, both short-term and long-term interest rates surged.

In addition, the rate of increase in wages began to accelerate. Under these conditions it was necessary to take vigorous action to reverse these trends before they did permanent damage. Working with the Congress and with the Federal Reserve, the President took such action. He proposed a program of budget reductions, and the Congress subsequently moved toward making these cuts a reality. Selective credit controls were imposed to halt excessive use of credit. The Federal Reserve also moved under its traditional powers to restrict the increase in credit. Taken altogether these actions were substantial and had a major effect—perhaps more quickly than anyone had believed possible.

Very shortly after these steps were taken interest rates began to decline; the subsequent reduction was unprecedented in its speed and magnitude. At the present time, short-term market interest rates are less than half of what they were at the peak and long-term rates have also fallen substantially. Inflationary expectations, while clearly not evaporating, have been substantially reduced.

Inflation has slowed. The 18 to 20 percent price inflation rate of early this year has slowed sharply. [The June consumer price index continued to show the lagged effects of earlier increases in mortgage interest rates.] In subsequent months, however, decreases in mortgage interest rates should significantly slow the rise in the consumer price index. Inflation as measured by the CPI may fall significantly during the next several months. However, the underlying or core rate of inflation is now running at something like 9 to 10 percent a year.

While major improvements in inflation and interest rates have occurred in the past three months, the economy has also entered into a fairly steep recession. The unemployment rate increased from the 6 percent level which characterized 1979 and early 1980 to about 7¾ percent in May and June. Between February and June, total employment fell by 1.4 million persons. By June, industrial production was 7½ percent below January. Domestic automobile sales in June were 30 percent below their fourth quarter 1979 level; and housing starts at 913,000 in May had fallen nearly 50 percent below their year-ago levels. In the second quarter real GNP declined at an annual rate of 9.1 percent below its first quarter peak.

Almost 90 percent of the drop in GNP in the second quarter was accounted for by declining production of automobile and housing. Similarly, the overwhelming part of the fall in employment from February to May occurred in the automobile and construction industries and their supplying firms. In June, however, the nature of the recession changed. Production and employment cutbacks—on a more modest scale—spread to many other industries as inventories were brought into line with sales.

Evidence has begun to accumulate that the severest part of the decline is behind us and some harbingers of a later upturn have begun to appear. The decline in automobile sales seems to have ended and at least a small increase may have occurred. Housing starts rose a sharp 30 percent in June. Real personal consumption expenditures, excluding automobiles, rose by about three-fourths of a percent in June, after falling in the earlier months of the year. And in the first two weeks of July, initial claims for unemployment insurance, seasonally adjusted, fell substantially below their June level.

It is a fair question to ask to what extent the recession was brought on by the anti-inflationary actions taken last March and to what extent these actions were necessary. It is probably true that failure to act last March might have postponed the decline in the economy; it may be that the recession could have been avoided for a time by the continuation of credit extensions at a very rapid pace. But to have avoided acting, in the face of rising inflation and accelerating expectations, would have led to a longer period of exceedingly high interest rates, would have threatened another rise in the hard-to-eliminate underlying rate of inflation, thus in the long run producing a much worse fall in employment and output.

SHORT-TERM OUTLOOK

Two of the major factors that caused the present recession are now in the process of correcting themselves. The first was the very rapid upsurge in inflation, especially during the early months of 1980, which in combination with relatively moderate increases in wages, led to a sharp fall in consumer purchasing power. This is how last year's large oil price increase exerted its recessionary force on the economy. Conversely, the decline in inflation that we have seen and that is in prospect will sharply slow this erosion of purchasing power and thereby moderate one of the major depressing forces on the economy.

Similarly the economic decline in which we now find ourselves can be importantly traced back to the surge in interest rates that accompanied the rise in actual and expected inflation late last year and early this year. The effect on housing was particularly sharp, but throughout the economy the high interest rates tended to depress economic activity. The recent dramatic fall in rates should, after a time, begin to set in motion conditions under which the recession can be halted and recovery began. This has already begun to take place in housing.

A third favorable factor is the failure of inventories to accumulate excessively during the recent period. This recession, unlike the one in 1974, was not preceded by a speculative inventory boom. Moreover, during the recession to date, businessmen have moved quickly to reduce inventories as sales have fallen. While these prompt adjustments in production contributed to the steepness of the decline, they also insure that there remains no large overhang of excess inventories still to be worked off once sales stop declining.

While there are a number of important forces working to moderate the decline and turn recession into recovery, there are still two important questions the answers to which will be critical in determining the length and depth of the recession. First, will consumers who earlier this year appeared to be buying ahead to beat inflation simply return to more normal buying habits or, as they observe the layoffs which have been occurring, will they retrench and sharply cut back their buying? While the evidence is not all in, the behavior of retail sales in June suggests a favorable answer to this question.

Second, to what extent will businessmen pare back their investment plans during the recession? In all postwar recessions, businessmen have tended to cut back somewhat on their investment spending compared to previously-announced plans, and this one will be no exception. But in some recessions the cutback was relatively mild, while in other cases it was substantial. This has been the most widely-advertised recession in history—it was being predicted but failed to show up all through 1979. As a consequence it is quite possible that business investment plans were drawn up with the possibility of recession in mind and the actual appearance of the recession need not lead to a large cutback of investment spending. So far the surveys of business investment intentions indicate that plans will be relatively well-maintained, but, again, the final evidence is not in.

On balance, it appears that the pace of the recession is moderating and that the trough of the recession may be reached before the end of this year. 1981 should see a rather slow recovery. Since the large rundown in inventories which often accompanies a recession does not appear in prospect for this recession, the subsequent boost to recovery occasioned by a sharp turnaround in inventory investment will also be absent.

Table 1 summarizes the main features of the short-term economic outlook as we now see it. Over the four quarters of 1980, GNP should decline by some 3.1 percent. From its peak in the first quarter to its trough in the fourth quarter, the decline should be 3.4 percent. This is the pattern of a recession that is steeper than the three very mild recessions of the postwar period, but substantially smaller than the very large decline of 1974–75.

TABLE 1.—ADMINISTRATION'S FORECAST

	1980	1981
Real GNP (percent change, Q_4/Q_4)	−3.1	2.6
GNP deflator (percent change, Q_4/Q_4)	10.1	9.7
CPI (percent change, Q_4/Q_4)	12.0	9.8
Unemployment rate (level, Q_4)	8.5	8.5

Over the four quarters of this year, inflation, as measured by the CPI, should run about 12 percent. The worst of the inflation, however, is behind us. Our forecast implies an increase in the consumer price index over the second half of the year of 8¼ percent. In 1981, consumer prices should rise by 9.8 percent. About one-half of 1 percent of this 1981 increase reflects the 10-cent/gallon gasoline tax, which the President will ask the Congress to enact next year.

Unemployment should rise to about 8½ percent by the end of this year, may increase just a bit further early in 1981, and then return to 8½ percent by the fourth quarter.

The budget consequences of this forecast are shown in detail in the Mid-Session Review document. The recession and Congressional repeal of the President's gasoline conservation fee together result in a $15 billion decline in revenues in fiscal year 1980 and a $24 billion decline in fiscal year 1981. At the same time, the changed economic conditions are expected to increase outlays by $7 billion in fiscal year 1980 and by $11 billion in fiscal 1981. Faster spending by the Department of Defense and unavoidable outlays such as those associated with the eruption of Mount St. Helens and the influx of Cuban and Haitian entrants are estimated to increase outlays by $2.8 billion in fiscal year 1980 and $11 billion in fiscal year 1981. In sum these result in a fiscal 1980 deficit of $61 billion, up $24 billion from the March estimate. The fiscal 1981 budget moves, in the absence of any policy changes, from a surplus of $16.5 billion to a deficit of $30 billion.

The economic forecast I have presented foresees an end to the recession before the end of 1980, followed by a slow recovery. The Administration considers that this outlook is not satisfactory. While recovery will occur, it will proceed at a pace insufficient to reduce unemployment significantly. Although inflation will slow, it will remain far too high. The Administration, therefore, will work with the Congress to develop a long-run economic program aimed at improving the prospects for non-inflationary and sustained recovery. In designing programs to assist economic recovery, it is absolutely vital that we do so in ways which attack fundamental structural problems and not merely inject a traditional anti-recession stimulus into the economy.

To drive home this essential point—that economic policy actions aimed at improving the economy must be designed in the light of long-run considerations—let me digress for a moment on some recent economic history. Tables 2 and 3 bring out a very critical set of facts. Over the past three years (prior to the beginning of the current recession) and over the decade of the 1970's taken as a whole, the American economy strikingly outperformed all other major countries in providing jobs. Indeed, the U.S. performance in this respect is amazing. Not only is it true of total jobs but the relative performance is even more noticeable when it comes to manufacturing jobs. Over the past three years manufacturing employment in France, Germany, the United Kingdom and Japan fell; in the United States, on the other hand, manufacturing employment rose by some 9 percent.

TABLE 2.—PERCENT CHANGE IN TOTAL EMPLOYMENT

	1979 4th quarter/ 1970	1979 4th quarter/ 1976 4th quarter
Germany	−3	3
France	−1	−2
"Big 4" European countries	1	2
Japan	10	4
United States	24	12

Source: OECD Main Economic Indicators.

TABLE 3.—PERCENT CHANGE IN INDUSTRIAL PRODUCTION

	1979 4th quarter/ 1970	1979 4th quarter/ 1976 4th quarter
Germany	26	11
France	33	6
"Big 4" European countries	28	9
Japan	51	21
United States	41	15

Source: Federal Reserve Board.

Over a longer period—the entire decade of the 1970's—manufacturing employment in the United States rose while it fell sharply in all of the major industrial countries. While some of our favorable employment performance reflects lagging productivity growth, much of it results from very large increases in output. As Table 3 shows, the United States also performed exceedingly well in terms of the increase in industrial production. U.S. industrial production increased much faster, over the past three years and over the decade as a whole, than that of any other major industrial country except Japan. Even they were not far ahead of us.

This set of facts has an important implication that we should bear in mind when designating policies to improve what would otherwise be an unsatisfactory recovery: The problem of the U.S. economy is not an inability to generate large increases in jobs and production. Indeed, in this respect we have far outperformed other major countries. Rather, our problem is to produce additional jobs in ways that are consistent with a simultaneous reduction of the inflation and an increase in productivity. The major challenge therefore is not to produce a traditional short-run economic stimulus aimed solely at increasing sales and output but a longer-run tax and economic program that, in the process of generating jobs, also contributes toward lower inflation and higher productivity.

I would like to discuss briefly with you some of the considerations which ought to go into the design of a longer term economic policy aimed at improving performance.

While the rate of inflation has been brought down substantially from the 13 percent of 1979 and the 18 to 20 percent of early this year, the core or underlying rate of inflation probably now runs at something like 9 to 10 percent a year. The most important task of economic policy will be to encourage a healthy growth in jobs and output during the economic recovery while at the same time unwinding that underlying rate of inflation which remains far too high. Meeting this very challenging objective will require two approaches:

First, long-run monetary and fiscal policies to control the growth of spending, to keep reasonable restraint on the growth of aggregate demand in the economy, and so to help bring about a gradual slowdown in the growth of hourly wages, salaries, and other costs;

Second, supply and structural policies designed to raise productivity and efficiency and to increase the rate at which output and employment can increase without setting in motion inflationary pressures.

In other words, we need to have both demand policies and supply policies.

CONTROLLING THE GROWTH OF DEMAND THROUGH MONETARY AND FISCAL POLICIES

If inflation is to be reduced in the long run, the Nation's monetary and fiscal policies must be geared toward reducing the growth of total public and private spending. That is, we must over time reduce the growth of nominal GNP. In one sense this is simply a truism. The rate of growth of nominal GNP is equal to the growth of output plus the rate of inflation. If, for example, real output grows by 3 percent and inflation is 10 percent, then nominal GNP will grow by 13 percent. Given a fairly steady advance in real output, a long-term reduction in inflation necessarily requires a decline in the growth of total spending measured in dollar terms, that is a decline in the growth of nominal GNP.

But this is also more than a truism. There is a momentum to inherited inflation as prices and wages chase each other, influenced by expectations about inflation in the future. Unless some force actively works against that inherited inflation, it tends to keep going unabated. So if monetary and fiscal policy year after year simply aim at a continuation of the prior year's growth in nominal GNP, or total spending, then inflation is likely to perpetuate itself. Indeed because our businessmen, consumers, and financial markets have become infected with inflationary psychology after a decade of inflation, such a policy might lead to an acceleration of inflation. Long-run reduction of the underlying rate of inflation therefore requires that economic policy aims on the average, to produce restraint on the growth of spending and thus a decline in the annual growth of nominal spending.

This need for long-term restrain in monetary and fiscal policy does not imply that policies cannot respond to changes in economic conditions from year to year. However, on the average, more restraint and greater caution will be required over the years ahead than would have been warranted or required were we in a period of price stability.

In that context, long-term supply and structural policies take on new meaning. Supply-side economics is not an alternative to demand restraint, but a complement. To the extent that supply and structural policies can speed up productivity and reduce the growth of costs and increase the competitiveness and flexibility of the economy, they thereby reduce inflationary momentum. The long-term demand restraint that is necessary to lower inflation becomes more and more compatible with sizable growth in output and in employment. Or, to say it another way, to the extent that we can speed up the growth of supply and increase the flexibility of the economy, the needed slowdown in nominal GNP can result in a quicker reduction in inflation and a faster growth in output.

Similarly, the long-term anti-inflation requirement for demand restraint has important implications for any tax measures which might be adopted to help speed recovery. In particular, it is not enough to pay attention to the immediate year's budgetary consequences of a proposed tax reduction. It is essential that the longer term revenue losses be carefully evaluated in terms of budget prospects over a number of years in the future. We must bend over backwards to assure that the "out-year" revenue losses from any proposed tax reduction are consistent with long-term fiscal and budgetary restraint. Otherwise, any immediate gain in output and employment from such a tax cut may be dissipated in later years by renewed inflationary pressures.

SUPPLY AND STRUCTURAL POLICIES

A substantial and durable increase in the flexibility of the American economy and of the growth of its productivity will require a number of supply and structural policies over the years ahead. Among these will be policies—some of which have already been enacted—to adjust our economy to higher energy prices and to reduce its vulnerability to supply and price decisions made abroad. Improving long-term economic performance also demands a continuation of deregulation and regulatory reform efforts already underway. It will most assuredly require that we take steps to increase the Nation's capital formation.

We do not know all of the reasons for the recent decline in the growth of American productivity, but we do know that reversing that trend will demand significant increases in the share of the Nation's output devoted to investment. That investment share will have to grow in the 1980s for a number of reasons. There will be substantial new needs for direct investment in alternative energy sources. The adjustment to higher energy prices will also levy substantial investment requirements on the economy indirectly as the Nation replaces large parts of its capital stock made obsolete by higher energy prices. Environmental and related objectives will continue to require significant investment. In addition to all of these requirements, we must speed up the increase in capital stock per worker as a prerequisite to an increase in the growth of productivity.

It is not likely that the requisite investment will be forthcoming without tax measures aimed at increasing investment incentives. Restraint in Federal spending, if steadfastly pursued, will free national resources for such use through tax reductions to increase investment.

However, we must all recognize that supply-side economics cannot provide a quick and painless way to cure inflation and speed growth. You cannot raise Federal revenues by cutting taxes. Federal revenues do indeed tend to rise year after year as nominal incomes grow. In the year after a typical tax cut, revenues will usually continue to rise since tax cuts are seldom large enough to offset the effect of income growth. Moreover, income growth tends to speed up somewhat after a tax cut so the net loss of revenues is less than the initial tax cut. But it is utter nonsense to attribute to the tax cut the absolute rise in revenues in the year after the cut was made. Faulty analysis of this point has plagued us ever since the 1964 tax cut.

Those who say that a tax reduction will increase GNP by such a large amount as to eliminate the revenue loss simply have not looked at the arithmetic. Roughly speaking, an additional dollar of GNP will produce about 20 to 25 cents of additional revenue. That is, the relationship is about one to four or five. A $40 billion tax cut, for example, must generate $160–$200 billion of additional GNP to provide enough additional income so that the initial tax loss is wiped out. Moreover, it does no good to produce additional spending unless it is matched by additional supply. Otherwise, we will simply get inflation. There is absolutely no body of evidence which suggests that for $1 of tax cuts, however, carefully designed, we can expect $4 to $5 of increase in GNP supplied to the economy.

Moreover, supply-side tax cuts cannot raise productivity by a large enough amount or quickly enough so that we can ignore the demand-increasing effect of such tax cuts. Investment-oriented tax reductions, by stimulating investment, can indeed improve the prospects for productivity growth. But the payoff is a long-term one. The magnitude of the productivity improvement is likely to be moderate in terms of how far it reduces the inflation rate or raises the Nation's potential growth rate. Raising the historical 2 percent rate of productivity growth by say ½ percentage point represents a 25 percent increase in the productivity growth rate. It is unlikely to be achieved by some modest investment incentive. When realized it would itself tend to lower the underlying inflation rate from say

9 percent to say 8½ percent—a highly worthy but hardly revolutionary accomplishment. This country does need responsible measures to increase investment. But exaggerated claims, which suggest that we will get such a large supply response that we can ignore demand-side economics, do disservice to the cause of supply-side economics.

We cannot use supply-side tax cuts to escape the need for long-term demand restraint and for careful attention to the long-term budgetary consequences of tax reductions.

Mr. Chairman, as I said earlier, this Administration is deeply concerned by the economic prospects that face the Nation. The prospective rise in unemployment and the fact that it fails to decrease in 1981 is highly troubling because of the human suffering it entails, the social dangers it poses, and the debilitating effect of prolonged slow growth on investment and productivity. The rate of inflation that we foresee for 1981 and future years will also be too high in the absence of further policies to correct the situation. We intend, therefore, Mr. Chairman, to work closely with the Congress toward the development of policies on both the demand and supply side of our economy to meet the problems I have outlined.

With respect specifically to taxes, the Administration believes that a tax cut may turn out to be appropriate and desirable in 1981. But by waiting to make a final decision we gain several important advantages.

First, we will have a better picture of the economic situation on which to base judgements about the magnitude and pattern of a tax program.

Second, before deciding on the magnitude of a tax reduction we ought to make sure that the spending restraints proposed by the President last March and contained in the First Concurrent Resolution of the Congress are actually being achieved.

Finally, and most importantly, we will get a much better tax cut by taking the time for responsible action. The tax cut we want must be a carefully-designed part of a long-range economic improvement program, not simply a traditional anti-recession stimulus. As I have been at pains to point out, we need to pay attention to both demand-side and supply-side economics; and to make sure that any tax reduction does not have excessive "out-year" costs. Otherwise, by violating the demand-side conditions of economic policy, that tax cut will lead to inflation. Tax burdens are rising and will need to be reduced. But it is absolutely essential to the long-run health of our economy that when tax burdens are reduced we put additional dollars back into the private economy in a way which accomplishes long-term structural objectives.

And so, Mr. Chairman, we believe that in considering measures to deal with today's economic challenges, we must specifically evaluate how they meet the requirements of sound policy along four dimensions: on the demand side, on the supply side, in the period immediately ahead, and in subsequent years. With respect to tax reductions, the Administration position has been and continues to be that they be developed with great care and deliberation to satisfy these criteria for long-term structural improvement, and not be hastily enacted simply as a quick stimulus package in an election year.

Senator BENTSEN. Before proceeding, and without objection, I would like to place in the record at this point the press release entitled "The Consumer Price Index—June 1980."

[The press release follows:]

News United States Department of Labor

Bureau of Labor Statistics Washington, D.C. 20212

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Wednesday, July 23, 1980

THE CONSUMER PRICE INDEX--JUNE 1980

The Consumer Price Index for All Urban Consumers (CPI-U) rose 1.1 percent before seasonal adjustment in June to 247.6 (1967=100), the Bureau of Labor Statistics of the U.S. Department of Labor announced today. The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) also increased 1.1 percent before seasonal adjustment in June to 247.8 (1967=100). The CPI-U was 14.3 percent higher and the CPI-W was 14.2 percent higher than in June 1979.

CPI for All Urban Consumers (CPI-U)--Seasonally Adjusted Changes

On a seasonally adjusted basis, the CPI for All Urban Consumers rose 1.0 percent in June, following increases of 0.9 percent in each of the 2 preceding months. The housing component continued to advance sharply, rising 1.8 percent and accounting for over four-fifths of the June increase. On the other hand, the transportation index declined slightly in June, following 2 months of comparatively moderate increases. Food prices increased at a slightly faster rate in June. Other major categories of consumer spending, however, continued to show the more moderate rates of change evident since April.

Table A. Percent Changes in CPI for All Urban Consumers (CPI-U)

Expenditure category	Seasonally adjusted: Changes from preceding month, 1979 Dec.	1980 Jan.	Feb.	Mar.	Apr.	May	June	Compound annual rate 3-mos. ended June '80	Unadjusted 12-mos. ended June '80
All items	1.2	1.4	1.4	1.4	.9	.9	1.0	11.6	14.3
Food and beverages	1.4	.1	0	1.0	.5	.3	.5	5.8	7.2
Housing	1.4	1.4	1.4	1.6	1.3	1.5	1.8	20.6	18.3
Apparel and upkeep	.6	.9	.6	2.0	.3	-.2	0	.5	6.9
Transportation	1.4	3.1	2.8	1.7	.6	.3	-.2	2.5	17.5
Medical care	1.1	1.3	1.5	.9	.7	.5	.5	7.3	11.4
Entertainment	.2	1.0	1.2	1.3	.8	.6	.6	8.4	9.1
Other goods and services	.7	1.1	1.0	.5	.6	.8	.8	8.9	9.3

(Data for CPI-U are shown in tables 1 through 3.)

During the 3 months ended in June, the CPI-U rose at a seasonally adjusted annual rate of 11.6 percent. This compares with an increase of 18.1 percent during the first quarter of 1980 and increases of about 13 percent during each of the 4 quarters of 1979. Indexes for housing and food advanced at about the same rate in the second quarter as in the first. The other major expenditure groups showed substantially smaller price increases in the second quarter.

Rising shelter costs accounted for most of the 1.8 percent increase in the housing component in June. Home financing costs rose 4.6 percent, reflecting an increase of 3.8 percent in mortgage interest rates and 1.2 percent in house prices. Conventional mortgage interest rates continued to increase in the June index, partly because of the lag between the publicized rate changes and actual mortgage transactions. These rates are represented in the CPI by actual mortgage loan transactions and not by current commitment rates. Property insurance costs rose 1.7 percent in June, following a 1.6 percent increase in May. The index for rent increased 1.2 percent. Prices for fuels and other utilities continued to increase as charges for electricity, telephone services, and water and sewerage maintenance rose sharply in June. Fuel oil prices and charges for natural gas, however, registered moderate increases. (The 12-month percent changes for 5 experimental measures of housing costs can be found at the end of this release.)

The index for food and beverages rose 0.5 percent in June, continuing the moderate trend evident throughout most of 1980. Prices for grocery store foods increased 0.4 percent in June compared with 0.2 percent in May. Prices for sugar and sweets, soft drinks, and other prepared food rose substantially. Most other grocery store foods also rose but by less than in May. The index for meats, poultry, fish, and eggs declined in June, but not as much as in the 2 previous months. Prices of the other two components of the food and beverage index--restaurant meals and alcoholic beverages--rose 0.9 and 0.7 percent, respectively.

The transportation index declined 0.2 percent in June, following increases of 0.3 percent in May and 0.6 percent in April. Gasoline prices declined 1.0 percent, following seasonal adjustment, and were largely responsible for the decrease. Gasoline prices, which rose at a seasonally adjusted annual rate of 105.7 percent during the first quarter, declined at a 6.2 percent rate during the second quarter. In June, used car prices continued to decline while new car prices increased slightly. Automobile finance charges, which rose at a monthly rate of 4.0 percent during the first 5 months of 1980, declined 0.8 percent in June. The index for public transportation rose 1.1 percent, reflecting large increases in airline and intercity train fares.

The index for apparel and upkeep was unchanged in June. Price declines in men's and boys' and women's and girls' spring and summer clothing were offset by price increases in infants' and toddlers' clothing, other apparel commodities, and higher charges for apparel services.

The medical care index rose 0.5 percent in June, the same as in May. Charges for medical care services rose 0.4 percent. The physicians' fees and hospital room components rose 0.6 and 0.8 percent, respectively. The index for medical care commodities rose 0.9 percent in June, about the same as in recent months.

The indexes for entertainment and other goods and services rose 0.6 and 0.8 percent, respectively, the same as in May.

CPI for Urban Wage Earners and Clerical Workers (CPI-W)--Seasonally Adjusted Changes

On a seasonally adjusted basis, the CPI for Urban Wage Earners and Clerical Workers rose 0.9 percent in June, about the same as in April and May and substantially less than increases of 1.4 percent in each of the first 3 months of 1980. The housing component continued to advance sharply and accounted for over four-fifths of the June increase. On the other hand, the transportation and apparel indexes declined slightly in June, following 2 months of comparatively moderate increases. Other major categories of consumer spending continued to show the more moderate trend which began in April.

Rising shelter costs accounted for most of the increase in the housing component in June. Home financing costs rose 4.7 percent, reflecting an increase of 3.9 percent in mortgage interest rates and 1.3 percent in house prices. Property insurance costs rose 1.6 percent in June, following a 1.7 percent increase in May. The index for rent increased 1.1 percent. Prices for fuels and other utilities continued to increase as charges for electricity, telephone services, and water and sewerage maintenance rose sharply in June. Fuel oil prices and charges for natural gas, however, registered moderate increases.

The index for food and beverages rose 0.5 percent in June, continuing the moderate trend evident throughout most of 1980. Prices for grocery store foods increased 0.3 percent. Prices for sugar and sweets rose 4.5 percent in June. Most other grocery store foods, also rose, but by less than in May. The index for meats, poultry, fish, and eggs declined in June, but not as much as in the two previous months.

The transportation index declined 0.3 percent in June, following increases of 0.2 percent in May and 0.6 percent in April. A 1.1 percent decline in gasoline prices, following seasonal adjustment, was largely responsible for the decrease. In June, used car prices continued to decline and new car prices rose 0.2 percent. Automobile finance charges, which rose at a monthly rate of 4.0 percent during the first 5 months of 1980, declined 0.2 percent in June. The index for public transportation rose 0.9 percent.

The index for apparel and upkeep declined 0.3 percent in June. Price declines in men's and boys' and women's and girls' spring and summer clothing were partially offset by price increases in infants' and toddlers' clothing and other apparel commodities.

The medical care index rose 0.4 percent in June, compared with 0.6 percent in May. Charges for physicians' fees and hospital rooms rose 0.6 and 0.8 percent, respectively.

The entertainment index rose 0.7 percent in June, following an increase of 0.5 percent in May, primarily due to increases in prices for movie admissions. The index for other goods and services rose 0.8 percent, the same as in May.

Table 3. Percent Changes in CPI for Urban Wage Earners and Clerical Workers (CPI-W)

Expenditure category	Seasonally adjusted								Unadjusted
	Changes from preceding month							Compound annual rate 3-mos. ended June '80	12-mos. ended June '80
	1979	1980							
	Dec.	Jan.	Feb.	Mar.	Apr.	May	June		
All items	1.2	1.4	1.4	1.4	1.0	.9	.9	11.4	14.2
Food and beverages	1.4	.2	0	0.9	.7	.5	.5	6.8	7.5
Housing	1.3	1.5	1.4	1.6	1.4	1.5	1.9	21.1	18.4
Apparel and upkeep	.5	.8	.9	1.7	.3	.1	-.3	.2	6.5
Transportation	1.5	3.1	2.8	1.7	.6	.2	-.3	2.5	17.3
Medical care	1.1	1.3	1.5	.9	.8	.6	.4	7.7	11.6
Entertainment	-.1	.8	1.2	1.6	.8	.5	.7	8.5	8.8
Other goods and services	.6	1.4	.9	.4	.5	.8	.8	8.7	9.2

(Data for CPI-W are shown in tables 4 through 6.)

Technical Notes

Brief Explanation of the CPI

The Consumer Price Index (CPI) is a measure of the average change in prices over time in a fixed market basket of goods and services. Effective with the January 1978 index, the Bureau of Labor Statistics began publishing CPI's for two population groups: (1) A new CPI for All Urban Consumers (CPI-U) which covers approximately 80 percent of the total noninstitutional civilian population; and (2) a revised CPI for Urban Wage Earners and Clerical Workers (CPI-W) which represents about half the population covered by the CPI-U. The CPI-U includes, in addition to wage earners and clerical workers, groups which historically have been excluded from CPI coverage, such as professional, managerial, and technical workers, the self-employed, short-term workers, the unemployed, and retirees and others not in the labor force.

The CPI is based on prices of food, clothing, shelter, and fuels, transportation fares, charges for doctors' and dentists' services, drugs, and the other goods and services that people buy for day-to-day living. Prices are collected in 85 urban areas across the country from about 18,000 tenants, 18,000 housing units for property taxes, and about 24,000 establishments- -grocery and department stores, hospitals, filling stations, and other types of stores and service establishments. All taxes directly associated with the purchase and use of items are included in the index. Prices of food, fuels, and a few other items are obtained every month in all 85 locations. Prices of most other commodities and services are collected every month in the five largest geographic areas and every other month in other areas. Prices of most goods and services are obtained by personal visits of the Bureau's trained representatives. Mail questionnaires are used to obtain public utility rates, some fuel prices, and certain other items.

In calculating the index, price changes for the various items in each location are averaged together with weights which represent their importance in the spending of the appropriate population group. Local data are then combined to obtain a U.S. city average. Separate indexes are also published by size of city, by region of the country, for cross-classifications of regions and population-size classes, and for 28 local areas. Area indexes do not measure differences in the level of prices among cities; they only measure the average change in prices for each area since the base period.

The index measures price changes from a designated reference date- -1967- -which equals 100.0. An increase of 122 percent, for example, is shown as 222.0. This change can also be expressed in dollars as follows: The price of a base period "market basket" of goods and services in the CPI has risen from $10 in 1967 to $22.20.

For further details see the following: *The Consumer Price Index: Concepts and Content Over the Years*, Report 517, revised edition (Bureau of Labor Statistics, May 1978). *The Revision of the Consumer Price Index*, by W. John Layng, reprinted from the *Statistical Reporter*, February 1978, No. 78-5 (U.S. Dept. of Commerce), *Revisions in the Medical Care Service Component of the Consumer Price Index*, by Daniel H. Ginsburg, *Monthly Labor Review*, August 1978; and *CPI Issues*, Report 593, (Bureau of Labor Statistics, February 1980).

A Note About Calculating Index Changes

Movements of the indexes from one month to another are usually expressed as percent changes rather than changes in index points because index point changes are affected by the level of the index in relation to its base period while percent changes are not. The example in the accompanying box illustrates the computation of index point and percent changes.

Percent changes for 3-month and 6-month periods are expressed as annual rates and are computed according to the standard formula for compound growth rates. These data indicate what the percent change would be if the current rate were maintained for a 12-month period.

Index Point Change	
CPI	236.4
Less previous index	233.2
Equals index point change.	3.2
Percent Change	
Index point difference	3.2
Divided by the previous index	233.2
Equals:	0.014
Results multiplied by one hundred	0.014x100
Equals percent change:	1.4

A Note on Seasonally Adjusted and Unadjusted Data

Because price data are used for different purposes by different groups, the Bureau of Labor Statistics publishes seasonally adusted as well as unadjusted changes each month.

For analyzing general price trends in the economy, seasonally adjusted changes are usually preferred since they eliminate the effect of changes that normally occur at the same time and in about the same magnitude every year—such as price movements resulting from changing climatic conditions, production cycles, model changeovers, holidays, and sales.

The unadjusted data are of primary interest to consumers concerned about the prices they actually pay. Unadjusted data also are used extensively for escalation purposes. Many collective bargaining contract agreements and pension plans, for example, tie compensation changes to the Consumer Price Index unadjusted for seasonal variation.

Seasonal factors used in computing the seasonally adjusted indexes are derived by the X-11 Variant of the Census Method II Seasonal Adjustment Program. The updated seasonal data at the end of 1977 replaced data from 1967 through 1977. Subsequent annual updates have replaced 5 years of seasonal data, e.g., data from 1975 through 1979 were replaced at the end of 1979. The seasonal movement of all items and 35 other aggregations is derived by combining the seasonal movement of 45 selected components. Each year the seasonal status of every series is reevaluated based upon certain statistical criteria. If any of the 45 selected components changes its seasonal status, seasonal data from 1967 forward for the all items and for any of the 35 other aggregations, that have that series as a component, are replaced.

24 Hour CPI Mailgram Service

Consumer Price Index data now are available by mailgram within 24 hours of the CPI release. The new service is being offered by the Bureau of Labor Statistics through the National Technical Information Service of the U.S. Department of Commerce.

The CPI MAILGRAM service provides unadjusted and seasonally adjusted data both for the All Urban Consumers (CPI-U) and for the Urban Wage Earners and Clerical Workers (CPI-W) Indexes as shown on the CPI-U sample page below. The unadjusted data include the current month's index and the percent changes from 12 months ago and one month ago. The seasonally adjusted data are the percent changes from one month ago.

CONSUMER PRICE INDEX FOR ALL URBAN CONSUMERS (CPI-U): U.S. CITY AVERAGE (1967=100)

GROUP	UNADJ INDEX MAY 1979	UNADJUSTED PER CHG FROM 12 MO AGO	UNADJUSTED PER CHG FROM 1 MO AGO	S ADJ PER CHG FROM 1 MO AGO
ALL ITEMS	214.1	10.8	1.2	1.1
ALL ITEMS(1957-59=100)	249.8	-	-	-
FOOD AND BEVERAGES	228.2	11.2	.8	.7
FOOD	234.3	11.4	.9	.7
FOOD AT HOME	233.4	11.3	.7	.5
CEREALS AND BAKERY PRODUCTS	218.2	9.5	.8	1.0
MEATS, POULTRY, FISH, AND EGGS	242.2	19.4	.9	.1
DAIRY PRODUCTS	233.8	11.1	.7	.8
FRUITS AND VEGETABLES	226.8	3.4	.1	-.2
FOOD AWAY FROM HOME	241.1	11.7	1.1	1.1
HOUSING	222.4	11.3	1.2	1.2
RENT, RESIDENTIAL	173.8	6.8	1.0	1.8
HOMEOWNERSHIP	254.9	14.4	1.3	1.3
FUEL AND OTHER UTILITIES	232.2	7.7	2.1	2.2
FUEL OIL, COAL, AND BOTTLED GAS	364.3	23.2	4.1	4.8
GAS (PIPED) AND ELECTRICITY	251.6	8.2	2.6	2.6
HOUSEHOLD FURNISHINGS AND OPERATION	189.2	7.5	.3	.4
APPAREL AND UPKEEP	166.1	3.9	.4	.0
TRANSPORTATION	207.7	13.4	2.4	1.8
NEW CARS	165.8	8.7	.9	1.1
USED CARS	235.4	11.3	2.7	-.3
GASOLINE	247.7	29.1	5.5	5.8
PUBLIC TRANSPORTATION	193.3	3.1	.4	.7
MEDICAL CARE	236.3	8.9	.5	.6
MEDICAL CARE SERVICES	254.4	9.4	.5	.6
ENTERTAINMENT	187.8	6.8	.7	.5
OTHER GOODS AND SERVICES	193.9	7.5	.4	.5
PERSONAL CARE 1/	193.9	7.5	.4	.6
COMMODITIES	225.8	10.9	1.2	.9
COMMODITIES LESS FOOD AND BEVERAGES	192.9	10.9	1.5	1.0
NONDURABLES LESS FOOD AND BEVERAGES	195.7	12.0	2.0	1.9
DURABLES	189.2	10.0	1.1	.5
SERVICES	229.5	10.3	1.1	1.3
ALL ITEMS LESS FOOD	203.9	10.5	1.3	1.2
ENERGY 1/	260.8	19.8	4.2	4.2
ALL ITEMS LESS FOOD AND ENERGY	204.1	9.5	.9	.9

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CPI-U

TABLE 1. Consumer Price Index for all urban consumers: U.S. city average, by expenditure category and commodity and service group, 1967=100

Group	Relative importance, December 1979	Unadjusted indexes May 1980	Unadjusted indexes June 1980	Unadjusted percent change to June 1980 from- June 1979	Unadjusted percent change to June 1980 from- May 1980	Seasonally adjusted percent change from- Mar. to Apr.	Seasonally adjusted percent change from- Apr. to May	Seasonally adjusted percent change from- May to June
Expenditure category								
All items	100.000	244.9	247.6	14.3	1.1	0.9	0.9	1.0
All items(1957-59=100)	-	284.8	288.0	-	-	-	-	-
Food and beverages	18.685	244.1	245.7	7.2	.7	.5	.3	.5
Food	17.655	250.4	252.0	7.1	.6	.5	.3	.5
Food at home	12.202	246.5	248.0	5.9	.6	.4	.2	.4
Cereals and bakery products 1/	1.518	244.5	245.9	12.9	.6	1.4	1.0	.6
Meats, poultry, fish, and eggs	4.189	231.5	231.2	-3.6	-.1	-1.3	-2.0	-.4
Dairy products	1.642	226.2	227.2	10.6	.4	1.0	1.8	.6
Fruits and vegetables	1.702	246.6	250.1	7.0	1.4	2.7	2.3	.5
Sugar and sweets 1/	.418	326.8	342.0	23.3	4.7	1.9	2.3	4.7
Fats and oils	.346	239.5	240.0	4.1	.2	.2	-.2	-.4
Nonalcoholic beverages	1.375	393.0	395.9	13.0	.7	.0	.2	.5
Other prepared foods	1.013	229.1	230.9	11.1	.8	1.1	1.4	1.0
Food away from home	5.454	264.6	266.6	9.8	.8	.7	.5	.9
Alcoholic beverages	1.029	185.4	186.4	8.3	.5	1.1	.7	.7
Housing	44.999	261.7	266.7	18.3	1.9	1.3	1.5	1.8
Shelter	30.910	280.2	286.3	21.0	2.2	1.6	1.6	2.1
Rent, residential 1/	5.273	188.9	191.1	9.4	1.2	.2	1.0	1.2
Other rental costs	.734	261.9	264.2	13.7	.9	1.1	.3	.7
Homeownership	24.904	312.9	320.4	23.8	2.4	1.9	1.8	2.3
Home purchase 1/	10.396	249.7	252.6	14.4	1.2	1.0	1.3	1.2
Financing, taxes, and insurance	10.902	399.7	416.1	37.7	4.1	2.9	2.5	3.9
Maintenance and repairs	3.606	284.9	285.9	11.9	.4	1.4	.7	-.1
Maintenance and repair services	2.778	310.1	310.6	12.0	.2	1.3	.7	-.4
Maintenance and repair commodities 1/	.828	225.8	228.0	11.5	1.0	1.3	.7	1.0
Fuel and other utilities 1/	6.477	275.9	282.2	18.1	2.3	.9	2.0	2.3
Fuels 1/	4.607	346.4	355.8	24.3	2.7	1.2	2.5	2.7
Fuel oil, coal, and bottled gas 1/	1.214	556.0	558.7	42.8	.5	.5	-.1	.5
Gas (piped) and electricity 1/	3.393	298.2	308.8	18.8	3.6	1.4	3.5	3.6
Other utilities and public services 1/	1.870	163.1	164.9	3.6	1.1	.2	.5	1.1
Household furnishings and operation	7.612	204.2	205.5	8.1	.6	.7	.6	.6
Housefurnishings	4.139	173.4	174.6	7.1	.7	.5	.5	.6
Housekeeping supplies 1/	1.459	243.6	245.4	10.8	.7	1.1	1.2	.7
Housekeeping services 1/	2.015	267.6	269.1	8.5	.6	.9	.6	.6
Apparel and upkeep	5.107	177.5	177.2	6.9	-.2	.3	-.2	.0
Apparel commodities	4.446	170.1	169.7	5.9	-.2	.1	-.4	-.1
Men's and boys' apparel	1.396	168.0	166.8	4.0	-.7	.6	.2	-.4
Women's and girls' apparel	1.701	154.1	153.0	1.5	-.7	-.8	-1.7	-.5
Infants' and toddlers' apparel 1/	.108	237.4	240.9	9.1	1.5	1.3	1.5	1.5
Footwear	.669	189.3	189.0	7.0	-.2	.2	.5	.2
Other apparel commodities 1/	.572	202.7	205.3	22.7	1.3	1.0	.4	1.3
Apparel services 1/	.662	232.2	233.6	14.1	.6	1.8	1.0	.6
Transportation	18.572	249.0	249.7	17.5	.3	.6	.3	-.2
Private transportation	17.506	249.2	249.7	17.1	.2	.6	.2	-.4
New cars	3.731	178.9	178.5	7.3	-.2	1.4	1.0	.1
Used cars	2.838	199.3	200.7	-3.9	.7	-1.8	-1.7	-1.1
Gasoline	5.619	375.4	376.2	42.0	.2	.0	-.6	-1.0
Maintenance and repair	1.473	266.1	267.3	10.5	.5	1.4	.8	.6
Other private transportation	3.845	224.5	225.0	14.0	.2	2.0	1.8	.4
Other private trans. commodities 1/	.712	195.3	195.5	13.8	.1	.7	.4	.1
Other private trans. services	3.133	234 5	235.0	14.1	.2	2.3	2.1	.5
Public transportation 1/	1.066	239.5	242.2	24.8	1.1	1.6	1.5	1.1
Medical care	4.817	263.4	264.7	11.4	.5	.7	.5	.5
Medical care commodities	.802	166.4	167.9	9.5	.9	.8	.9	.9
Medical care services 1/	4.015	284.7	285.9	11.7	.4	.7	.5	.4
Professional services 1/	1.911	250.3	251.8	11.6	.6	1.2	.6	.6
Other medical care services 1/	2.104	326.3	327.4	11.9	.3	.2	.2	.3
Entertainment	3.738	204.0	205.3	9.1	.6	.8	.6	.6
Entertainment commodities	2.214	207.0	208.3	10.4	.6	.8	.5	.5
Entertainment services 1/	1.523	200.1	201.4	7.2	.6	.8	.8	.6
Other goods and services	4.081	211.2	212.5	9.3	.6	.6	.8	.8
Tobacco products 1/	1.080	200.4	203.4	9.1	1.5	.2	.8	1.5
Personal care 1/	1.632	211.6	212.4	8.9	.4	.8	.9	.4
Toilet goods and personal care appliances 1/	.728	204.1	205.1	9.2	.5	.8	1.1	.5
Personal care services 1/	.905	218.8	219.6	8.7	.4	.7	.7	.4
Personal and educational expenses	1.369	229.2	229.5	9.8	.1	.6	.8	.5
School books and supplies	.174	207.1	207.1	8.1	.0	.7	.5	.5
Personal and educational services	1.195	234.7	235.0	10.0	.1	.6	.8	.5
Commodity and service group								
All items	100.000	244.9	247.6	14.3	1.1	0.9	0.9	1.0
Commodities	59.063	231.4	232.8	11.7	.6	.5	.3	.3
Food and beverages	18.685	244.1	245.7	7.2	.7	.5	.3	.5
Commodities less food and beverages	40.379	222.0	223.2	13.9	.5	.5	.4	.3
Nondurables less food and beverages	17.706	240.3	241.1	20.2	.3	.5	.2	.0
Apparel commodities	4.446	170.1	169.7	5.9	-.2	.1	-.4	-.1
Nondurables less food, beverages, and apparel	13.261	280.4	282.0	25.4	.6	.8	.3	.0
Durables	22.672	207.1	208.6	9.2	.7	.5	.6	.5
Services	40.937	269.2	274.2	18.1	1.9	1.5	1.6	1.8
Rent, residential 1/	5.273	188.9	191.1	9.4	1.2	.2	1.0	1.2
Household services less rent	21.692	319.6	328.8	24.3	2.9	2.0	2.1	2.7
Transportation services	5.473	241.5	242.6	15.0	.5	2.0	1.6	.7
Medical care services 1/	4.015	284.7	285.9	11.7	.4	.7	.5	.4
Other services	4.285	215.9	216.9	9.3	.5	.8	.8	.6
Special indexes:								
All items less food	82.345	242.6	245.5	15.9	1.2	1.1	1.0	1.1
All items less shelter	69.090	233.4	234.9	11.5	.6	.6	.5	.5
All items less mortgage interest costs	91.346	233.7	235.4	11.6	.7	.7	.6	.6
All items less home purchase and mortgage interest costs	80.950	232.0	233.5	11.2	.6	.7	.6	.5
All items less medical care	95.183	243.6	246.4	14.5	1.1	.9	.9	1.0
Commodities less food	41.408	220.2	221.4	13.7	.5	.5	.4	.3
Nondurables less food	18.736	235.5	236.3	19.6	.3	.6	.2	.1
Nondurables less food and apparel	14.290	267.9	269.3	24.1	.5	.7	.3	.1
Nondurables	36.391	243.2	244.5	13.4	.5	.5	.2	.3
Services less rent	33.664	284.4	290.0	19.5	2.0	1.7	1.7	1.9
Services less medical care 1/	36.921	265.7	271.0	18.9	2.0	1.6	1.6	2.0
Energy	10.313	363.2	367.8	33.4	1.3	.9	.8	.3
All items less energy	89.687	235.7	238.3	12.3	1.1	1.0	.9	1.0
All items less food and energy	72.032	231.0	233.7	13.4	1.2	1.1	1.0	1.1
Commodities less food and energy	34.488	199.9	201.2	8.9	.7	.7	.6	.6
Energy commodities	6.920	403.0	404.1	41.8	.3	.3	-.3	-.8
Services less energy	37.544	267.0	271.5	18.1	1.7	1.5	1.4	1.6
Purchasing power of the consumer dollar:								
1967=$1.00 1/	-	$.408	$.404	-12.6	-1.0	-1.2	-1.0	-1.0
1957-59=$1.00 1/	-	.351	.347	-	-	-	-	-

1/ Not seasonally adjusted.
NOTE: Index applies to a month as a whole, not to any specific date.

CPI-U

TABLE 2. Consumer Price Index for all urban consumers: Seasonally adjusted U.S. city average, by expenditure category and commodity and service group, 1967=100

Group	Seasonally adjusted indexes				Seasonally adjusted annual rate percent change for-					
					3 months ending in				6 months ending in	
	Mar. 1980	Apr. 1980	May 1980	June 1980	Sept. 1979	Dec. 1979	Mar. 1980	June 1980	Dec. 1979	June 1980
					Expenditure category					
All items	-	-	-	-	13.8	13.7	18.1	11.6	13.8	14.8
Food and beverages	240.8	242.1	242.9	244.2	6.5	11.9	4.3	5.8	9.1	5.0
Food	247.1	248.4	249.2	250.5	6.5	12.1	3.8	5.6	9.3	4.7
Food at home	243.5	244.5	245.1	246.0	5.3	12.3	2.0	4.2	8.7	3.1
Cereals and bakery products 1/	238.6	242.0	244.5	245.9	15.1	11.1	12.5	12.8	13.1	12.7
Meats, poultry, fish, and eggs	238.5	235.3	230.6	229.6	-13.2	20.2	-3.3	-14.1	2.1	-8.9
Dairy products	220.1	222.4	226.4	227.7	12.2	7.4	8.4	14.5	9.7	11.4
Fruits and vegetables	229.4	235.7	241.1	242.3	22.9	3.2	-17.1	24.5	12.7	1.6
Sugar and sweets 1/	313.5	319.5	326.8	342.0	6.8	3.7	47.2	41.6	5.3	44.4
Fats and oils	239.7	240.2	239.7	238.8	9.0	4.2	13.2	-1.5	6.6	5.6
Nonalcoholic beverages	387.9	388.0	388.7	390.8	26.3	17.3	6.4	3.0	21.8	4.7
Other prepared foods	223.2	225.7	228.9	231.1	11.2	5.9	12.5	14.9	8.5	13.7
Food away from home	260.6	262.5	263.8	266.1	9.0	11.6	10.1	8.7	10.3	9.4
Alcoholic beverages	181.5	183.5	184.7	186.0	5.9	10.0	6.9	10.3	8.0	8.6
Housing	254.8	258.2	262.2	267.0	15.9	17.4	19.5	20.6	16.7	20.0
Shelter	272.2	276.6	281.0	286.8	17.6	22.4	21.2	23.2	20.0	22.2
Rent, residential 1/	186.6	187.0	188.9	191.1	10.2	9.0	8.3	10.0	9.6	9.2
Other rental costs	258.1	261.0	261.9	263.7	12.4	15.2	18.5	9.0	13.8	13.6
Homeownership	302.7	308.5	314.0	321.1	19.5	25.6	24.1	26.6	22.5	25.3
Home purchase 1/	244.0	246.5	249.7	252.6	17.1	18.8	7.0	14.9	17.9	10.9
Financing, taxes, and insurance	381.4	392.6	402.5	418.2	25.3	38.1	43.9	44.5	31.5	44.2
Maintenance and repairs	279.8	283.6	285.5	285.2	10.9	-11.3	17.4	7.9	11.1	12.6
Maintenance and repair services	304.7	308.8	311.0	309.7	9.7	11.8	20.0	6.7	10.8	13.2
Maintenance and repair commodities 1/	221.4	224.3	225.8	228.0	14.6	10.0	9.2	12.5	12.3	10.8
Fuel and other utilities 1/	268.0	270.3	275.9	282.2	22.0	6.4	21.8	22.9	13.9	22.4
Fuels 1/	333.9	337.8	346.4	355.8	31.7	7.0	31.5	28.9	18.7	30.2
Fuel oil, coal, and bottled gas 1/	553.4	556.4	556.0	558.7	93.9	24.9	65.4	3.9	55.6	31.1
Gas (piped) and electricity 1/	284.0	288.0	298.2	308.8	16.6	1.0	21.0	39.8	8.6	30.0
Other utilities and public services 1/	161.9	162.3	163.1	164.9	1.5	5.4	.0	7.6	3.4	3.7
Household furnishings and operation	201.2	202.6	203.9	205.2	4.9	7.9	11.5	8.2	6.4	9.8
Housefurnishings	171.3	172.2	173.1	174.1	3.0	7.5	11.0	6.7	5.2	8.8
Housekeeping supplies 1/	238.0	240.7	243.6	245.4	4.8	9.4	16.3	13.0	7.1	14.6
Housekeeping services 1/	263.4	266.0	267.6	269.1	9.0	7.6	8.8	8.6	8.3	8.7
Apparel and upkeep	177.0	177.5	177.2	177.2	7.7	5.1	15.3	.5	6.4	7.6
Apparel commodities	170.4	170.5	169.8	169.7	7.2	4.0	14.9	-1.6	5.6	6.3
Men's and boys' apparel	165.9	166.9	167.3	166.6	4.3	4.5	5.2	1.7	4.4	3.4
Women's and girls' apparel	158.0	156.7	154.1	153.3	7.9	-3.6	15.2	-11.4	2.0	1.1
Infants' and toddlers' apparel 1/	231.4	234.3	237.4	240.9	4.6	6.8	7.8	17.5	5.7	12.5
Footwear	187.2	187.5	188.5	188.8	7.7	9.2	7.4	3.5	8.4	5.4
Other apparel commodities 1/	199.9	201.9	202.7	205.3	13.3	20.7	49.1	11.3	16.9	28.8
Apparel services 1/	225.9	230.0	232.2	233.6	11.0	12.7	18.3	14.3	11.9	16.3
Transportation	246.2	247.6	248.3	247.7	20.6	14.3	35.2	2.5	17.4	17.7
Private transportation	246.5	247.9	248.4	247.5	20.3	13.1	35.9	1.6	16.6	17.5
New cars	174.5	177.0	178.7	178.9	7.1	.0	12.3	10.5	3.5	11.4
Used cars	202.3	198.7	195.4	193.2	-4.9	10.5	-2.5	-16.8	2.5	-10.0
Gasoline	378.1	378.1	375.8	372.1	63.1	29.1	105.7	-6.2	45.1	38.9
Maintenance and repair	259.9	263.6	265.8	267.3	9.6	9.5	11.0	11.9	9.6	11.4
Other private transportation	215.8	220.2	224.2	225.2	11.2	8.3	18.3	18.6	9.7	18.5
Other private trans. commodities 1/	192.7	194.1	195.3	195.5	14.5	19.0	16.2	5.9	16.7	11.0
Other private trans. services	224.1	229.2	234.0	235.2	10.5	6.2	18.7	21.3	8.3	20.0
Public transportation 1/	232.1	235.9	239.5	242.2	25.2	39.5	17.3	18.6	32.1	18.0
Medical care	260.1	261.9	263.3	264.7	10.7	12.0	15.9	7.3	11.3	11.5
Medical care commodities	163.3	164.6	166.1	167.6	8.1	9.3	9.9	11.0	8.7	10.4
Medical care services 1/	281.5	283.4	284.7	285.9	11.2	12.6	16.9	6.4	11.9	11.5
Professional services 1/	245.3	248.2	250.3	251.8	8.4	10.1	16.9	11.0	9.2	13.9
Other medical care services 1/	325.3	325.8	326.3	327.2	13.6	15.1	17.0	2.4	14.4	9.4
Entertainment	200.6	202.2	203.5	204.7	7.7	5.3	15.0	8.4	6.5	11.7
Entertainment commodities	203.4	205.1	206.2	207.3	9.7	7.7	16.7	7.9	8.7	12.2
Entertainment services 1/	197.0	198.5	200.1	201.4	5.0	1.9	12.9	9.2	3.4	11.1
Other goods and services	208.9	210.1	211.8	213.4	12.2	5.1	10.6	8.9	8.6	9.8
Tobacco products 1/	198.4	198.8	200.4	203.4	10.0	2.5	13.8	10.5	6.2	12.1
Personal care 1/	208.1	209.7	211.6	212.4	8.5	8.3	10.4	8.5	8.4	9.5
Toilet goods and personal care appliances 1/	200.2	201.8	204.1	205.1	7.7	9.5	9.3	10.2	8.6	9.7
Personal care services 1/	215.7	217.2	218.8	219.6	9.0	7.2	11.3	7.4	8.1	9.4
Personal and educational expenses	228.2	229.5	231.3	232.5	18.3	3.5	10.3	7.8	10.7	9.0
School books and supplies	206.1	207.5	208.6	209.6	24.0	-7.8	11.4	7.0	6.9	9.2
Personal and educational services	233.6	234.9	236.8	238.1	17.7	5.2	9.8	7.9	11.3	8.9
					Commodity and service group					
All items	-	-	-	-	13.8	13.7	18.1	11.6	13.8	14.8
Commodities	228.6	230.0	230.8	231.6	13.3	12.5	16.1	5.0	12.9	10.4
Food and beverages	240.8	242.1	242.9	244.2	6.5	11.9	4.3	5.8	9.1	5.0
Commodities less food and beverages	219.7	220.8	221.6	222.2	16.8	12.8	22.6	4.6	14.8	13.2
Nondurables less food and beverages	238.7	240.0	240.5	240.6	26.2	12.8	42.2	-3.2	19.3	21.1
Apparel commodities	170.4	170.5	169.8	169.7	7.2	4.0	14.9	-1.6	5.6	6.3
Nondurables less food, beverages, and apparel	278.0	280.2	281.0	280.9	34.4	16.2	51.9	4.2	25.0	25.8
Durables	204.0	205.1	206.3	207.4	9.1	13.2	7.6	6.8	11.1	7.2
Services	261.6	265.6	269.8	274.7	14.3	15.8	20.9	21.6	15.1	21.2
Rent, residential 1/	186.6	187.0	188.9	191.1	10.2	9.0	8.3	10.0	9.6	9.2
Household services less rent	308.1	314.4	320.9	329.5	17.3	21.2	28.5	30.8	19.3	29.6
Transportation services	232.6	237.2	241.1	242.7	12.7	12.7	16.3	18.5	12.7	17.4
Medical care services 1/	281.5	283.4	284.7	285.9	11.2	12.6	16.9	6.4	11.9	11.5
Other services	212.9	214.7	216.4	217.7	10.2	5.6	12.3	9.3	7.9	10.8
Special indexes:										
All items less food	237.8	240.3	242.6	245.2	15.4	14.2	21.7	13.0	14.8	17.3
All items less shelter	230.5	231.7	232.9	234.0	12.1	10.2	17.1	6.6	11.2	11.7
All items less mortgage interest costs	230.3	231.8	233.2	234.5	12.3	11.8	14.8	7.5	12.0	11.1
All items less home purchase and mortgage interest costs	228.7	230.2	231.5	232.6	11.3	10.4	15.9	7.0	10.9	11.4
All items less medical care	239.1	241.3	243.4	245.8	13.9	14.0	18.4	11.7	14.0	15.0
Commodities less food	217.9	219.0	219.8	220.4	16.4	12.7	22.1	4.7	14.5	13.0
Nondurables less food	233.6	235.1	235.5	235.8	25.2	12.8	39.8	3.5	18.9	20.3
Nondurables less food and apparel	265.4	267.3	268.2	268.5	32.1	15.7	48.3	4.8	23.6	24.6
Nondurables	240.8	242.0	242.5	243.3	16.2	12.6	21.4	4.2	14.4	12.5
Services less rent	275.7	280.4	285.1	290.5	14.9	16.9	22.8	23.3	15.9	23.0
Services less medical care 1/	257.4	261.5	265.7	271.0	16.2	15.3	22.2	22.9	15.8	22.1
Energy	357.9	361.0	363.9	366.9	49.9	19.2	64.8	8.1	33.7	33.4
All items less energy	231.0	233.4	235.5	237.8	10.6	13.5	12.9	12.3	12.1	12.6
All items less food and energy	226.2	228.7	231.0	233.5	10.9	13.9	15.7	13.5	12.4	14.6
Commodities less food and energy	197.1	198.4	199.5	200.6	8.3	10.4	9.7	7.3	9.3	8.5
Energy commodities	404.2	405.5	404.2	400.9	67.9	26.7	96.5	-3.2	45.8	37.9
Services less energy	253.9	263.9	267.6	272.0	14.2	17.1	21.0	20.0	15.7	20.5

1/ Not seasonally adjusted.
NOTE: Index applies to a month as a whole, not to any specific date.

TABLE 3. Consumer Price Index for all urban consumers: Selected areas, all items index, 1967=100 unless otherwise noted

Area 1/	Pricing schedule 2/	Other index base	Indexes				Percent change to June 1980 from-			Percent change to May 1980 from-		
			Mar. 1980	Apr. 1980	May 1980	June 1980	June 1979	Apr. 1980	May 1980	May 1979	Mar. 1980	Apr. 1980
U.S. city average			239.8	242.5	244.9	247.6	14.3	2.1	1.1	14.4	2.1	1.0
Chicago, Ill.-Northwestern Ind.	M		235.5	240.1	243.1	248.2	16.3	3.4	2.1	15.7	3.2	1.2
Detroit, Mich.	M		242.9	248.2	248.4	256.7	19.2	3.4	3.3	16.1	2.3	.1
L.A.-Long Beach, Anaheim, Calif.	M		241.3	244.6	249.1	250.1	17.5	2.2	.4	18.1	3.2	1.8
N.Y., N.Y.-Northeastern N.J.	M		231.2	233.1	234.5	237.2	11.6	1.8	1.2	11.4	1.4	.6
Philadelphia, Pa.-N.J.	M		234.6	237.4	239.4	242.5	13.4	2.1	1.3	13.7	2.0	.8
Anchorage, Alaska	1	10/67	223.5	-	226.5	-	-	-	-	11.3	1.3	-
Baltimore, Md.	1		245.0	-	249.1	-	-	-	-	15.7	1.7	-
Boston, Mass.	1		234.2	-	236.9	-	-	-	-	13.1	1.2	-
Cincinnati, Ohio-Ky.-Ind.	1		247.8	-	251.6	-	-	-	-	13.6	1.5	-
Denver-Boulder, Colo.	1		255.2	-	258.0	-	-	-	-	11.6	1.1	-
Miami, Fla.	1	11/77	127.7	-	129.7	-	-	-	-	15.3	1.6	-
Milwaukee, Wis.	1		242.7	-	250.3	-	-	-	-	15.3	3.1	-
Northeast Pennsylvania	1		229.0	-	232.5	-	-	-	-	12.2	1.5	-
Portland, Oreg.-Wash.	1		253.6	-	257.3	-	-	-	-	16.6	1.5	-
St. Louis, Mo.-Ill.	1		238.1	-	241.8	-	-	-	-	14.5	1.6	-
San Diego, Calif.	1		258.3	-	269.7	-	-	-	-	18.1	4.4	-
Seattle-Everett, Wash.	1		243.8	-	249.6	-	-	-	-	17.5	2.4	-
Washington, D.C.-Md.-Va.	1		238.8	-	241.2	-	-	-	-	11.7	1.0	-
Atlanta, Ga.	2		-	235.3	-	242.2	13.9	-2.9	-	-	-	-
Buffalo, N.Y.	2		-	233.7	-	235.4	12.5	.7	-	-	-	-
Cleveland, Ohio	2		-	247.3	-	250.1	13.7	1.1	-	-	-	-
Dallas-Fort Worth, Tex.	2		-	251.4	-	256.4	17.9	2.0	-	-	-	-
Honolulu, Hawaii	2		-	227.4	-	227.5	11.3	.0	-	-	-	-
Houston, Tex.	2		-	260.8	-	266.5	13.2	2.2	-	-	-	-
Kansas City, Mo.-Kans.	2		-	243.8	-	247.8	12.9	1.6	-	-	-	-
Minneapolis-St.Paul, Minn.-Wis.	2		-	244.3	-	246.4	10.8	.9	-	-	-	-
Pittsburgh, Pa.	2		-	240.9	-	246.1	14.7	2.2	-	-	-	-
San Francisco-Oakland, Calif.	2		-	243.5	-	248.0	16.7	1.8	-	-	-	-
Region 3/												
Northeast	2	12/77	-	126.8	-	129.1	13.0	1.8	-	-	-	-
North Central	2	12/77	-	131.3	-	134.7	14.4	2.6	-	-	-	-
South	2	12/77	-	130.8	-	133.4	13.9	2.0	-	-	-	-
West	2	12/77	-	132.7	-	135.5	16.1	2.1	-	-	-	-
Population size class 3/												
A-1	2	12/77	-	128.9	-	131.9	14.8	2.3	-	-	-	-
A-2	2	12/77	-	131.1	-	133.7	14.4	2.0	-	-	-	-
B	2	12/77	-	131.6	-	134.2	14.2	2.0	-	-	-	-
C	2	12/77	-	130.9	-	133.3	13.7	1.8	-	-	-	-
D	2	12/77	-	128.6	-	132.0	14.0	2.6	-	-	-	-
Region/population size class cross classification 3/												
Northeast/A	2	12/77	-	125.0	-	127.1	12.3	1.7	-	-	-	-
North Central/A	2	12/77	-	133.2	-	136.7	15.7	2.6	-	-	-	-
South/A	2	12/77	-	130.7	-	133.5	14.2	2.1	-	-	-	-
West/A	2	12/77	-	132.8	-	136.1	17.3	2.5	-	-	-	-
Northeast/B	2	12/77	-	129.0	-	131.0	13.6	1.6	-	-	-	-
North Central/B	2	12/77	-	130.9	-	134.4	13.9	2.7	-	-	-	-
South/B	2	12/77	-	131.7	-	134.7	14.6	2.3	-	-	-	-
West/B	2	12/77	-	134.1	-	136.0	14.6	1.4	-	-	-	-
Northeast/C	2	12/77	-	132.7	-	135.6	15.7	2.2	-	-	-	-
North Central/C	2	12/77	-	128.9	-	131.9	12.9	2.3	-	-	-	-
South/C	2	12/77	-	131.3	-	133.1	13.3	1.4	-	-	-	-
West/C	2	12/77	-	131.4	-	133.6	14.3	1.7	-	-	-	-
Northeast/D	2	12/77	-	127.4	-	131.0	13.4	2.8	-	-	-	-
North Central/D	2	12/77	-	128.7	-	131.9	13.1	2.5	-	-	-	-
South/D	2	12/77	-	128.3	-	131.4	13.7	2.4	-	-	-	-
West/D	2	12/77	-	130.4	-	134.3	16.7	3.0	-	-	-	-

1/ Area is generally the Standard Metropolitan Statistical Area (SMSA), exclusive of farms. L.A.-Long Beach, Anaheim, Calif. is a combination of two SMSA's, and N.Y., N.Y.-Northeastern N.J. and Chicago, Ill.-Northwestern Ind. are the more extensive Standard Consolidated Areas. Area definitions are those established by the Office of Management and Budget in 1973, except for Denver-Boulder, Colo. which does not include Douglas County. Definitions do not include revisions made since 1973.

2/ Foods, fuels, and several other items priced every month in all areas; most other goods and services priced as indicated:
M - Every month.
1 - January, March, May, July, September, and November.
2 - February, April, June, August, October, and December.

3/ Regions are defined as the four Census regions.
The population size classes are aggregations of areas which have urban population as defined below:
A-1 More than 4,000,000.
A-2 1,250,000 to 4,000,000.
B 385,000 to 1,250,000.
C 75,000 to 385,000.
D Less than 75,000.
Population size class A is the aggregation of population size classes A-1 and A-2.

NOTE: Price changes within areas are found in the Consumer Price Index; differences in living costs among areas are found in Family Budgets.

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TABLE 4. Consumer Price Index for urban wage earners and clerical workers: U.S. city average, by expenditure category and commodity and service group, 1967=100

Group	Relative importance, December 1979	Unadjusted indexes May 1980	Unadjusted indexes June 1980	Unadjusted percent change to June 1980 from- June 1979	Unadjusted percent change to June 1980 from- May 1980	Seasonally adjusted percent change from- Mar. to Apr.	Seasonally adjusted percent change from- Apr. to May	Seasonally adjusted percent change from- May to June
				Expenditure category				
All items	100.000	245.1	247.8	14.2	1.1	1.0	0.9	0.9
All items (1957-59=100)	-	285.1	288.2	-	-	-	-	-
Food and beverages	20.353	244.7	246.4	7.5	.7	.7	.5	.5
Food	19.237	251.0	252.7	7.3	.7	.6	.4	.5
Food at home	13.427	246.1	247.7	6.0	.7	.5	.3	.3
Cereals and bakery products 1/	1.683	244.4	245.7	12.6	.5	1.2	.9	.5
Meats, poultry, fish, and eggs	4.663	230.7	230.4	-3.6	-.1	-1.2	-2.0	-.5
Dairy products	1.810	226.9	227.8	10.6	.4	1.0	1.8	.5
Fruits and vegetables	1.762	245.5	250.2	8.1	1.9	3.6	2.6	.6
Sugar and sweets 1/	.447	328.0	342.9	24.0	4.5	2.1	2.2	4.5
Fats and oils	.376	240.1	240.5	6.1	.2	-.2	.3	-.5
Nonalcoholic beverages	1.557	392.3	395.1	13.4	.7	.3	.3	.6
Other prepared foods	1.129	229.6	230.8	11.0	.5	1.2	1.5	.8
Food away from home	5.810	267.6	269.9	10.4	.9	.8	.8	1.0
Alcoholic beverages	1.116	186.9	188.0	9.0	.6	1.1	.9	.7
Housing	41.667	261.7	266.9	18.4	2.0	1.4	1.5	1.9
Shelter	28.038	281.6	288.0	21.4	2.3	1.7	1.6	2.2
Rent, residential 1/	4.982	188.7	190.8	9.2	1.1	.3	1.0	1.1
Other rental costs	.502	261.7	263.9	13.8	.8	.9	.5	.6
Homeownership	22.553	315.4	323.4	24.4	2.5	2.0	1.8	2.5
Home purchase 1/	9.157	249.8	253.0	14.6	1.3	1.1	1.3	1.3
Financing, taxes, and insurance	10.163	404.9	422.0	38.7	4.2	3.0	2.5	4.1
Maintenance and repairs	3.254	283.4	283.8	10.6	.1	1.2	.5	-.1
Maintenance and repair services	2.322	309.1	308.5	10.1	-.2	1.3	.4	-.6
Maintenance and repair commodities 1/	.931	226.5	228.8	11.7	1.0	.9	1.0	1.0
Fuel and other utilities 1/	6.375	276.4	283.0	18.2	2.4	.9	2.0	2.4
Fuels 1/	4.584	346.0	355.8	24.4	2.8	1.1	2.5	2.8
Fuel oil, coal, and bottled gas 1/	1.209	557.1	559.8	43.0	.5	.5	.0	.5
Gas (piped) and electricity 1/	3.375	297.5	308.5	18.7	3.7	1.3	3.4	3.7
Other utilities and public services 1/	1.788	163.1	164.9	3.6	1.1	.2	.5	1.1
Household furnishings and operation	7.256	201.9	202.9	7.5	.5	.7	.6	.5
Housefurnishings	4.231	172.2	172.9	6.2	.4	.5	.5	.4
Housekeeping supplies 1/	1.499	241.2	243.0	10.5	.7	1.1	1.3	.7
Housekeeping services 1/	1.527	265.6	267.0	8.1	.5	.6	.5	.5
Apparel and upkeep	5.114	176.8	176.0	6.5	-.5	.3	.1	-.3
Apparel commodities	4.489	169.8	168.8	5.5	-.6	.1	-.2	-.4
Men's and boys' apparel	1.391	168.9	168.1	4.5	-.5	.7	.5	-.1
Women's and girls' apparel	1.719	154.1	151.2	.9	-1.9	-.8	-1.0	-1.9
Infants' and toddlers' apparel 1/	.124	242.8	246.8	10.2	1.6	1.6	.7	1.6
Footwear	.706	189.3	188.9	7.3	-.2	.5	.5	.1
Other apparel commodities 1/	.550	197.4	201.0	19.8	1.8	.4	-.6	1.8
Apparel services 1/	.625	230.8	231.8	13.9	.4	1.1	2.1	.4
Transportation	20.902	249.9	250.6	17.3	.3	.6	.2	-.3
Private transportation	19.962	250.1	250.8	17.1	.3	.6	.2	-.3
New cars	3.946	179.6	179.4	8.1	-.1	1.6	1.1	.2
Used cars	3.622	199.3	200.8	-3.9	.8	-1.7	-1.7	-1.1
Gasoline	6.429	377.1	377.6	41.8	.1	-.1	-.6	-1.1
Maintenance and repair	1.621	266.1	268.0	10.6	.7	1.2	.8	.9
Other private transportation	4.344	226.7	227.3	15.0	.3	2.6	2.0	.6
Other private trans. commodities 1/	.794	196.7	196.8	14.0	.1	1.3	.5	.1
Other private trans. services	3.550	236.8	237.6	15.2	.3	2.8	2.3	.8
Public transportation 1/	.940	232.9	234.9	20.6	.9	1.6	1.4	.9
Medical care	4.372	264.9	265.9	11.6	.4	.8	.6	.4
Medical care commodities	.731	167.2	168.5	9.1	.8	.9	.6	.8
Medical care services 1/	3.641	286.3	287.3	12.2	.3	.8	.6	.3
Professional services 1/	1.843	253.5	255.1	12.2	.6	1.4	.9	.6
Other medical care services 1/	1.798	326.5	326.5	12.1	.0	.3	.4	.0
Entertainment	3.556	202.4	204.0	8.8	.8	.8	.5	.7
Entertainment commodities	2.248	203.4	204.5	9.1	.5	1.0	.3	.4
Entertainment services 1/	1.308	201.8	204.3	8.2	1.2	.4	1.0	1.2
Other goods and services	4.035	210.6	212.1	9.2	.7	.5	.8	.8
Tobacco products 1/	1.306	200.5	203.6	9.2	1.5	.2	.8	1.5
Personal care 1/	1.684	210.9	211.8	8.8	.4	.9	.7	.4
Toilet goods and personal care appliances 1/	.796	203.9	204.5	8.9	.3	1.1	1.0	.3
Personal care services 1/	.888	218.1	219.1	8.8	.5	.6	.4	.5
Personal and educational expenses	1.046	229.4	229.8	9.6	.2	.6	.7	.6
School books and supplies	.156	210.9	210.9	8.6	.0	.6	.6	.6
Personal and educational services	.890	234.2	234.8	9.9	.3	.6	.8	.7
				Commodity and service group				
All items	100.000	245.1	247.8	14.2	1.1	1.0	0.9	0.9
Commodities	61.878	231.7	233.0	11.6	.6	.5	.3	.3
Food and beverages	20.353	244.7	246.4	7.5	.7	.7	.5	.5
Commodities less food and beverages	41.524	222.3	223.4	13.8	.5	.5	.3	.2
Nondurables less food and beverages	18.832	242.6	243.2	20.6	.2	.5	.2	.0
Apparel commodities	4.489	169.8	168.8	5.5	-.6	.1	-.2	-.4
Nondurables less food, beverages, and apparel	14.343	282.7	284.1	25.8	.5	.7	.3	-.1
Durables	22.692	205.4	206.8	8.4	.7	.6	.6	.4
Services	38.122	269.9	275.1	18.4	1.9	1.6	1.7	1.9
Rent, residential 1/	4.982	188.7	190.8	9.2	1.1	.3	1.0	1.1
Household services less rent	19.677	322.2	331.9	25.0	3.0	2.0	2.1	2.9
Transportation services	6.111	241.5	242.7	14.7	.5	2.2	1.8	.8
Medical care services 1/	3.641	286.3	287.3	12.2	.3	.8	.6	.3
Other services	3.711	216.5	217.9	9.7	.6	.6	1.0	.8
Special indexes:								
All items less food	80.763	242.9	245.7	15.9	1.2	1.0	1.0	1.0
All items less shelter	71.962	234.2	235.7	11.5	.6	.6	.6	.4
All items less mortgage interest costs	91.812	234.3	236.0	11.6	.7	.7	.6	.6
All items less home purchase and mortgage interest costs	82.675	232.9	234.3	11.3	.6	.7	.6	.4
All items less medical care	95.628	243.7	246.5	14.3	1.1	1.0	.9	.9
Commodities less food	42.641	220.5	221.6	13.7	.5	.5	.4	.2
Nondurables less food	19.948	237.7	238.3	20.0	.3	.5	.2	.0
Nondurables less food and apparel	15.459	270.0	271.4	24.5	.5	.7	.3	.0
Nondurables	39.185	244.6	245.7	13.6	.4	.5	.4	.2
Services less rent	33.140	285.4	291.2	19.8	2.0	1.8	1.7	2.0
Services less medical care 1/	34.481	266.3	271.8	19.1	2.1	1.6	1.7	2.1
Energy	11.115	367.3	371.8	34.1	1.2	.8	.6	.3
All items less energy	88.885	235.1	237.6	11.9	1.1	1.1	.9	.9
All items less food and energy	69.648	230.0	232.7	13.2	1.2	1.2	1.0	1.2
Commodities less food and energy	34.900	198.6	199.8	8.3	.6	.6	.6	.5
Energy commodities	7.740	404.7	405.6	41.7	.2	.3	-.3	-.9
Services less energy	34.747	267.8	272.5	18.4	1.8	1.6	1.5	1.8
Purchasing power of the consumer dollar:								
1967=$1.00 1/	-	$.408	$.404	-12.4	-1.0	-1.2	-1.0	-1.0
1957-59=$1.00 1/	-	.351	.347	-	-	-	-	-

1/ Not seasonally adjusted.
NOTE: Index applies to a month as a whole, not to any specific date.

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TABLE 5. Consumer Price Index for urban wage earners and clerical workers: Seasonally adjusted U.S. city average, by expenditure category and commodity and service group, 1967=100

Group	Seasonally adjusted indexes: Mar. 1980	Apr. 1980	May 1980	June 1980	Seasonally adjusted annual rate percent change for— 3 months ending in: Sept. 1979	Dec. 1979	Mar. 1980	June 1980	6 months ending in: Dec. 1979	June 1980
Expenditure category										
All items	-	-	-	-	13.6	13.7	18.1	11.4	13.7	14.7
Food and beverages	241.0	242.6	243.7	245.0	6.5	12.1	4.3	6.8	9.2	5.5
Food	247.3	248.8	249.9	251.2	6.5	12.1	4.0	6.5	9.3	5.2
Food at home	242.9	244.2	244.9	245.7	5.3	12.5	1.8	4.7	8.8	3.3
Cereals and bakery products 1/	239.3	242.2	244.4	245.7	16.3	10.4	12.6	11.1	13.3	11.9
Meats, poultry, fish, and eggs	237.6	234.8	230.0	228.8	-13.0	20.2	-3.9	-14.0	2.3	-9.1
Dairy products	220.9	223.1	227.1	228.3	12.4	7.5	8.8	14.1	9.9	11.4
Fruits and vegetables	226.7	234.9	240.9	242.4	23.6	3.1	-18.0	30.7	12.9	3.6
Sugar and sweets 1/	314.1	320.8	328.0	342.9	6.8	4.2	49.4	42.0	5.5	45.7
Fats and oils	240.2	239.7	240.3	239.1	7.1	6.8	12.9	-1.8	7.0	5.3
Nonalcoholic beverages	385.6	386.9	388.0	390.4	25.1	16.8	7.6	5.1	20.8	6.3
Other prepared foods	223.1	225.7	229.1	231.0	10.6	6.3	12.3	14.9	8.4	13.6
Food away from home	262.7	264.8	266.8	269.4	9.2	11.7	10.5	10.6	10.4	10.6
Alcoholic beverages	182.6	184.6	186.3	187.6	6.9	10.0	7.8	11.4	8.4	9.6
Housing	254.6	258.1	262.0	267.1	16.1	17.0	19.3	21.1	16.6	20.2
Shelter	273.2	277.8	282.3	288.5	17.7	22.7	21.2	24.4	20.2	22.7
Rent, residential 1/	186.4	186.9	188.7	190.8	10.0	8.8	8.4	9.8	9.4	9.1
Other rental costs	258.1	260.5	261.7	263.4	12.3	15.6	19.2	8.5	13.9	13.7
Homeownership	304.7	310.8	316.3	324.1	19.9	26.2	24.1	28.0	23.0	26.0
Home purchase 1/	243.8	246.5	249.8	253.0	17.7	19.0	6.1	16.0	18.3	10.9
Financing, taxes, and insurance	385.6	397.3	407.3	424.1	25.7	39.2	44.7	46.3	32.3	45.5
Maintenance and repairs	279.0	282.3	283.8	283.4	10.0	10.6	15.0	6.5	10.3	10.7
Maintenance and repair services	304.7	308.6	309.7	307.9	9.2	11.1	16.2	4.3	10.1	10.1
Maintenance and repair commodities 1/	222.3	224.3	226.5	228.8	12.0	9.8	12.6	12.2	10.9	12.4
Fuel and other utilities 1/	268.7	271.0	276.4	283.0	22.2	6.5	21.9	23.0	14.1	22.5
Fuels 1/	333.9	337.6	346.0	355.8	31.9	7.0	31.5	28.9	18.8	30.2
Fuel oil, coal, and bottled gas 1/	554.1	557.1	557.1	559.8	94.6	25.0	64.9	4.2	55.9	31.1
Gas (piped) and electricity 1/	283.9	287.6	297.5	308.5	16.5	1.2	21.0	39.4	8.6	29.9
Other utilities and public services 1/	161.9	162.3	163.1	164.9	1.5	5.1	.2	7.6	3.3	3.9
Household furnishings and operation	199.0	200.4	201.6	202.7	4.8	6.7	11.2	7.6	5.7	9.4
Housefurnishings	170.1	171.0	171.9	172.6	3.2	5.2	10.8	6.0	4.2	8.4
Housekeeping supplies 1/	235.5	238.1	241.2	243.0	5.0	8.5	15.4	13.4	6.7	14.4
Housekeeping services 1/	262.7	264.3	265.6	267.0	8.5	8.8	8.3	6.7	8.7	7.5
Apparel and upkeep	176.0	176.5	176.7	176.1	6.9	4.6	14.9	.2	5.8	7.3
Apparel commodities	169.7	169.9	169.6	168.9	6.4	4.0	14.1	-1.9	5.2	5.8
Men's and boys' apparel	166.2	167.3	168.2	168.1	3.8	3.5	6.0	4.7	3.6	5.3
Women's and girls' apparel	157.1	155.9	154.4	151.5	5.2	-2.3	16.5	-13.5	1.3	.4
Infants' and toddlers' apparel 1/	237.3	241.1	242.8	246.8	3.8	8.2	12.3	17.0	6.0	14.6
Footwear	186.5	187.5	188.5	188.7	8.0	9.2	7.2	4.8	8.6	6.0
Other apparel commodities 1/	197.8	198.5	197.4	201.0	18.0	19.6	36.8	6.6	18.8	20.8
Apparel services 1/	223.5	226.0	230.8	231.8	10.4	9.3	20.3	15.7	9.9	18.0
Transportation	246.9	248.5	249.1	248.4	20.3	14.7	34.9	2.5	17.4	17.6
Private transportation	247.3	248.8	249.3	248.5	20.5	13.6	35.8	2.0	17.0	17.7
New cars	174.9	177.7	179.6	179.9	7.7	.5	13.1	11.9	4.0	12.5
Used cars	202.3	198.8	195.4	193.3	-4.9	10.7	-2.7	-16.6	2.6	-10.0
Gasoline	379.9	379.7	377.5	373.5	63.5	29.4	105.2	-6.6	45.4	38.5
Maintenance and repair	260.4	263.5	265.6	268.0	9.8	10.7	9.9	12.2	10.2	11.1
Other private transportation	216.3	221.9	226.3	227.7	11.8	8.9	17.2	22.8	10.4	20.0
Other private trans. commodities 1/	193.2	195.8	196.7	196.8	14.9	18.4	15.4	7.7	16.6	11.5
Other private trans. services	224.6	231.0	236.3	238.1	11.1	7.0	17.6	26.3	9.0	21.8
Public transportation 1/	226.1	229.7	232.9	234.9	20.5	32.8	13.4	16.5	26.3	14.9
Medical care	260.9	263.0	264.7	265.8	11.7	12.1	15.3	7.7	11.9	11.4
Medical care commodities	164.2	165.7	166.7	168.0	7.5	9.0	10.1	9.6	8.2	9.8
Medical care services 1/	282.2	284.5	286.3	287.3	12.6	12.7	16.2	7.4	12.6	11.7
Professional services 1/	247.8	251.2	253.5	255.1	10.6	9.2	16.9	12.3	9.9	14.6
Other medical care services 1/	324.4	325.3	326.5	326.5	14.6	16.5	15.4	2.6	15.5	8.8
Entertainment	199.4	200.9	202.0	203.5	7.0	4.5	15.4	8.5	5.7	11.9
Entertainment commodities	200.1	202.2	202.8	203.7	7.5	5.6	16.5	7.4	6.5	11.9
Entertainment services 1/	199.1	199.9	201.8	204.3	6.5	2.5	13.3	10.9	4.5	12.1
Other goods and services	208.3	209.4	211.0	212.7	11.1	5.1	11.5	8.7	8.1	10.1
Tobacco products 1/	198.6	198.9	200.5	203.6	9.8	2.5	14.2	10.5	6.1	12.3
Personal care 1/	207.7	209.5	210.9	211.8	8.0	8.1	11.1	8.1	8.1	9.6
Toilet goods and personal care appliances 1/	199.6	201.8	203.9	204.5	7.0	7.5	10.9	10.2	7.3	10.5
Personal care services 1/	215.8	217.2	218.1	219.1	9.0	8.8	11.1	6.3	8.9	8.6
Personal and educational expenses	228.1	229.5	231.2	232.6	18.3	3.3	9.5	8.1	10.5	8.8
School books and supplies	209.9	211.1	212.4	213.7	25.3	-7.5	11.9	7.4	7.7	9.6
Personal and educational services	232.9	234.3	236.1	237.7	17.3	5.5	8.9	8.5	11.1	8.7
Commodity and service group										
All items	-	-	-	-	13.6	13.7	18.1	11.4	13.7	14.7
Commodities	229.1	230.3	231.1	231.8	13.3	12.3	16.7	4.8	12.8	10.6
Food and beverages	241.0	242.6	243.7	245.0	6.5	12.1	4.3	6.8	9.2	5.5
Commodities less food and beverages	220.1	221.1	221.8	222.2	16.5	12.6	23.7	3.9	14.5	13.4
Nondurables less food and beverages	241.0	242.2	242.8	242.7	27.5	12.7	43.5	2.9	19.8	21.5
Apparel commodities	169.7	169.9	169.6	168.9	6.4	4.0	14.1	-1.9	5.2	5.8
Nondurables less food, beverages, and apparel	280.4	282.5	283.3	283.0	35.6	15.9	53.5	3.8	25.3	26.2
Durables	202.2	203.5	204.8	205.6	8.0	11.9	7.0	6.9	9.9	7.0
Services	261.8	266.0	270.4	275.6	14.5	15.8	20.5	22.8	15.1	21.6
Rent, residential 1/	186.4	186.9	188.7	190.8	10.0	8.8	8.4	9.8	9.4	9.1
Household services less rent	310.4	316.7	323.3	332.8	17.8	21.8	28.9	32.1	19.7	30.5
Transportation services	231.7	236.9	241.1	243.0	12.0	11.5	14.9	21.0	11.8	17.9
Medical care services 1/	282.2	284.5	286.3	287.3	12.6	12.7	16.2	7.4	12.6	11.7
Other services	213.5	214.8	216.9	218.6	10.2	5.8	12.9	9.9	8.0	11.4
Special indexes:										
All items less food	238.1	240.5	242.8	245.3	15.4	14.0	22.3	12.7	14.7	17.4
All items less shelter	230.9	232.4	233.7	234.7	12.1	10.4	17.2	6.7	11.2	11.9
All items less mortgage interest costs	230.7	232.4	233.8	235.1	12.1	11.3	15.0	7.8	11.7	11.3
All items less home purchase and mortgage interest costs	229.5	231.0	232.4	233.4	11.5	10.2	16.3	7.0	10.9	11.5
All items less medical care	239.1	241.4	243.5	245.8	13.7	13.6	18.6	11.7	13.7	15.1
Commodities less food	218.2	219.3	220.1	220.5	15.4	12.5	23.0	4.3	14.4	13.2
Nondurables less food	236.0	237.2	237.7	237.8	26.0	12.8	41.5	3.1	19.2	20.8
Nondurables less food and apparel	267.6	269.5	270.3	270.3	33.3	15.4	49.8	4.1	24.0	24.9
Nondurables	241.9	243.1	244.1	244.5	16.3	12.5	21.9	4.4	14.4	12.8
Services less rent	276.1	281.1	286.0	291.8	15.1	17.0	22.4	24.8	16.0	23.6
Services less medical care 1/	257.7	261.9	266.3	271.8	16.1	15.3	21.4	23.7	15.7	22.6
Energy	362.5	365.5	367.7	368.8	51.1	20.0	66.5	7.1	34.6	35.6
All items less energy	230.2	232.7	234.9	237.1	9.8	12.9	12.5	12.5	11.4	12.5
All items less food and energy	225.1	227.7	230.0	232.7	10.3	13.3	15.1	14.2	11.8	14.7
Commodities less food and energy	195.9	197.1	198.2	199.2	7.4	9.3	9.7	6.9	8.3	8.3
Energy commodities	406.0	407.3	405.9	402.4	67.3	27.2	96.5	-3.5	45.9	37.7
Services less energy	260.2	264.4	268.3	273.0	14.2	17.5	20.6	21.2	15.8	20.9

1/ Not seasonally adjusted.
NOTE: Index applies to a month as a whole, not to any specific date.

TABLE 6. Consumer Price Index for urban wage earners and clerical workers: Selected areas, all items index, 1967=100 unless otherwise noted

Area 1/	Pricing schedule 2/	Other index base	Indexes: Mar. 1980	Indexes: Apr. 1980	Indexes: May 1980	Indexes: June 1980	Percent change to June 1980 from-: June 1979	Percent change to June 1980 from-: Apr. 1980	Percent change to June 1980 from-: May 1980	Percent change to May 1980 from-: May 1979	Percent change to May 1980 from-: Mar. 1980	Percent change to May 1980 from-: Apr. 1980
U.S. city average			239.9	242.6	245.1	247.8	14.2	2.1	1.1	14.4	2.2	1.0
Chicago, Ill.-Northwestern Ind.	M		235.2	239.8	243.0	248.0	16.3	3.4	2.1	15.9	3.3	1.3
Detroit, Mich.	M		242.4	248.0	248.9	255.8	18.7	3.1	2.8	16.3	2.7	.4
L.A.-Long Beach, Anaheim, Calif.	M		243.9	247.8	252.6	253.4	18.1	2.3	.3	18.9	3.6	1.9
N.Y., N.Y.-Northeastern N.J.	M		230.8	232.4	234.1	236.7	11.5	1.9	1.1	11.3	1.4	.7
Philadelphia, Pa.-N.J.	M		235.1	237.9	239.9	243.8	13.7	-2.5	1.6	13.5	2.0	.8
Anchorage, Alaska	1	10/67	220.2	-	223.1	-	-	-	-	10.2	1.3	-
Baltimore, Md.	1		243.9	-	247.8	-	-	-	-	14.7	1.6	-
Boston, Mass.	1		234.2	-	236.8	-	-	-	-	13.5	1.1	-
Cincinnati, Ohio-Ky.-Ind.	1		249.7	-	252.9	-	-	-	-	13.4	1.3	-
Denver-Boulder, Colo.	1		259.4	-	262.4	-	-	-	-	12.5	1.2	-
Miami, Fla.	1	11/77	128.8	-	130.9	-	-	-	-	15.0	1.6	-
Milwaukee, Wis.	1		247.8	-	255.2	-	-	-	-	16.3	3.0	-
Northeast Pennsylvania	1		231.3	-	235.8	-	-	-	-	12.5	1.9	-
Portland, Oreg.-Wash.	1		251.7	-	255.9	-	-	-	-	15.3	1.7	-
St. Louis, Mo.-Ill.	1		238.5	-	242.6	-	-	-	-	15.4	1.7	-
San Diego, Calif.	1		255.6	-	264.8	-	-	-	-	17.1	3.6	-
Seattle-Everett, Wash.	1		241.3	-	246.8	-	-	-	-	17.0	2.3	-
Washington, D.C.-Md.-Va.	1		239.2	-	242.0	-	-	-	-	11.1	1.2	-
Atlanta, Ga.	2		-	239.3	-	244.7	14.1	2.3	-	-	-	-
Buffalo, N.Y.	2		-	233.3	-	234.6	11.9	.6	-	-	-	-
Cleveland, Ohio	2		-	248.4	-	250.5	13.2	.8	-	-	-	-
Dallas-Fort Worth, Tex.	2		-	249.6	-	254.5	16.7	2.0	-	-	-	-
Honolulu, Hawaii	2		-	228.4	-	228.0	12.0	-.2	-	-	-	-
Houston, Tex.	2		-	257.3	-	262.8	12.1	2.1	-	-	-	-
Kansas City, Mo.-Kans.	2		-	242.2	-	246.3	12.8	1.7	-	-	-	-
Minneapolis-St.Paul, Minn.-Wis.	2		-	245.7	-	248.4	11.2	1.1	-	-	-	-
Pittsburgh, Pa.	2		-	242.2	-	246.8	14.8	1.9	-	-	-	-
San Francisco-Oakland, Calif.	2		-	242.8	-	247.7	15.9	2.0	-	-	-	-
Region 3/												
Northeast	2	12/77	-	126.8	-	129.2	13.0	1.9	-	-	-	-
North Central	2	12/77	-	131.6	-	134.9	14.4	2.5	-	-	-	-
South	2	12/77	-	130.8	-	133.4	13.7	2.0	-	-	-	-
West	2	12/77	-	133.2	-	135.9	16.1	2.0	-	-	-	-
Population size class 3/												
A-1	2	12/77	-	129.1	-	132.3	14.9	2.5	-	-	-	-
A-2	2	12/77	-	131.1	-	133.6	14.1	1.9	-	-	-	-
B	2	12/77	-	131.8	-	134.3	14.1	1.9	-	-	-	-
C	2	12/77	-	130.8	-	133.3	13.7	1.9	-	-	-	-
D	2	12/77	-	128.8	-	132.1	13.4	2.6	-	-	-	-
Region/population size class cross classification 3/												
Northeast/A	2	12/77	-	124.9	-	127.1	12.3	1.8	-	-	-	-
North Central/A	2	12/77	-	133.4	-	136.9	15.7	2.6	-	-	-	-
South/A	2	12/77	-	130.8	-	133.6	13.7	2.1	-	-	-	-
West/A	2	12/77	-	133.4	-	136.6	17.5	2.4	-	-	-	-
Northeast/B	2	12/77	-	128.8	-	131.0	13.4	1.7	-	-	-	-
North Central/B	2	12/77	-	132.0	-	135.4	14.0	2.6	-	-	-	-
South/B	2	12/77	-	131.6	-	134.4	14.3	2.1	-	-	-	-
West/B	2	12/77	-	134.6	-	136.3	14.5	1.3	-	-	-	-
Northeast/C	2	12/77	-	132.6	-	135.6	15.3	2.3	-	-	-	-
North Central/C	2	12/77	-	128.3	-	131.2	12.6	2.3	-	-	-	-
South/C	2	12/77	-	131.7	-	133.5	13.5	1.4	-	-	-	-
West/C	2	12/77	-	131.5	-	133.9	13.9	1.8	-	-	-	-
Northeast/D	2	12/77	-	128.0	-	131.5	13.5	2.7	-	-	-	-
North Central/D	2	12/77	-	129.1	-	132.4	13.0	2.6	-	-	-	-
South/D	2	12/77	-	128.3	-	131.2	13.4	2.3	-	-	-	-
West/D	2	12/77	-	130.1	-	134.1	16.2	3.1	-	-	-	-

1/ Area is generally the Standard Metropolitan Statistical Area (SMSA), exclusive of farms. L.A.-Long Beach, Anaheim, Calif. is a combination of two SMSA's, and N.Y., N.Y.-Northeastern N.J. and Chicago, Ill.-Northwestern Ind. are the more extensive Standard Consolidated Areas. Area definitions are those established by the Office of Management and Budget in 1973, except for Denver-Boulder, Colo. which does not include Douglas County. Definitions do not include revisions made since 1973.

2/ Foods, fuels, and several other items priced every month in all areas; most other goods and services priced as indicated:
M - Every month.
1 - January, March, May, July, September, and November.
2 - February, April, June, August, October, and December.

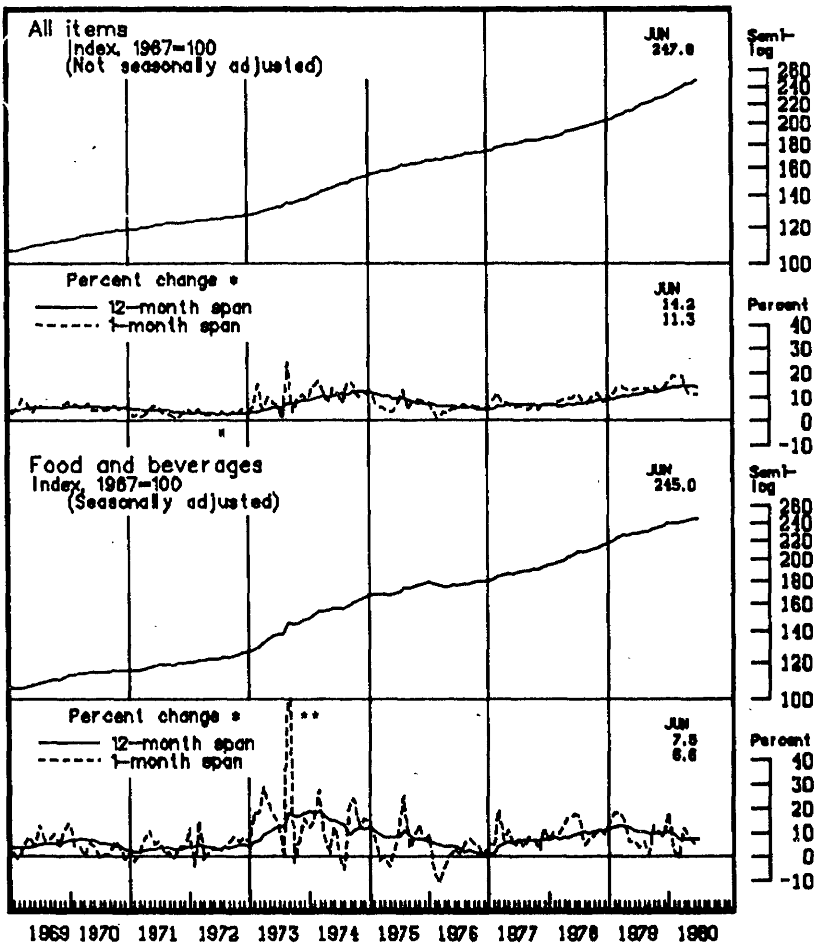
3/ Regions are defined as the four Census regions.
The population size classes are aggregations of areas which have urban population as defined below:

A-1	More than 4,000,000.
A-2	1,250,000 to 4,000,000.
B	385,000 to 1,250,000.
C	75,000 to 385,000.
D	Less than 75,000.

Population size class A is the aggregation of population size classes A-1 and A-2.

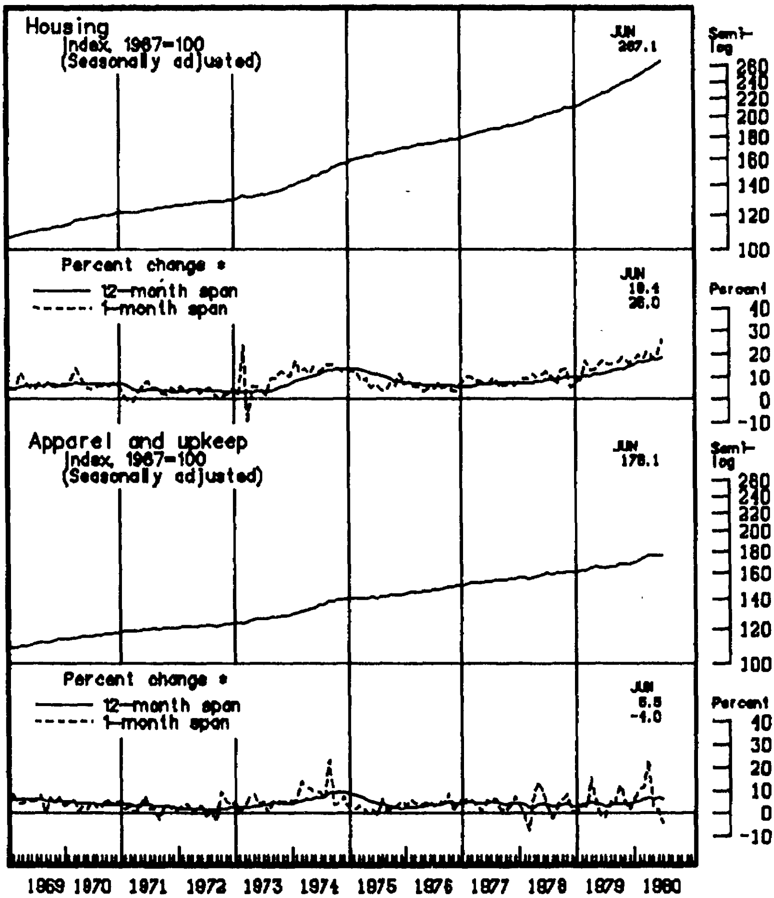
NOTE: Price changes within areas are found in the Consumer *Price Index*; differences in living costs among areas are found in Family Budgets.

CHART 1: CPI–W: All items, food and beverages, 1969–80



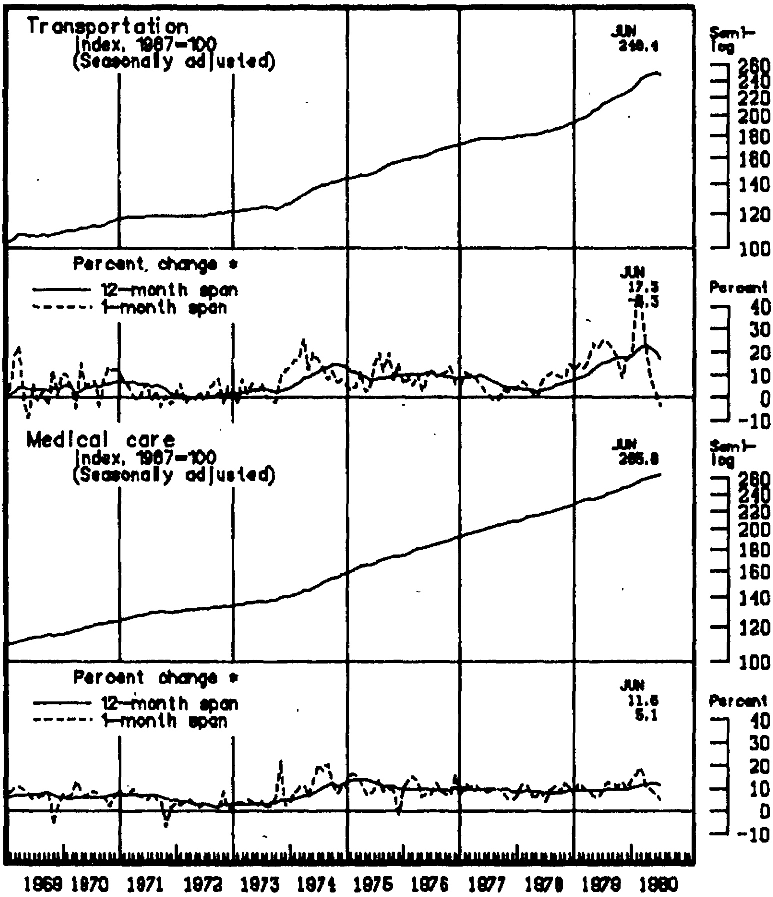
* Unadjusted data used to calculate 12-month percent change. Percent changes over 1-month spans are annual rates calculated from seasonally adjusted data.
** August 1973 = 92 percent

CHART 2: CPI–W: Housing, apparel and upkeep, 1969–80



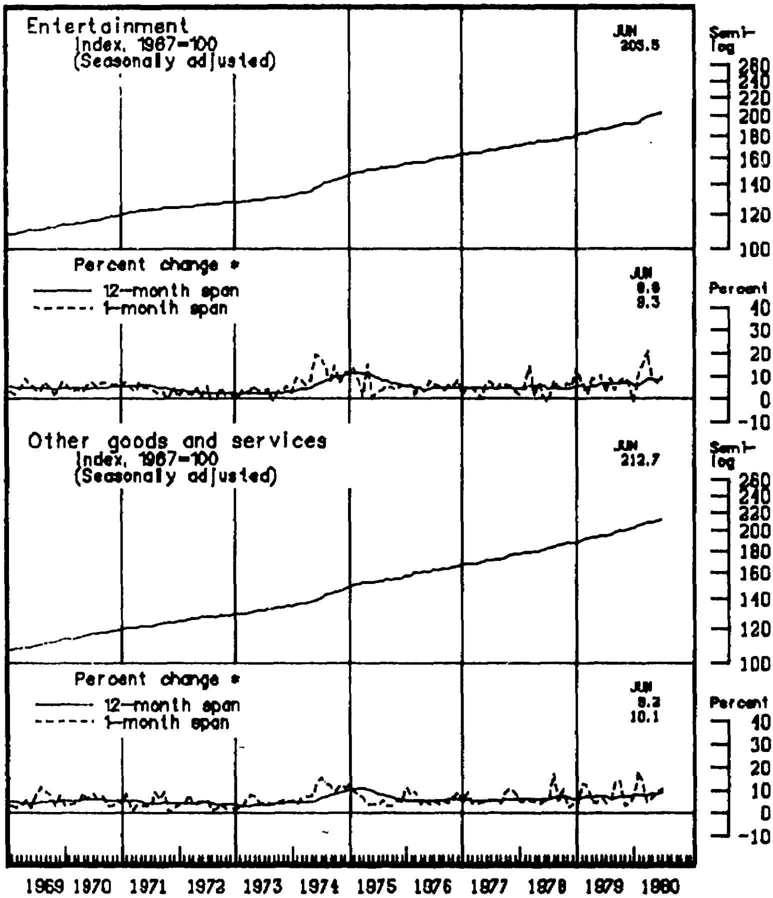
* Unadjusted data used to calculate 12-month percent change. Percent changes over 1-month spans are annual rates calculated from seasonally adjusted data.

CHART 3: CPI-W: Transportation and medical care, 1969-80



* Unadjusted data used to calculate 12-month percent change. Percent changes over 1-month spans are annual rates calculated from seasonally adjusted data.

CHART 4: CPI-W: Entertainment, other goods and services, 1969-80



* Unadjusted data used to calculate 12-month percent change. Percent changes over 1-month spans are annual rates calculated from seasonally adjusted data.

Table C. HOMEOWNERSHIP COMPONENTS used in official CPI-U and in experimental measures: Percent change over 12 months

12 months ended	Official Consumer Price Index for All Urban Consumers (CPI-U)	Experimental measures of homeownership				
		Flow-of-services measures			Outlays measures	
		X-1 Rental equivalence using CPI rent	X-2 User cost using current interest cost	X-3 User cost using average interest cost	X-4 Outlays using current interest cost	X-5 Outlays using average interest cost
December:						
1968	7.6	2.8	11.0	8.0	11.0	6.0
1969	10.2	3.8	7.1	3.5	13.2	8.3
1970	10.2	4.5	4.2	1.7	12.6	10.1
1971	2.7	3.8	-12.1	-8.9	0.3	7.7
1972	4.1	3.5	2.4	3.2	4.8	6.2
1973	7.7	4.9	23.0	18.9	10.8	4.4
1974	13.3	5.4	16.9	12.9	14.9	9.1
1975	7.9	5.2	2.8	3.4	7.1	9.0
1976	3.8	5.5	-1.1	1.9	2.7	7.6
1977	9.2	6.5	2.5	0.4	10.4	9.0
1978	12.4	7.3	5.7	-1.1	12.0	5.3
July 1979	15.2	7.1	16.7	9.4	15.3	6.8
August 1979	16.0	7.5	20.1	13.2	15.9	7.0
September 1979	16.1	7.6	18.3	11.5	16.4	7.5
October 1979	16.8	8.4	22.2	15.5	17.2	7.8
November 1979	18.3	8.1	24.5	16.3	19.0	7.9
December 1979	19.8	7.9	28.2	20.5	22.6	11.2
January 1980	21.1	8.1	30.7	22.0	24.4	11.5
February 1980	20.6	8.5	31.2	23.3	24.5	12.1
March 1980	21.7	8.9	38.0	29.7	26.5	12.7
April 1980	22.2	8.7	42.3	33.1	27.7	12.9
May 1980	22.8	8.7	42.8	33.9	28.3	13.3
June 1980	23.8	9.4	47.7	36.5	30.6	13.5
Relative importance December 1977	22.8	14.5	11.4	10.0	10.0	8.7

Table D. Official ALL-ITEMS CPI-U and EXPERIMENTAL MEASURES using alternative homeownership components: Percent change over 12 months

12 months ended	Official Consumer Price Index for All Urban Consumers (CPI-U)	Experimental measures using alternative homeownership components				
		Flow-of-services measures			Outlays measures	
		X-1 Rental equivalence using CPI rent	X-2 User cost using current interest cost	X-3 User cost using average interest cost	X-4 Outlays using current interest cost	X-5 Outlays using average interest cost
December:						
1968	4.7	3.9	4.9	4.6	4.7	4.2
1969	6.1	5.2	5.6	5.2	6.0	5.7
1970	5.5	4.5	4.5	4.2	5.2	4.9
1971	3.4	3.5	1.6	2.2	3.2	3.8
1972	3.4	3.3	3.2	3.3	3.4	3.5
1973	8.8	8.5	10.4	10.0	9.2	8.7
1974	12.2	11.1	12.6	12.1	12.3	11.8
1975	7.0	6.6	6.4	6.4	6.8	6.9
1976	4.8	5.1	4.3	4.7	4.8	5.2
1977	6.8	6.3	5.9	5.7	6.6	6.5
1978	9.0	7.9	7.8	7.1	8.5	7.8
July 1979	11.3	9.7	10.9	10.1	10.7	9.9
August 1979	11.8	10.1	11.5	10.7	11.0	10.2
September 1979	12.1	10.4	11.7	10.9	11.5	10.6
October 1979	12.2	10.5	12.2	11.3	11.5	10.6
November 1979	12.6	10.5	12.5	11.4	11.8	10.6
December 1979	13.3	10.8	13.2	12.1	12.5	11.3
January 1980	13.9	11.2	13.9	12.7	13.1	11.7
February 1980	14.1	11.6	14.3	13.1	13.4	12.1
March 1980	14.7	12.0	15.5	14.1	13.9	12.5
April 1980	14.7	11.7	15.7	14.2	13.8	12.3
May 1980	14.4	11.4	15.4	13.9	13.5	11.9
June 1980	14.3	11.1	15.6	13.7	13.4	11.5

Explanations of Homeownership Measures

Official CPI-U includes five components. (1) The weights for property taxes, property insurance, and home maintenance and repairs represent expenditures of all homeowers in the base period. The weights for house prices and contracted mortgage interest cost represent only those homeowners who actually purchased a home in the base period. Included are the total price paid for the home and the total amount of interest expected to be paid over half the stated life of the mortgage. (2) Current monthly prices are used for each of these components.

Experimental Measure X-1: (1) The weight for this rental equivalence measure is the estimate of the rental value of all owner-occupied homes in the base period compiled from a specific question asked on the 1972-73 Consumer Expenditure Survey. This covers the entire stock of owned homes. (2) Prices used are the current rents collected for the residential rent component of the CPI. The CPI rent component is designed to represent changes in residential rents for all types of housing units, not just changes in rents for units that are typically owner occupied. The CPI rent component is, therefore, not appropriate for this measure.

Experimental Measure X-2: (1) The weight for this user cost method includes expenditures for mortgage interest, property taxes, property insurance, maintenance and repairs, the estimated base-period cost of homeowners' equity in their houses, and the offset to shelter costs resulting from the estimated appreciation of house values in the base period. This measure covers the entire stock of owned houses. To derive the weights for mortgage interest costs and equity costs, the total value of the housing stock in the base period was apportioned into its debt and equity components. The debt component equals the amount owed, and the equity component is the amount owned, i.e., payments on principal plus appreciation from the time of purchase to the base period. Each component was subsequently multiplied by the average mortgage interest rate in the base period to determine its cost. (2) Prices used are current ones except for the appreciation term which uses a 5-year moving average of the changes in appreciation rates.

Experimental Measure X-3: (1) The weights are the same as in Experimental Measure X-2, except that mortgage interest costs are calculated as the total interest amount *paid out* by homeowners in the base period. As in X-1 and in X-2, this measure covers the entire homeowner population. (2) The prices for all components except mortgage interest costs and appreciation are current monthly prices. As in X-2, appreciation is represented by a 5-year moving average of the changes in house prices. However, X-3 uses past and current mortgage interest costs in a 15-year weighted moving average, which reflects the base period age distribution of mortgage loans.

Experimental Measure X-4: (1) The weights for this outlays approach include expenditures actually made in the base period for property taxes, property insurance, and maintenance and repairs. The weight for the mortgage interest term is calculated in the same manner as in X-2. However, no appreciation or equity terms are included. Not all homeowners are represented in this measure because those who made no mortgage debt payment in the base period are excluded. (2) The prices used for each of these items are current ones.

Experimental Measure X-5: (1) The weights for this outlays approach include, as in X-4, expenditures actually made in the base period for property taxes, property insurance, and maintenance and repairs. The weight for the mortgage interest cost term is the same as for the X-3. No appreciation or equity elements are used. As in X-4, not all homeowners are represented in this measure because those who made no mortgage debt payment in the base period are excluded. (2) Current prices are used in X-5 except for mortgage interest which uses the 15-year weighted moving average also used in the X-3.

Senator BENTSEN. Mr. Schultze, when you talk about these tax cuts, I want to ask about a proposal for a tax cut which would have the following elements: First, a 10-percent cut in personal income tax rates over each of the next 3 years; second, enactment of the 10–5–3 formula for depreciation; third, after the third 10-percent tax cut, personal income tax rates will be indexed to inflation.

I want to ask you three questions. One, what would be the revenue loss for 1981 and for the "out-years" as you refer to them in your prepared statement?

Mr. SCHULTZE. Mr. Chairman, measured gross—before allowing for feedback—in an economy already growing at a good rate, almost 4 percent a year over the next 5 years, the revenue loss for that combined set of proposals for 1981 would be something like $34 billion; for 1983, something like $135 billion; and for 1985, something like $282 billion. These are Treasury estimates of the revenue losses gross from that proposal.

Next, the question, of course, arises, how much of this would you get back by improved economic performance? And that, of course, would depend, Mr. Chairman, on how much you would increase supply and how much you would increase prices, obviously. But under normal circumstances—before I get into the question of would it or would it not be inflationary—you might expect a feedback or something in the neighborhood of 40 percent.

Obviously, these are very rough numbers, but of the 280, you might take away 40 percent feedback, leaving you with a 60-percent loss. It might even go as high as 50 percent. The point is, you are dealing with very massive net revenue—losses.

As a second proposition, Mr. Chairman, an easier way to look at this—at least, I find it easier—is to ask yourself, what proportion of our GNP would be taken by taxes after these cuts, and how much would we have to cut spending roughly to balance the budget.

Senator BENTSEN. Well, you're getting to my next question. The next question is, What kind of reductions in Federal expenditures would be needed to try to balance spending and revenues—put them in rough balance as we approach full employment—so that the proposed tax reductions don't lead to deficits and to substantial inflationary pressures?

Mr. SCHULTZE. If you go out to the period in which these cuts are all in place—go out to the end of the forecast period for which we have budget reviews—that's 1985, with that package of tax cuts in place, Federal revenues would be 18.5 percent of GNP. Actually it's 18.6.

Expenditures are now 23 percent of GNP, 22.9, I believe it is, rounded off. So you'd have to cut Federal spending from 23 percent of GNP to 18.5 percent of GNP.

Senator BENTSEN. By when?

Mr. SCHULTZE. By 1985, and fairly steadily along the way. Actually, we'd cut most of it by 1983 and some more by 1985.

Next, under the defense program which President Carter has proposed, defense spending would stay at roughly the same proportion of GNP. With a pretty good growth in GNP of about 3.9 percent a year, the defense share will stay constant.

Under the current demographic projection which we know is in the bag, in terms of the number of aged and other people seeking social security benefits, social security spending will stay approximately at the same precentage of GNP. That means you've got to take that entire cut—23 down to 18.5—out of the rest of the budget, and that means even if I don't make any special provisions for interest or medicare or anything else—they are all subject to cuts—we have got to cut the share of the rest of Federal spending in the GNP by 40 percent—something like 12 down to something like 7.

If I then say it's really going to be pretty darn hard to cut interest on the public debt, and you're projecting, just allowing for not a big deficit, we won't be able to get all of it our from medicare. You've got to look at the rest of the budget, and you've got to cut the share of the Federal Government in everything. But excluding defense, social security and retirement programs, medicare, and interest—everything else has got to be cut in half as a percentage of GNP.

Senator BENTSEN. Well, let's go to another point, then. Let's try it from another approach.

If you want to avoid the spending cuts, what additional growth in GNP would be needed to generate the additional types of revenues from economic growth to offset the initial losses from the tax cut, so that we don't end up in an inflationary deficit? Is that a realistic possibility?

Mr. SCHULTZE. All the projection I have given you already assume a pretty good growth in GNP, almost 4 percent a year. Now, you can ask yourself, well, look, you don't have to make all those spending cuts because the tax cuts will increase GNP by so much that even though you've got a smaller share of Federal spending, the GNP is so big, you don't really have to cut. Or to say it another way, you'll generate revenues which help to offset your initial revenue cuts.

It comes to the same thing—GNP growth rates. Let's take a look at that. Let's do this a little closer in. The arithmetic can be done in either year, but let's try 1983.

The gross revenue losses are a $135 billion before you allow for feedback. With this tax in effect, the Government would take about 20 cents out of every additional dollar of GNP. So for every $5 of GNP growth, you get back $1 of additional revenue. Or in order to get back $135 billion, GNP would have to grow by five times that much, or $675 billion which is a 20-percent growth above the growth we've already assumed.

Over a period of 1980–83, 3 years, you've got to grow 20 percent in a hurry to get those revenues back so you don't have to do the kind of budget cutting I was talking about.

Query: Is it possible to get that kind of an increase in the GNP?

First, it doesn't do you any good to get the kind of increase that puts money in people's pockets and have it just for spending. You've got to get a 20-percent increase above what otherwise is going to occur in output, which means either more labor force—longer work hours—or more productivity—20 percent. The numbers would be proportionate if I did it in 1985 instead of 1983.

Well, you know, maybe the economy, even with good growth, might have a little slack in it. So maybe you've got idle resources you could put to work, get 3 or 4 percent of the 19 percent out of that. Ask yourself, for this kind of tax cut, would it induce a big expansion into the labor force or the number of hours that people work?

The Congressional Budget Office surveyed all of the literature on the impact of taxes on this. To cut a long story short, it said that with a 30-percent cut in individual tax rates, you might get something like a 1½- to 3-percent increase in the labor force, hours or the number of people working. So if you've got a 3- to 4-percent slack in the economy to take up, and maybe 1 to 3 percent additional labor force growth, you've got to make up something in the neighborhood of 13 to 14 percent in additional productivity growth over the 3-year period in order to do this.

Absolutely no set of economic studies that I know of anywhere would even come close to giving you that. In order to even come close to it, you'd have to double—I say, to even come close—you'd have to at least double the share of business investment in GNP over a 3-year period, from 10 to 20 percent, and at the end of 10 years, having done that, you might come close to what you need. But you're sure not going to do it in 3 years, and the idea that you're going to double the share of investment in GNP seems to me just absolutely unrealistic.

In summary, Mr. Chairman, there's no doubt about it, that a supply-oriented tax cut can increase productivity and may conceivably produce more work effort. It's hard to tell. But what's critical are the magnitudes.

What we cannot do is avoid the need for careful tax cuts, looking at your revenue losses and making sure your budget will take it. You can't get around that by saying you're going to get enough economic impacts so you're going to make up all the revenue losses by higher output or higher supply. You're not. You can make up some, but you're not about to make up all. And, therefore, what you do if you overdo a supply-side tax cut, instead of helping with inflation, you hurt it substantially.

So this is not an argument against a supply-side cut. It is an argument for saying you cannot ignore the magnitude of the cut in the "out years"; you cannot ignore the spending restraint that has to go with it; and you've got to look at those things very carefully. Otherwise, you'll have inflation.

Senator BENTSEN. All right. To put all that together, what's your best judgment, then, as to what your deficit would be and what your inflation rate would be if we took that approach?

Mr. SCHULTZE. We made one estimate which said, suppose you did this and you put this into effect—this is 30 percent, 10–10–10, a 30-percent cut in individual rates: 10–5–3 depreciation; and indexing of the taxes. If the Congress and the administration got together and held the Federal spending down to 21 percent—from 23 down to 21 percent of GNP—if you had good economic growth, 4 percent a year steady, you would end up with something in the neighborhood of a $100 billion deficit in 1985, after taking into account reasonable feedback, reasonable economic growth, everything else.

Senator BENTSEN. What about inflation?

Mr. SCHULTZE. It's very difficult for me to tell you exactly how much inflation you'd get out of that, except it would be a very substantial amount. It would depend—how much inflation you got out of it and actually how much recession—on what you did with monetary policy.

If you absolutely accommodated it, if the Fed printed the money to make sure you could do this with no restraint, you'd get very substantial inflation and you'd postpone any output decline. Conversely, if the Federal Reserve is not going to finance it, not going to accommodate it, then what you'd get would be some inflation and a rapid rise in interest rates and then a turndown.

It's very difficult for me to estimate how much inflation and exactly when it would come. It's going to be some combination of the two.

Senator BENTSEN. Let's take another approach. There's strong sentiment in this Congress, I believe—and I happen to share it—for a $25 billion to $30 billion tax cut, half of which would be directed toward investment incentives, the other half to individuals—maybe something in the way of a tax credit to help ease the increase in social security taxes.

What kind of an effect would that kind of tax cut have on your forcast for 1981—for the economy and for the budget?

Mr. SCHULTZE. Well, I don't have a forecast of the impact of that tax cut. I can do it in qualitative terms.

Let me start with a side digression. If one is going to reduce taxes by the route of liberalized depreciation, you have to be very careful how you measure the proportion of taxes going to business and consumers. For example, the way depreciation tax cuts work is to have a very small revenue loss the first year and grow fairly substantially over the year. Therefore, a tax cut which in the first year might be 3 to 1, personal versus business, but the end of the fifth year might be a ratio of 2 to 3, 2 personal to 3 business, the same cut, simply because of that.

I'm not exactly sure that I know what you mean by half and half, but I'm assuming maybe 2 or 3 years out, it would be half and half.

Senator BENTSEN. What you're saying, then, is that you have to look at the specific proposal.

Mr. SCHULTZE. Let me look at it this way, Mr. Chairman. A tax reduction with some kind of a mix like that—without being able to give a number—would have a moderate effect on employment in 1981, and its major consequences would be felt by way of what it did to the expansion of jobs and output over a 3- or 4-year period. So that if you looked only at the 1981 consequences, it would make a difference, but the real difference would be the structure over that number of years.

Senator BENTSEN. All right. I have one more question. Congressman Brown has been very patient here. I know he has a number of questions that he would like to ask on the budget report. The budget report talked about a fiscal 1981 deficit of $29.8 billion, while the first concurrent budget resolution propounds a balanced budget. Is there any way that we can have a balanced budget in 1981?

Mr. SCHULTZE. No, sir.

Senator BENTSEN. Congressman Brown.

Representative BROWN. Thank you, Mr. Chairman. I appreciate the runthrough, Mr. Schultze, of your responses to these questions based upon the predicate that Senator Bentsen laid out for you. However, I must raise a question about your ability to predict, because I think you may be using either some old models that reflect in themselves a bias on the results that you would get by some of the proposals that Senator Bentsen made or perhaps just some inaccuracy of prediction.

I would like to just refer to one. In February of this year, I suggested to you that President Carter would face an unemployment figure on the day that he was seeking reelection in November that would be higher than the figure on the day that he took office. You assured me that that was not going to be the case. Have you modified your position?

Mr. SCHULTZE. Yes, sir.

Representative BROWN. To what degree?

Mr. SCHULTZE. We've said in the fourth quarter of this year the unemployment rate was likely to be 8½ percent in the fourth quarter. We don't have it by month. That clearly means that will not meet your criteria.

Representative BROWN. And what was your unemployment estimate in February for that period of time?

Mr. SCHULTZE. It was about the same as most other forecasters'; 7.2.

Representative BROWN. Let's move to another prediction concerning the balanced budget. When were you struck by lightning on the road to Damascus regarding the balanced budget and discover that it wasn't going to be balanced in 1981 and 1980?

Mr. SCHULTZE. I would hardly describe it as being struck by lightning. One does not become——

Representative BROWN. When did the slow, uncomfortable realization begin to dawn on you?

Mr. SCHULTZE. It had to come gradually. I can't tell you when. Clearly, as one looked at the economic forecasts, which we and the other economic forecasters were getting, one was a little bit worried. It didn't happen at any one point in time.

I just want to say there's a huge difference between forecasting and conditional predictions; that is, a forecast says you've got to know everything that's going to happen, right in your model. We ask, "What is the impact of a tax cut?" That's still uncertain. But the conditional forecast is much different, because what you're then trying to do is ask what's the difference between a world with a tax cut and a world without? That's the only thing you've got to know.

Let's not take my numbers. When Congressman Kemp first introduced his proposal, he accompanied it with a forecast from Chase Econometrics. That showed that over a 10-year period it would raise the rate of growth by one-tenth of a percent per year and the rate of inflation by eight-tenths. So I mean it isn't just me.

Representative BROWN. My memory may be as bad as your forecasting, but I am under the impression that the figure that you used back in February for unemployment was——

Mr. SCHULTZE. 7.2.

Representative BROWN. I thought it was 6.7.

Mr. SCHULTZE. 7.2 in the fourth quarter; 6.7 may be the average for the year as a whole.

Representative BROWN. I guess that's it. This was the Executive Office of the President, Office of Management and Budget prediction in March 1980 for fiscal year 1981 budget provisions, giving the 1980 forecast for 6.7 total annual average unemployment for the year. That's correct.

Mr. SCHULTZE. If you'll look above that, you'll see the number you're interested in, which is election time, which is the fourth quarter which is 7.2.

Representative BROWN. Yes, that's correct.

Mr. SCHULTZE. Am I right? Yes.

Representative BROWN. My point is that you use the 6.7 figure in planning the balanced budget.

Mr. SCHULTZE. That's correct.

Representative BROWN. I assume this figure has been modified also in view of the fact the 7.2 figure has reached 8.5.

Mr. SCHULTZE. That's right. I am just trying to see why. I never pay much attention to the year as a whole. Let me see what that is now. If you do it by quarters, I could tell you.

Representative BROWN. Isn't the year as a whole the basis on which we get the balanced budget?

Mr. SCHULTZE. Not the calendar year. It's a number of fiscal quarters. It's 7.6 for the year as a whole. So it goes up from 7.6, nine-tenths.

Representative BROWN. Almost a whole percentage point, what is it now?

Mr. SCHULTZE. It's now 7, 7¾ percent.

Representative BROWN. Unemployment was 7.8 last month, is 7.7 now, and may reach 8.5 by the end of the year. However, you feel we will average 7.6 unemployment for the year?

Mr. SCHULTZE. I think it's a perfectly straightforward averaging. What happened, as you may recall——

Representative BROWN. What will the bottom out figure be? 8.5?

Mr. SCHULTZE. 8.5 at the end of the year. We say it'll go to 8.6 in the first quarter of next year and then come down to 8.5. But this year the highest number would be 8.5, yes.

Representative BROWN. Yet, average unemployment for next year will be 7.6?

Mr. SCHULTZE. No, no. This year.

Representative BROWN. The average for this year is going to be 7.6?

Mr. SCHULTZE. I am sorry. Were you asking for 1981? Please excuse me.

Representative BROWN. The average for this year is going to be 7.6. We are at 7.7 now. We were at 7.8 last month, and we are headed for 8.5. You're going to have to have some good months in there.

Mr. SCHULTZE. No. We had good months: January, February, and March, you know, were 5¾ to 6, as far as I know. Sometimes our forecasts are wrong, but our averaging is pretty good. [Laughter.]

Representative BROWN. I hope it can average out. When you have 8.5, it would be nice for the figure to average to 3.4, but I doubt it.

Let me talk about tax increases. I think you are in the process of doing essentially what a previous administration did in the late 1920's and early 1930's. That is, in a deteriorating economic situation, you are adding taxes onto the economy. Is that a fair statement, or is that unreasonable?

Mr. SCHULTZE. No. There are some tax increases coming along.

Representative BROWN. Some?

Mr. SCHULTZE. That's right.

Representative BROWN. Could you identify them?

Mr. SCHULTZE. The windfall profits tax. In effect, what that really is is transferring money from the decontrol of oil prices, transferring some of that from oil companies to consumers—I am sorry—to the Government. That's about—if you go from year to year, that's about $15 billion.

Representative BROWN. In 1981?

Mr. SCHULTZE. Compared to 1980, if you're looking at the increase. Social security taxes go up, to pay for additional social security benefits, and that's—depending on how you count it—$13 billion on the rate; if you take the base increase, it comes out to about $15 billion.

Representative BROWN. In 1981? That is a total of $30 billion.

Mr. SCHULTZE. Then you have bracket creep, which is worth maybe $15 billion. You've got to remember that $30 billion of that——

Representative BROWN. Tax increases, due to bracket creep, accumulated $15 billion in 1 year?

Mr. SCHULTZE. Pardon?

Representative BROWN. How much will taxes increase during 1980, due to bracket creep?

Mr. SCHULTZE. 1980 to 1981 is $15 billion.

Mr. MUNRO. 1980 is very little.

Representative BROWN. What is very little?

Mr. MUNROE. A couple of $4 billion.

Representative BROWN. This amount is due to bracket creep?

Mr. MUNROE. I am sorry. I thought you meant social security.

Representative BROWN. Mr. Schultze talked about bracket creep. How much is bracket creep?

Mr. SCHULTZE. I have to back and calculate because 1980 will reflect through a refund on some of the tax cut that came back in 1979. So I frankly don't know.

Representative BROWN. What is the 1-year estimate for bracket creep—1980 to 1981.

Mr. SCHULTZE. 1980 to 1981 is $15 billion.

Representative BROWN. That puts the total increase in taxes to $45 billion.

Mr. SCHULTZE. That's right. You've got to remember, $15 billion of that is to pay for higher social security benefits; $15 billion of that is simply transferring money from the oil companies windfall to the Government. Decontrol is what's raising the price of oil, and, in turn, that's going from the oil companies to the Government. So it's $15 billion which is not associated with higher social security benefits.

Representative BROWN. That's a $45 billion tax increase in 1 year. The thing that disturbs me is the dismay with which you view a $10 billion tax decrease in 1 year.

Mr. SCHULTZE. I am sorry, I missed that.

Representative BROWN. Why fight the 10-percent tax decrease in 1 year?

Mr. SCHULTZE. My problem is not the 10-percent decrease in 1 year. It is the cumulative impact of that plus 10–5–3 plus the second two stages.

Representative BROWN. We just talked about the tax increase from 1980 to 1981. There is a tax increase from 1981 to 1982, 1982 to 1983, and so forth. Is there not?

Mr. SCHULTZE. No question. That's right, yes.

Representative BROWN. The tax increases then would be balancing a tax decrease.

Mr. SCHULTZE. Oh, yes.

Representative BROWN. A 10-percent tax reduction does not absorb the tax increase.

Mr. SCHULTZE. Congressman Brown, I took the measure effective rates into account in the calculations about Governor Reagan's proposed tax cuts that the chairman laid out. After taking into account the bracket creep, the Governor's proposed program still ends up reducing the share of Federal revenues in GNP to 18½ percent. I took bracket creep and other currently scheduled tax changes into account in making that calculation. You're right that Governor

Reagan is not reducing tax rates from a constant level. It would get future revenues far much below 18½ percent if it weren't for bracket creep. You're quite right. But I took that into account.

Representative BROWN. All right. Now, bracket creep, which I consider to be an automatic fiscal dividend, indexes government to always higher expenditures——

Mr. SCHULTZE. Maybe, Congressman Brown, I can cut through this. If you were suggesting that over the years ahead we are clearly going to need tax reductions, absolutely no disagreement.

Representative BROWN. If there's no disagreement, why are you letting taxes increase and fighting tax reductions?

Mr. SCHULTZE. What we are trying to get, Congressman Brown, is, in our judgment, the kind of tax reductions which don't overdo it over time, and, will have the maximum possible benefit by way of productivity and inflation.

Representative BROWN. I'll talk about that—if I can steer the conversation for just 1 minute. I don't want to be rude, but I do want to be firm.

How long did it take government expenditures to increase from 18½ percent to the current 23 percent?

Mr. SCHULTZE. It didn't take very long, because part of that is the recession. Actually, probably apart from that recession it might be 22 percent.

Representative BROWN. Can you give me a guess on how long the rise from 18½ to 23 percent took? Four years?

Mr. SCHULTZE. No, It'll depend on where you place your base point because of the recession. The share is the numerator and the denominator. My guess is that if you put the denominator back at 6 percent unemployment, 23 would—22—make it 21½. I'd have to go back and see.

Representative BROWN. Back in those good old days when we had only 6 percent unemployment or maybe even the good old days before that, when we first recommended a tax cut, if we had taken the tax cut at that time, isn't it possible that the stimulative effects of that tax cut would now be flowing through the economy?

Mr. SCHULTZE. We had a tax cut in 1979.

Representative BROWN. If we had taken that step, you would have an increase in GNP income now, and you might have ameliorated some of the effects of this recession.

In other words, I am trying to point out that we have a fundamental problem in society. We have had increasing taxes that discourage productivity; and we have accumulated deficits that discourage productivity; by inflation and increase the percentage of government in the whole GNP, which I consider the cancer part of the body politic.

Wouldn't we really have a better situation now if we had made a supply-side tax cut when the Joint Economic Committee recommended it?

Mr. SCHULTZE. It depends on the kinds of cuts and a lot of other things and what you did with Federal spending.

Representative BROWN. Let us assume we had controlled Federal spending to some degree when we recommended a tax cut in 1977.

Mr. SCHULTZE. We'd have to go a long way back. Real Federal spending in the first 7 years of 1970 to 1977 grew at 3 percent a year, and since that, about 1. So we'd have to go a long way back.

Representative BROWN. Let's talk about just 1977.

Mr. SCHULTZE. Well, OK. I am saying we'll have to go well back. I am saying from 1977 on, real Federal spending and growth has been virtually brought to a halt.

Representative BROWN. By "real Federal spending," you mean the increase above——

Mr. SCHULTZE. Inflation.

Representative BROWN. Why should we have an increase above inflation?

Mr. SCHULTZE. We don't think we should. In fact, we've just about cut it out. That's right. The only problem was it wasn't done in the prior 15 years. No, we agree.

Representative BROWN. You have over the last few years raised taxes faster than inflation. Is that right?

Mr. SCHULTZE. Taxes faster?

Representative BROWN. I think you have. We just talked about it.

Mr. SCHULTZE. Because of bracket creep.

Representative BROWN. You've raised taxes faster than inflation. Bracket creep raises them; social security taxes raise them; windfall profits tax raise them. The President's proposal for an oil tax would have raised them. The President's proposal for withholding on savings and investment income would have raised them.

Mr. SCHULTZE. We also reduced them in 1979. I don't know what the net is.

Representative BROWN. We reduced them in 1968, too. I am talking about what has been proposed in the way of an increase.

Mr. SCHULTZE. Congressman Brown, all I am trying to do is when you say say "increased taxes faster than inflation," I am not quite sure what you mean. That taxes have been increased, that's correct; that they've increased faster than inflation is what I am not sure I understand.

Inflation last year, say, was 13 percent. Or if you want to measure it another way, it was about 11 percent; 11 percent of GNP is a lot more than a tax increase. So I can't say it has increased faster than inflation.

Representative BROWN. In the last year, I grant you the inflation increase probably went up faster than anything else in the society.

Mr. SCHULTZE. Even if you get 7 percent inflation, 7 percent of GNP is a lump much larger than the tax increases.

Representative BROWN. The thing that discourages me in your approach in this problem is that the answers are the same as they've always been. Let's give the Government more of the resources instead of a tax cut. No matter how the tax cut is configured, it will not stimulate fast enough.

Mr. SCHULTZE. Sorry, Congressman Brown, that just isn't the case. I just don't agree that that is what we have proposed or what we have done. If you go back and read the economic messages, the President has said every year his objective is to hold down the growth in spending and reduce taxes. We did in 1978, with a tax reduction in 1979.

You're quite right, we did do two things, two things which are tax raising: One, the windfall profits tax; and, two, the increase in social security taxes back in 1977 to finance the increase in benefits. And one of those stages comes in in 1981; you're quite correct.

But the President has indicated all along his desire is to halt the growth of Federal spending. We're not arguing about the need for a tax cut; we're arguing about what, how much, and when.

Representative BROWN. That may have been a future plan. It may have been his past ambition, but it just wasn't accomplished. My figures indicate that the revenues of the Federal Government have gone up something like $300 billion in 1976 to over $600 billion anticipated in 1981. Now, that's a doubling of the income of the Federal Government. I would give you and the President great marks for marketing if it were private business, but awful marks for management. Because we had to go to a heavy deficit throughout that period, a heavy deficit in 1981 is the result of the inability to constrain Government in its growth of revenues and its growth of expenditures.

Mr. SCHULTZE. Again Congressman Brown, on that we will just have to disagree. Again, if you look at this President, he has brought the real growth of Federal spending virtually to a halt, No. 1. No.2, in 1974 and again this year—a 125-percent increase in oil prices this year—a huge oil price increase then and now gave us more inflation and more recession and deficits.

Representative BROWN. I wish you wouldn't talk about the oil prices.

Mr. SCHULTZE. I can't help it.

Representative BROWN. The increase in oil prices really is a false argument about what caused the inflation. The fact of the matter is oil prices have increased in other major countries of the world, and they haven't experienced any kind of inflation the way we have. With all due respect, it was the Secretary of the Treasury who made those decisions when he was on the Federal Reserve Board. He accommodated those price increases in oil by turning loose the money machine, and that's why we had the inflation.

The oil prices were an implementing mover, but if he hadn't responded in that way, you wouldn't have the inflation that we've got now. Everybody else in the world knows it; I can't figure out why the administration has never determined it. They reacted by dumping dollars in 1978 and by dumping them again in 1979, because they knew that our monetary system was just simply out of control.

Mr. SCHULTZE. The dollar went up in 1979.

Representative BROWN. The dollar went up in 1979 after Mr. Volcker came in and put the brakes to it.

Mr. SCHULTZE. After November 1, 1979.

Representative BROWN. Since 1977, when the ratio of Federal spending to GNP was 18.8 the ratio has gone up in 4 years to what you now cite as 23 percent. I think you may be even using a little hyperbole there. It's not quite 23.

Mr. SCHULTZE. It's 22.9, something like that.

Representative BROWN. It seems to me that if you can increase the Government's share that rapidly, you might be able to decrease it also.

Mr. SCHULTZE. Oh, I agree we can decrease it. I'm just saying——

Representative BROWN. If you'd show the same kind of dedication to the concept of decreasing it as you did to increasing it.

Mr. SCHULTZE. Do you think defense spending should be down, Congressman Brown?

Representative BROWN. I think you could make the effort to reduce it as aggressively as you made the effort to increase it.

Mr. SCHULTZE. The defense share?

Representative BROWN. I'm talking about the percentage. The effort made by this administration was an effort to induce a recession to break inflation. We've had that testimony before this committee consistently now for the last 2 years. It's finally working. I think it's working a little bit better than you would like to have it work in terms of the nature of the year and in terms of the percentage of unemployment that it's going to create. I give you credit for that.

However, it is a ratio of the growth of Government and the deterioration of the economy, those two things have both been induced by this administration and this Congress; have they not?

Mr. SCHULTZE. Congressman Brown, let me get back to the point about that share. The share now is about 22.9. With all those tax cuts in effect by 1985, it'll be 18¼. The defense share, unless you want to cut defense, is not going to be down, and the social security share isn't going to be down.

We're dealing. I think, in arithmetic. I am not sure how you can get the rest of it down. If you can get it down 40 percent, then you can do it and balance the budget.

Representative BROWN. I've been as generous with my time as Chairman Bentsen was with his, and I don't want to be more generous. And I want to yield to Senator Sarbanes and Senator Javits.

But let me just suggest to you that there is some merit in the idea of trying to have an expanding economy in this country. And if that will reduce it—and the method by which that's done—and we can discuss this again in a few minutes—is how you cut the taxes, where you cut them. If you cut taxes and people put that money into savings, you at least finance the debt, whatever debt you have, to an increasing degree with private investment, rather than financing it by turning on the printing press.

It seems to me that that has one positive impact, and that is that it helps reduce inflation.

I'll give you to Senator Sarbanes for his questions and then Senator Javits.

Senator SARBANES. I'll defer.

Senator JAVITS. Mr. Schultze, I apologize for being late. But we have a habit of having not less than four committee meetings every morning.

I came because I'm very deeply concerned about all of us, Republicans and Democrats alike, in being more impressed with the season than the needs of the country. It seems now to be a very clean-cut issue of tax cut or no tax cut. And what troubles me is, I don't know whether you have heeded this line of thinking, which is one I must assume of the administration. It's a report of the Secretary of the Treasury's testimony yesterday, which said, quote:

> Mr. Miller testified that a tax cut might be needed next year to allay the growing tax burden on individuals generated by inflationary tax bracket creep, and also to provide additional incentives for business investments aimed at spurring productivity.

As we all agree, to get us out of the recession soonest—also, to me, Mr. Schultze, to get us out at a plateau level which will not lead in

2 or 3 years to a much worse recession, or perhaps even a depression, might apply to a level being established essentially by inflation and unemployment.

I wonder why, if we do accept the fact that before you get out of this recession a tax cut will be needed—that's the clear implication of Secretary Miller's testimony, that he said he wouldn't be recommending one if we were back out of the recession—why shouldn't we supply that part of it which relates to incentive for business investment, to spur productivity now?

Let's assume that we're not going to do the other one, which has much greater inflationary dangers, which I gather you've just kind of argued out with the chairman. But we should do the one now which relates to business investment, aimed at spurring productivity. Why cannot, therefore, a tax cutting initiative which the administration speaks of the next year be divided, so that that part of it which is so urgently needed for modernization of American business and for the increase in research and development, in which we're catastrophically behind; and the other part of it, which relates to progressive rate creep and the social security increase in January, why can't the administration say, that we will defer until next year? But the business thing, target it. We both agree on it, let's do it now.

Mr. SCHULTZE. I think the main reason, Senator, is the reason you gave earlier—that we want something that'll stick with us for a long time. We do not believe that that kind of a carefully structured tax cut could be done at the tag end of an election year session. There are too many pressures to tie all kinds of things onto it.

The one proposal which has been put forward explicitly, 10–5–3, has the advantage of liberalizing depreciation and a great number of disadvantages in its structure. There is a great controversy over whether it ought to be put in place or how it ought to be modified.

So our problem is precisely that we want something that's going to do the job over the long term and not something which bears the mark, as it inevitably will, of what's done hastily in an election year and with all the special interests climbing all over it.

Senator JAVITS. The difficulty with that thesis is that in my own speeches for 3 years—and I'm sure it has been called to your attention; I'm only one example; there have been many more—we have been calling attention to the fact that investment capital was very short, that productivity—we were in the cellar on productivity and we still are, in terms of the 10 leading industrial countries. So that's been going on for a minimum, I'd say, of 3 years—let's discount me and say 2 years.

Haven't we been doing all that thinking right along, so that at least the administration will know what to do?

Now, I'll tell you about 10–5–3. It is a crude measure and I'm on this bill only to get things off the ground and get something going. But it seems to me that certainly the administration must have been refining its policy over the last couple of years in order to determine what it would do and in order to do it.

What's your answer?

Mr. SCHULTZE. Several things. First, let me just note as a historical footnote. Of course, we haven't been idle during this period, neither the administration nor the Congress. And taking effect in 1979 there was a tax reduction, a larger than historical share of which went to businesses. That's No. 1.

No. 2, the administration has, of course, been working on this. We are formulating ideas. The proposition I made is not that we wouldn't be able to put something forward. But there are, after all, 535 very important people involved in this. We believe that under the conditions I described earlier, this is not the time to get the kind of tax cut that you want and we want.

It's a matter of judgment as to how one best gets the kind of thing that'll stick with you in the long run and do some good on productivity and research and competitiveness.

Senator JAVITS. As a matter of fact, isn't it true that capital gains originated here? As I recall, it was very much a congressional initiative.

Mr. SCHULTZE. Yes. We preferred reduction in corporate rate. There was a difference in terms of how we wanted to get investment incentives. But the Congress and the administration were agreed on the share of that tax cut that went toward investment incentives. We did disagree on how. And I must say, you won.

Senator JAVITS. Well, I cannot help—I don't think I'm considered one of the most partisan Members of the Senate—but feel very deeply that we are making a very unwise decision in holding off a business inducement to spur modernization, which is probably our most trying problem, because allegedly we're not ready, when, as I say, I'm confident that we've been working on it.

We have had a task force in the Senate on the Republican side for 2 years running. We've got ideas on the subject. I certainly believe it could be done.

I would urge you, Mr. Schultze, very strongly that at least that be done. I think the Congress would be very ready to lay everything else aside if the administration would join in that targeted request. I cannot think of any other single thing that would be more conducive to getting the country's attention to the improvement in productivity and to what really will break the back of inflation.

I might tell you this, too, which is to me very important: One of our Members, in connection with the first budget which we passed after a long struggle, sharpened his pencil in the Senate and made the toughest cuts that he could think of; and he brought the budget thing down to $575 billion. So that was $40 billion. That's the big difference between the most rigorous cuts and where we are now at $613 billion.

Now, it seems to me that if anything demonstrates how critical it is to get the private sector off its seat in this matter, it is that, because that's going to blow up all the idea of, well, it's a Government expenditure, Government waste, that's destroying this economy.

Now, that's perfectly true. We're all united on balancing the budget, and so on. But that isn't what's troubling this economy, really. What's troubling it is what we're talking about.

So I would strongly urge you, sir, to reconsider and again to see if the administration would not give the country what it needs now. It can't happen, I don't think, without the administration, which is a targeted tax cut to increase productivity.

Mr. SCHULTZE. Senator, let me just make one point. I think that you, I, and almost any observer, come 1983, who looks back on 1980 and 1981, what they would really care about is the shape and nature of that tax cut, not whether it went into effect 4 or 5 months earlier or later. I think it is so important to the longrun health of the economy—we do, the administration does—that we believe we should do it in a way which raises the greatest possible chance of doing it well.

The judgment is, we don't think this, the tag end of the session, is the time to do it.

Senator JAVITS. One other point in that connection. Assuming it is this administration, which we must assume in making this statement, will you contemplate that that would be retroactive? In other words, treat the elapsed time—would you consider that it could be retroactive, say, for 6 months?

Mr. SCHULTZE. What one does with retroactivity has to be decided when you look at the very specifics and timing of what you are doing. As you know, Senator, our approach is that any tax cut affecting investment should become retroactive to the date at which first proposed. Beyond that, I think we would have to look at the specifics of the situation.

Senator JAVITS. When you say "first proposed," I gather you mean when the measure is first proposed, rather than our discussion of it?

Mr. SCHULTZE. Oh, yes.

Senator JAVITS. Thank you.

Senator SARBANES [presiding]. Do you have some further questions? Go ahead if you do.

Representative BROWN. I'm going to pick up on what Senator Javits said. There was an article in yesterday's Wall Street Journal about the steel industry and three of the major steel companies, U.S. Steel, Bethlehem, and National, having new CEO's. This is of particular interest in my State, Pennsylvania, and in some others.

The sad news in that story is that they are not thinking of reinvesting in the steel industry, but of diversifying. I assume purchases of existing businesses and other lines of operation.

If we are ever to regain our competitive edge in the world, we must modernize and become more competitive in the world.

The industries that have allowed themselves or have been allowed by the system to become uneconomic in world competition must modernize and get back in the competitive race; 10–5–3 has that as its primary objective.

If for some reason fine-tuning is not appropriate, then it's incumbent on somebody, the administration or the Congress or someone, to modify that and act on it. I agree with you that a matter of 2 or 3 months may not make a critical difference, but I am inclined to think that in economics as well as in politics timing is everything; you have to do it somewhere around the area of the need or you've lost the opportunity, because the economy goes down further.

That brings me to your discussion of Kemp-Roth and a generalized tax cut, as opposed to a more focused tax cut. Both Senator Bentsen and I have proposed rather specifically focused tax cuts. His is in a somewhat different vein than mine. His was related to increasing the allowance or the amount of income one could earn from investments in savings or the stock market, or housing, or entrepreneurship, that would not be taxed. Mine relates to separating income earned from investment as it goes to income earned from personal activities and reduces the rate to 14 percent.

Both of us, I believe, would reduce the maximum tax on investment income. That puts money into savings as opposed to simply cutting taxes and allowing an individual to make his determination as to whether the money he did not have to pay in taxes would go to increased consumption, which is stimulative to some extent, or whether it should go to savings.

I am personally of the opinion that now is the time, in a recession, when we need to focus it into savings. We will have the opportunity to finance whatever debt the Federal Government may be forced to accumulate, even as the decline in its income and its continued proclivity for overspending its agreement. That increased savings could finance the debt without being inflationary.

Would you accept that?

If you increase personal savings, you can absorb some increased Federal debt without it being inflationary.

Mr. SCHULTZE. If you assume first, that all the tax cut goes to increased savings funds.

Representative BROWN. Never mind the tax cut, that isn't what I said. You'll increase personal savings, which is the decision to save ra her than consume.

Mr. SCHULTZE. That's all you do?

Representative BROWN. Never mind the taxes. If you increase savings you can absorb more Federal debt, can you not?

Mr. SCHULTZE. Normally, your problem in this situation is not absorbing the Federal debt.

Representative BROWN. You're not answering my question. If you increase savings, you can absorb more Federal debt without it being inflationary; right or wrong?

Mr. SCHULTZE. I can't answer right or wrong to that, Congressman Brown. My point is what that would do would drive the economy further down to recession and probably, yes, a further recession would leave some of us open to pressures on wages and prices. But you're not going to have a problem financing the Federal debt in the recession. That's not your problem.

Representative BROWN. Suppose we had increased savings 3 years ago when the economy was not in recess but moving toward recovery, could you have financed more Federal debt then without it being inflationary?

Mr. SCHULTZE. If that's all you look at, yes.

Representative BROWN. It seems to be an economics 101 question.

Mr. SCHULTZE. Look at it just that way. What you're saying is it's going to reduce demand for goods and services. Yes; that will be less inflationary.

Representative BROWN. What I'm saying is if there's more savings you can finance more debt. That's what I'm saying. And I don't think it's terribly complicated.

Mr. SCHULTZE. Sure, but there a e all sorts of other consequences. That's my point.

Representative BROWN. I understand the other consequences. If you focus nto savings in your tax cut and reinvestment in your tax cut, both together—in other words, if you put your personal tax cut in the area of encouraging savings and your business tax cut in the area of encouraging investment or modernization—don't you have a pretty good double whammy for stimulating the expansion of the economy?

Mr. SCHULTZE. I agree with the first part, that is, putting it in through incentives for investment. Now remember when you do that, let us say, by liberalizing depreciation, you also increase savings. You increase retained business earnings. That is savings, savings by business firms not by individuals, but that is a major increase in savings, along with your increased investments.

When you use the same money to try and increase individual savings, what you'll normally find when you give away $1 of Federal revenue, which lowers national savings, you got to finance that buck. You've got to borrow more the other way. If you put it into consumer pockets, they may save an extra 20 cents out of it, 30 cents even—that would be high by most estimates. So you lost a buck on national savings, and you pick up 30 cents.

Representative BROWN. The 30 cents would be quite high considering that the average savings now is 4 cents on each buck.

Mr. SCHULTZE. What I'm saying is—you've got 30. All I'm saying is you have to be a little bit careful. I fully agree on the investment incentive side. I agree on the savings side, except that you're going to be doing that. If you're going to increase, say, depreciation, or anything which increases investment, also tends to increase business savings.

Representative BROWN. Let me move just one step further. If—and you may not accept this as the premise, but some other economists might—a tax cut that would stimulate savings would stimulate more savings and investments than it costs the Federal Government in revenues; do you think that would be a good thing?

Mr. SCHULTZE. If it stimulated investment.

Representative BROWN. More savings and investment.

Mr. SCHULTZE. In the first place, it's quite possible it might. It would then depend on what's happening in the rest of the economy. It's going to depend on the situation with respect to inflation. I can't answer that generally. Under some circumstances, clearly, yes. Under other circumstances——

Representative BROWN. If it costs less and if it stimulates more savings and investment than is lost in Federal revenues, would you accept that as a good thing or a bad thing?

Mr. SCHULTZE. In the first place, looked at in terms of national savings, unless you're cutting Federal spending at the same time, it's not going to increase overall national savings. You're taking a dollar away from the Federal Government which it's got to borrow. You're giving a dollar to individuals, some of which they may save, some of which they won't. So I can't go with your premise. If magically you could reduce that dollar of Federal spending, and you didn't have to borrow it and transfer it over as investment, yes.

But that's my key point. You have to look down the line at your total picture, spending and taxes, in order to see whether the size of the tax cut makes sense, even when the tax cut's going to investment. So I don't disagree it would be a good thing, but I'm saying you can't automatically assume a dollar going into savings comes out magically without costing the Government to borrow the dollar.

What's going to happen to Government spending?

Representative BROWN. I'm not going to belabor this with you, but the proposal that I have has been assessed to produce more in savings than it costs in terms of reduction in revenues to the Federal Government. Now let's just keep everything else equal for a minute. This is a pretty good tax cut in terms of doing only one thing, if that's all you consider desirable; and that is financing the Federal debt. You finance the Federal debt, because you've increased savings. You make the prospect that the Federal Government has to pay less interest on that Federal debt. That's a good thing. If money is put into investment as the result of that, that's a good thing. The other part of your savings is absorbed and private investment is increased. And that's what we want to accomplish; isn't it?

Mr. SCHULTZE. Congressman Brown, I cannot answer a question whose premise is 2 plus 2 equals 5. If you add another thing to it: You cut a dollar out of Federal spending, you cut a dollar out of Federal revenues, you put that into additional investment and save it; right? Is that good? I'd say under current circumstances it probably is.

Representative BROWN. You misunderstood the premise. The structure of the tax reduction would be such that you increase savings.

Mr. SCHULTZE. Personal savings.

Representative BROWN. You would increase personal savings more than you reduce the Federal revenues. You don't just take the money out of Federal revenues; you take the money out of consumption. In other words, you encourage somebody to save to the extent that they take some of their money out of consumption and put it in savings.

Mr. SCHULTZE. I have $2 for $1 then. If you tell me you give somebody $1 and they'll save $2, then maybe you could do it. You have increased Government borrowing by $1 and you have somehow got $2 additional. You've increased personal savings by enough to take that $1 into account plus increased savings by $1.

Representative BROWN. It isn't quite $2 or $1. By a tax cut, you encourage people to reduce consumption and put some of that into savings, as well as saving what they get out of their taxes.

Mr. SCHULTZE. If people's normal propensity to save is not 20 percent but 200 percent, maybe you could work that. I don't know any economic model that gets you there, but, yes, that arithmetic would work.

Representative BROWN. I'll show you the savings tax proposal. We can also add to it the 10–5–3, which I must tell you, as a businessman, would cost the Government less in the early years and would stimulate investment. Speaking as one businessman, I am hard pressed right now to come up with money to modernize some of the little business needs that my very modest company has.

However, if you could assure me that I'll have to pay less taxes if I make that investment now, I'll take the risk in hope that I will get the return, and save on taxes that will see me pay for the new investment. And that's going to be more stimulative than the costs to the Government, in my opinion.

Mr. SCHULTZE. You have to remember that what you're doing is making a choice to give some industries about seven times as much investment incentive as others quite arbitrarily.

And second, in effect, by the second half of the 1980's you've cut your corporate tax in half. I say you cannot do that until you have gotten yourself in the position of knowing where you're going to cut spending to offset it, because that would be inflationary.

Representative BROWN. I believe if we continue to wait, the recession may turn into something much worse. We may have to take further and more drastic action, unless we propose what you call the reckless consideration of the Congress.

I would suggest to you that recovery, no matter how unfair to certain elements of society, is better than a continued recession or further depressions.

Senator SARBANES. Do you have any questions, Senator Javits?

Senator JAVITS. No.

Senator SARBANES. The committee is adjourned.

[Whereupon, at 11:50 a.m., the committee adjourned, subject to the call of the Chair.]

THE 1980 MIDYEAR REVIEW OF THE ECONOMY

FRIDAY, AUGUST 1, 1980

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

The committee met, pursuant to notice, at 9:37 a.m., in room 6226, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Present: Senators Bentsen, Sarbanes, and Javits; and Representatives Reuss, Brown, and Wylie.

Also present: John M. Albertine, executive director; Louis C. Krauthoff II, assistant director-director, SSEC; Charles H. Bradford, minority counsel; Mary E. Eccles, professional staff member; and Stephen J. Entin and Mark R. Policinski, minority professional staff members.

OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator BENTSEN. The hearing will come to order.

The United States is really stepping toward a threshold that can lead to a new era of economic prosperity. Our goals should be those of high employment, low inflation, and booming production. That certainly is in contrast to the chronic boom-and-bust prosperity, or the lack of prosperity that we have seen because of misguided policies in the early seventies. I don't say this lightly.

For example, this administration and the Congress, working in a partnership that is virtually unprecedented, has developed the framework of an energy policy that could lead to new industries and, eventually, break the yoke of dependence on unstable foreign oil supplies. That is not to say that very serious economic problems are not currently standing in the way of our entrance into this bright, new era.

Inflation is eating away the paychecks. Too many people are without work. But, as President Carter recently said, the Nation has gone through wars and depressions in the past, and has emerged stronger with a brighter future.

The situation today demands our immediate attention. The administration recognizes this. The Congress recognizes this. And the Joint Economic Committee has been working vigilantly to find constructive answers to unleash the greatest productive forces in the world that are currently under harness in this recession.

Because of this recession, the rate of capital formation that should have been increasing, has instead slowed. For example, capacity utilization for manufacturing stood at 76.1 percent in June—down a full 10 percentage points from June of last year. There are some encouraging signs, such as the 2.5 percent rise in June in the index of leading indicators.

Let us hope that it bears fruit. You testified recently that Congress should not consider tax cut legislation in the pressure cooker atmosphere of an election year. Mr. Secretary, in a sense, the Nation itself is suffering in a pressure cooker. Held back inside that pot is the productive potential of America. That doesn't mean we lift the lid, as some are demanding, and set off an explosion of soaring inflation again. But some relief is being demanded.

As you know, for some time, I have felt that the Nation needs and wants a noninflationary tax cut to stimulate investment and produce higher rates of growth in productivity. As I said when I announced this hearing, "I hope we can go beyond broad generalities and deal with specifics of the next tax cut. We want to know when, in the administration's view, a tax cut should take effect, and how it ought to be structured." So let's not be distracted by other issues. Let's move on to the real issue that is facing America, and that is unleashig America's productive capacity. Having said that, it is certainly a pleasure to have with us the Secretary of the Treasury, G. Willian Miller, on our second hearing on the midyear review of the economy.

Welcome, Mr. Secretary. We are pleased to have you here. I would like to turn now to the ranking minority member.

Opening Statement of Representative Brown

Representative Brown. Mr. Secretary, the chairman has been somewhat more generous than I intend to be. That difference of perspective does not change the unamity between the chairman and myself with reference to what we think needs to be done for the future. However, I would have to assess the current situation of the United States as being adrift. We have drifted into another brutal and needless recession. We have drifted into falling incomes and falling hopes. We have drifted until we are pushed around all over the world. Our fuel bills are pushed sky high by OPEC. Our exports are pushed out of foreign markets. Our U.S.-made automobiles are pushed off American streets and out of American showrooms by foreign imports. Our people are pushed into debt, out of work and into despair.

We are not a nation of quitters. These events are not due to a so-called "malaise" among America's workers, businessmen, and savers. The fault lies with selfish, shortsighted, and destructive Government policy.

In 4 years, this administration has not successfully dealt with one major economic problem. Inflation has been out of control for 3 years. Unemployment is higher today than when the President took office and is expected to skyrocket. I am delighted the unemployment figures released today did not indicate further jumps this month. Tax reform, a big campaign promise by President Carter, is in shambles, and taxes have doubled during the Carter years. The balanced budget which President Carter promised this Nation is an impossibility because of the total failure of this administration to deal with our economic problems.

The total incompetence of this administration over the past 4 years is clearly seen in its basic economic policy. That policy is: To fight unemployment, inflate; to fight inflation, throw people out of work.

Incompetent Government policy has pushed this economy over the edge. Creeping regulatory paralysis, inadequate depreciation allowances, and soaring tax rates have crushed the incentives to work, to save, and to invest in this country.

The administration's solution to our economic ailments was to run the printing presses to inflate the problem away. This policy turned mere stagnation into the twin disasters of inflation and recession at the same time.

The great tragedy is that the inflation, stagnation, and recession were totally unnecessary in my opinion. A modest attempt to control Federal spending, by taking just 3 to 5 percent off each of the last three budgets, would have reduced spending and money growth enough to have avoided this inflation. In addition, to the $25 to $30 billion in noninflationary supply-side tax cuts, recommended by Senator Bentsen and myself in a joint news conference more than a year ago and urged by many leading economists at that time, would have prevented this recession. If this administration is not with us after November, it will be because it has understood nothing, learned nothing, admitted nothing, and done nothing about the economy of this country.

I think it is time to take steps to move on the problems that face us so that recovery can be an improvement over the record of the last 2 or 3 years.

Senator BENTSEN. Other than that, Mr. Secretary, we are very pleased to have you with us.

STATEMENT OF HON. G. WILLIAM MILLER, SECRETARY OF THE TREASURY

Secretary MILLER. Thank you very much, Mr. Chairman.

I welcome the opportunity to be here. I have submitted for the record a rather full prepared statement. With your permission, I would ask you to include it in the record. Rather than run through it, I would suggest I make a few comments from that and then refer to some of the exhibits that have been made available this morning. That might be the best way to illustrate.

Senator BENTSEN. That will be done.

Secretary MILLER. The issues that are involved are complex and do require careful study and deliberation. The timing and scale of any tax reduction are particularly critical in view of the inflationary expectations, the budgetary realities, and the impacts that these factors have on domestic and international financial markets. As you said, Mr Chairman, it is the considered judgment of the administration that Congress should not seek to enact a tax-cutting bill prior to the national election.

During 1981, properly targeted tax cuts directed at strengthening the productive foundations of the economy may well prove to be desirable. If designed with care and deliberation as part of an overall economic program, such action may well improve our economic performance over the next several years. But hasty tax cutting now would be counterproductive.

One of the probable causes of the current recession was the fever of inflationary expectations earlier this year which brought serious disarray to the financial markets and resulted in severe credit restraints

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on businesses, on farmers, and on families. Following the strong initiatives undertaken by the administration last March after extensive consultations with Congress, both the inflation rates and interest rates have come down dramatically.

These trends, aided by responsible budgetary actions by the Congress, are laying the foundation for recovery. Taking premature actions which might be perceived as undermining fiscal responsibility could well interrupt or reverse those trends and thus impair the recovery.

In addition, the brief and busy legislative session remaining before the election is not likely to provide the time or the climate for considered action.

Our joint responsibility—responsibility of the administration and the Congress—is to secure a robust, noninflationary path of growth of the economy over the years ahead. This objective will not be served by rushing forward at this time with large injections of purchasing power or undigested plans for transforming the revenue side of our fiscal accounts.

Nevertheless the opportunity to examine in depth the important issues before this committee is greatly appreciated. In order to do this, my prepared statement reviews the long- and short-term economic developments, suggests appropriate criteria against which to evaluate any future program, and outlines major choices in establishing tax policy.

Mr. Chairman, there is a natural tendency to place emphasis on short term economic policy even though the underlying problems are long term in nature. The adverse trends in inflation and productivity which we are experiencing did not occur overnight. They have been developing for at least 15 years. Therefore, we need to give serious attention to the origin of these and other economic problems as a basis for dealing with them effectively.

During the 1950's and early 1960's, the United States had strong economic performance. This period following World War II was one in which the economy moved forward to fill up the deferred demands and needs from the wartime and to help rebuild the world's ravaged economies. It was a more difficult world during the 1970's and early 1980's Inflation, generated over 15 years, has become a clear and present danger; energy prices have been pushed up very sharply by the oil exporting countries.

The international financial system has been placed under great strain. International trade has become increasingly competitive and domestic industries sometimes bear a heavy burden of adjustment.

We face a range of complex economic problems both at home and abroad. There are no simple solutions, no easy ways out. These problems can be mastered, but only if we face them squarely and resolutely, and forgo easy answers based merely on hope or rhetoric.

Significant gains have been made in the last few years. There is growing recognition that our economic problems are structural in nature and long standing in origin. The energy problem as you pointed out, Mr. Chairman, is being attacked now in a coordinated way for the first time. Fiscal and monetary policies are being formulated with greater discipline to bring inflation under control. New approaches are being explored to reinvigorate the industrial sectors of our economy.

At the present, attention is properly being focused on the economic downturn; on the recession. The current recession was not deliberately sought. It was the result—inevitable result—of the large increase in oil prices and some of the underlying factors that I will review in the exhibits. It does cause suffering to have this recession, and we will act and are acting to mitigate this distress.

The downturn also inevitably will result in some reduction in the rate of inflation, but we should plan the recovery so that we can grow without reigniting the inflationary forces. As we contemplate recovery over the coming year, economic policies should, therefore, be shaped in the interest of longrun stability. The economy needs to perform much more strongly in the future in the key areas of capital formation, productivity growth, and international competitiveness so that employment gains can be sustained without generating new waves of inflation.

If our difficulties were simple or of recent origin, the straightforward countercylical use of fiscal policy might meet the needs of the situation. But our problems are deep seated. They have developed over a long period of time. Simply pumping purchasing power into the economy will not raise the capital-labor ratio. It will not increase the rate of growth of potential output. It will not improve U.S. competitive ability in foreign markets. So the range of policy options that we need to look at needs to be reviewed in terms of long-term objectives.

Mr. Chairman, I would call attention to the special exhibits that I have made available, and just make a few points before turning to your questions.

Exhibit 1 addresses the recent performance over the 1976–79 period, between the U.S. economy and other major industrial countries. What you see quickly in this exhibit, the hatched bars show that the U.S. performance has been somewhat ahead of the other major industrial countries over this period in real terms—in terms of GNP, in terms of industrial production, and in terms of real consumption. But we have been marginally ahead. What is impressive is that we, like no other economy in the world, have been able to provide jobs for our people.

In the 3 years covered by this particular review, 3 years of the Carter administration, our employment increased 11 percent, compared with only a 2.3 percent in the other major industrial countries.

Exhibit 2 turns from that performance over the 3-year period of time and looks somewhat at the current conditions. I won't dwell on these because they are well known. Exhibit 2 reviews the various recessions since World War II, and gives the average decline from the peak to the bottom. It then compares the average recession over this period with the consensus of 42 private forecasters who view the prospects for the current period as containing a 12-month downturn that will show a decline in real terms of 3.5 percent.

The next exhibit, exhibit 3, makes a comparison between the forecast underlying the Mid-Session Budget Review, which is the subject of this hearing, and private economic forecasts.

The four leading models contain the path shown. The consensus of business forecasters provides another comparison. The Mid-Session Review submitted by the administration shows that we expect the downturn to involve about 3.1 percent contraction of real GNP output in 1980, followed by a pickup of 2.6 percent real growth in 1981.

You will notice that these are somewhat in line with the other models, although the recovery is shown to be a little slower. The unemployment rate is contemplated to reach 8½ percent.

The rate of growth of the consumer price index is shown to decline in 1981, and so is the GNP deflator. Against our forecast, the consensus seems to be a little more optimistic on the inflation outlook, and somewhat more optimistic on unemployment. The results that are shown here are not acceptable to the administration, and we intend, working with Congress, to come forward with an economic recovery program which will improve the results by this particular path, which is a forecast of what would happen if we take no additional policy measures.

Exhibit 4 shows some of the short-term impacts that we have experienced, first as a result of the rapid rise of inflationary expectations earlier this year, and then from the actions that have been taken since to dampen those expectations. What we see, of course, is a rapid runup of interest rates and then a dramatic fall of interest rates. At the same time we saw first a rapid runup of the consumer price index, and then a very substantial decline in its rate of advance. That slowing continues through the year.

So, we begin to see the movements of short-term interest rates and prices.

Mr. Chairman, you noted some encouraging signs. Exhibit 5 does list some of the better signs recently in the economy. We do not suggest from these signals that we have a recovery at hand. What we think we have is a forming of a foundation for recovery.

June housing starts were up about 30 percent.

July initial claims for unemployment insurance benefits were below earlier peaks. These are, of course, volatile numbers, and need to be confirmed by additional data.

Business inventory holdings in May, and now in June, have shown very modest gains, which is a good sign. We are not building up inventories.

Auto sales have bounced back in the first 20 days of July, not to the levels we would like, but very substantially above May and June.

We have had real growth in retail sales for the first month in quite awhile. And we have seen the leading indicators, as you have mentioned, take a substantial jump forward.

Now, the July unemployment rate that was released this morning shows that we are on a plateau. We have had 3 months now of relatively flat unemployment. These are all signs that, perhaps, we are forming a base for recovery.

But we do face four major economic challenges over the decade of the 1980's, as indicated on exhibit 6: Productivity, price stability, energy security, and improved international position.

Moving to exhibit 7, let me address the first major challenge we face. And that is the problem of productivity. This is not a problem that has been generated in the last few years; it is a long-term problem.

I have divided my analysis into three periods: There was the reconstruction period following World War II that ran up to the mid-1960's. Then there was a transition period, as the world economies expanded rapidly, and the United States suddenly had to deal with economic power rising in other parts of the world.

No longer were we the single major economy of the world. We were a first among many growing and prosperous economies. What we see very quickly is that through the postwar construction period, compensation per hour rose at 5.1 percent per year. But it was accompanied with high levels of productivity.

Senator BENTSEN. Which exhibit are you speaking from?

Secretary MILLER. Exhibit 7.

Senator BENTSEN. Seven?

Secretary MILLER. Seven.

Senator BENTSEN. Thank you.

Secretary MILLER. And look at the left panel. You will see that that panel is described as 1947--65. In that panel you will see the first bar shows compensation per hour increasing on an average annual rate of 5.1 percent. But this was accompanied by a relatively strong gain in productivity of 3.2 percent a year, so that unit labor costs were rising only at 1.8 percent.

In the period from 1965 to 1976, between the mid-1960's until the beginning of this administration, growth of compensation rates jumped up to 7.6 percent because of the unleashing of inflation during that period. But what was even more disturbing was the productivity dropdown to 1.9 percent, so that unit labor costs increased by 5.6 percent per year, and added to the inflation.

Once this inflation cycle starts, it feeds upon itself. And it has continued to feed upon itself during the last 3 years, with compensation claims increasing more rapidly, as workers try to keep up with inflation, productivity growth continuing to slow, and unit labor costs increasing sharply. This is one of our serious problems.

Our second major challenge is shown on exhibit 8. Very simply stated, in real terms, the cost of oil has just skyrocketed. We have had two great waves of increase in the real cost of petroleum. You will see that through the postwar period into the early 1970's we actually had an almost continuing decline in the real cost of oil. And we are talking about imported oil, oil that sold on the world markets.

Then after the oil embargo of 1973, we had the giant leap upward which, of course, set off a wave of inflation as we tried to absorb that new higher price for petroleum.

Then what with the great economic disturbances that followed that period, real oil prices did not increase until 1979. The fall of the Shah of Iran and the withdrawal of Iranian oil supplies from the market set up conditions which along with other elements, led to the second great oil price shock. Again we had a skyrocketing increase in the price of oil, and this has exacerbated all of our economic problems.

You can see also on exhibit 9, the problem is not only the price of oil, but the aggregate dollars that we in the United States needed to pay in order to import oil. Through the postwar period up until 1970, we had modest outflows of cash to pay for imported oil. We depended more on domestic oil.

In 1970, we imported about $3 billion worth of oil. But by 1977, it was $45 billion; and in 1979, $60 billion. And this year it will be in the $85 to $90 billion range. At this rate of transfer of wealth outside our country, with no change in the real volume or the energy that we receive, we have obviously a great problem. The thing to do is to hammer out a national energy policy which will break the link between growth of our economy and energy requirements, which will reduce our dependence on imported oil, and which will cause a shift to indigenous sources of energy and to nonoil sources.

From exhibit 10 we see, after a long period of growth in the volume of petroleum imports that in the last few years, at least, we have turned the corner, and there has been a very substantial decline in the amount of petroleum we import. We peaked at about 8½ million barrels per day of imports in 1977. This year we will be down to 6½ or 7 million. So thanks to the policies that have been worked out in the last few years and also to the effects of decontrol of domestic crude, we are seeing opportunities for expanding domestic sources of energy production and reducing dependence upon imported oil.

Our third great economic challenge is inflation. From exhibit 11 we see, for the periods of time shown, how the interaction of slower productivity, growth of the oil price shocks, and of inflation feeding upon itself, has caused inflation to steadily grow until it is a clear and present danger.

The fourth challenge is to be sure that we improve our competitiveness in the world so that we can export enough of our goods and services to pay for the needed imports. Of course, we now live in a much more interdependent world where many of our materials must be imported.

Exhibit 12 shows that during the postwar reconstruction period our exports substantially exceeded our imports. We, therefore, operated with a continuing large merchandise trade surplus.

During the transition period from 1966 to 1976, exports and imports were equal. But in the recent years, imports have outpaced exports. This was the result of the enormous growth of oil imports, and came about even though our exports have skyrocketed in terms of percent of GNP, going from 4 percent in the earlier period and 5 percent in the transition period to a 7-percent average over the last few years. We are currently much higher than that in terms of exports as a percent of GNP.

Exports are, of course, an important source of job creation at home. And it is important to have competitive production here to serve our own markets so we do not lose these markets by default to intense competition from abroad. But the main thing we need to do is to increase our competitiveness so that we can export more and close that trade deficit.

Mr. Chairman and members of the committee I will not read it, but in exhibit 13 are listed the components of a comprehensive long-term economic strategy to deal with these challenges. We obviously must address the issue of productivity. It involves increased investment, and it involves continuing reduction of the regulatory burden upon productivity.

We need to achieve price stability through a comprehensive strategy that includes monetary and fiscal restraint and continues to seek moderation in wage and price actions in order to avoid another spiral. We need to continue to pursue our energy security, and we need to improve our international position and assure a strong trade balance.

Exhibit 14 indicates some of the factors contributing to declining productivity growth. But perhaps it's easier to see this in a major way by looking at exhibit 15.

There are many factors that affect productivity, but one of the main factors is the ratio of capital to labor. That represents the number of modern tools and equipment that we put in the hands of American workers that allow them to be productive.

In the period of the postwar reconstruction, the left panel, what we see is that the capital-labor ratio grew annually at a 3-percent rate, and productivity increased at 3.2 percent per year. In the period 1965 to 1976, the capital labor ratio grew at only 1.8 percent and productivity grew at 1.9 percent. In the 1976–79 period, what with a great influx of new workers, our capital-labor ratio did not keep pace, and our productivity growth declined. We need to address this particular problem.

On exhibit 16, we point out that an increase of 1 percentage point in the share of GNP for business fixed investment would raise the real net stock after replacement, the net stock of business fixed capital, by about 5 percent over 5 years, and would raise the level of productivity at the end of 5 years by 1½ percent. And this would substantially increase the real standard of living over the coming decades. Additional productivity could help offset inflationary pressures, and so this is a key element of what we must do. This means that we must favor investment and not encourage excess demands for goods and services so that we put in place the productive capacity to produce a growing volume of goods and services.

Exhibit 17 points our another problem with productivity. That is, while we had a strong growth in the postwar reconstruction period in Federal support for research and development, during the transition years, 1965–76, there was a decline after adjustment for inflation. The Carter administration has made a conscious effort to increase the support for research and development by at least 3 percent in real terms each year. This is designed to lay the base for developing the best technology, the best practice, in order that we may increase the base for productivity gains of American workers. This effort will be continued and enhanced.

Exhibit 18 points out how the relationship between potential GNP and acutal GNP affects inflation and affects our current thinking on economic strategy.

The line that curves up normally shows the potential GNP. When actual GNP falls below potential, we have a gap, and slack in the economy.

Of course, when we have excess demands when we are beyond our potential, we create considerable inflation. During the period from 1947 to the midsixties, basically we had a very good relation between potential GNP and actual performance. We did not strain resources. From 1965, on, we have tended more and more to try to manage our economy by stimulating demand before we increased the productive potential.

You see a period during 1965 to 1970 where constantly we operated above our potential output. The result was that we got higher prices because we created demand for which there was not adequate production of goods and services. What we must be careful about now is to concentrate our efforts on obtaining more investment to increase our potential before we push the demand for goods and services up against that potential and simply exacerbate inflation.

We must remember that, for historical reasons, we are now trying to build our economic growth from the base in which inflation has been inherited at a high level, and, if we are not careful, we could start if off again.

Exhibit 19 is important because it indicates that if we are to deal with our problem of inflation and our other economic challenges, it is clear that we must restrain the growth of the Federal Government. We must particularly be cautious that the Federal Government doesn't take an increasing share of GNP and thereby restrain the capacity fo the private sector to produce more goods and services more efficiently.

This is a very important exhibit, and I hope we can look at it carefully. From the left panel, we see that in the postwar period the real growth of Federal spending—this is budget outlays in real terms—grew at an annual rate of 3.4 percent. At the same time, the potential of economy grew at 3.8 percent. Thus, we did not increase the ratio of the Federal Government to total economy.

However, look what happened between 1965 and 1976. We were increasing real Federal spending at 4 percent a year while the potential of our economy was only growing at 3.4 percent. Thus, year after year we were putting more of the economy into the Federal Government and drawing it out of the private sector.

Look what's happened in the last 3 years plus what's projected in the budget you have before you. We will have made a major reduction in the annual rate of growth of real Federal spending, down to 1.7 percent, the lowest in the whole postwar era, while the potential of the economy will have grown to 2.7 percent.

And we can get our economy growing faster. If we can hold down Federal spending, then we will, over time, greatly reduce the portion of GNP represented by Federal spending, and that will release the resources, as the chairman pointed out, to the private sector to get growth, to get investment, and to revitalize our economy.

This may be looked at in another way on exhibit 20. It shows the same figures for growth of total Government spending. In the postwar reconstruction period, our total Federal spending grew at 3.4 percent a year, real terms. Our defense spending grew at 4.8 percent per year, and our nondefense spending at 2.7 percent.

Look what happened in the period of 1965–76. Initially, there was a rapid runup in defense spending, but then a rapid rundown. And over the whole period, growth per year, as we have already seen in the other chart of total Government spending, was 4 percent. Our spending for defense over the whole period, in terms of annual rate of real growth, was actually negative.

Nondefense spending shot up by 6.2 percent in real terms, so that overall, we increased the level of real Government spending. And since Government spending grew faster than the growth of the economy, we made Government a bigger part of our lives. What we have been endeavoring to do throughout the Carter administration is to reverse that trend.

If the 1981 budget, as now before the Congress, is approved, the growth over 5 years will have been in real terms 1.7 percent, of which 3.2 percent per year would be for defense spending to build back our security forces, and 1.3 percent for nondefense spending.

Now, I must warn the committee that growth was not steady during this period. For the first 2 years of this period, we have very low or negative growth of real outlays. In 1980, because of a number of factors, including the recession, the growth in real outlays was 5 percent, and we will have a negative growth in 1981 if the present budget is approved. So growth has been low, jumps up in 1980, then drops back down. Overall, this holds the rate of increase in real spending to 1.7 percent.

It is for these reasons that we have felt so strongly that we needed to show discipline and restraint in the 1981 budget before we looked at other economic policies that could undercut that discipline. If we let this particular situation get out of control, we will go back to the experience of prior times, and we will defeat our long-term objectives of generating an atmosphere in which greater private investment can build greater growth of the economy, more jobs, lower unit costs of output and greater price stability.

Mr. Chairman, elements of a tax policy meeting the particular criteria set forth in my presentation are shown in exhibit 21.

Elements of a depreciation program are shown on exhibit 22. Details have been submitted in my prepared statement. I will not take your time now to review them, except to make the point that I think, as we look at tax policy in the future, we should do so in the context of, first, making sure that we relate our tax policy to an agreed-upon strategy and agreed-upon criteria. We just shouldn't take everyone's ideas and dump them into a pot without sorting them out and relating them to primary objectives. We cannot afford to do everything. We must assign priorities. We must attack the four basic problems with vigor and with consistency.

The United States stands on the threshold of a new economic era. While there may be pessimism now because of the recession, actually the task ahead for the 1980's is very exciting because we do have the opportunity to revitalize our economy through the actions already taken by the Congress. We are on the threshold of unleashing a major expansion in the energy sector. We will build an entire synthetic fuels industry in this decade. We will rebuild the automobile industry to make new fuel-efficient cars. We will double our production of coal. We will revitalize our steel and basic industries, we will support in the public sector those public investments that are consistent with the needs of the economy in pursuit of these primary objectives, improving our transportation, our housing stock, our public buildings, our ports and facilities for exports. All of these, give us a great opportunity as we pursue that objective of building and revitalizing our country.

We should constantly keep in mind those four objectives:

First, to improve our competitive capacity, which means more investment in the private sector supported by consistent public investment which enhances and supplements private objectives;

Second, to reachieve price stability, digest the oil price shock, and to improve the capacity for our country to produce at stable prices;

Third, to improve our competitive position in the world, both because we then can better serve our own markets, and because we can reach markets throughout the world; and

Fourth, to make ourselves secure in energy and other areas so we will no longer be vulnerable to the kinds of shocks we have seen in the recent period.

Thank you very much, Mr. Chairman.

Senator BENTSEN. Thank you, Mr. Secretary.

[The prepared statement of Secretary Miller, together with exhibits 1–22 referred to in his oral statement, follows:]

PREPARED STATEMENT OF HON. G. WILLIAM MILLER

Mr. Chairman and Members of the Committee, thank you for inviting me to present the Administration's views on the important subject of tax policy. The question is whether a tax reduction package should be enacted in the near future, and if so when and with what characteristics and of what magnitude.

The issues involved are complex and require careful study and deliberation. There are many criteria against which alternate courses of tax action should be evaluated. The timing and scale of any tax reduction are particularly critical in view of inflationary expectations and budgetary realities—and the impact of these factors on domestic and international financial markets.

It is the considered judgment of the Administration that the Congress should not seek to enact tax cutting legislation prior to the national election.

During 1981, properly targeted tax cuts directed at strengthening the productive foundations of the economy may well prove to be desirable. If designed with care and deliberation as part of an overall economic program, such action may well improve our economic performance over the next several years.

But hasty tax cutting now could be counterproductive. One proximate cause of the current recession was the fever of inflationary expectations early this year which brought serious disarray into the financial markets and resulted in severe credit constraints on businesses, farmers, and families. Following strong initiatives undertaken by the Administration last March after extensive consultations with Congress, both inflation rates and interest rates have come down dramatically. These trends, aided by responsible budgetary actions by the Congress, are laying a foundation for recovery. Taking premature action which might be perceived as undermining fiscal responsibility could well interrupt or reverse those trends and thus impair the recovery.

In addition, the brief and ~~busy legislative~~ session remaining before the election is not likely to provide the time or climate for properly analyzing the kind of structural and well-focused tax and other economic measures essential to the long-term health of the economy. Our joint responsibility is to secure a robust, non-inflationary path of growth for the economy over the years ahead. This objective is not served by rushing forward at this time with large injections of purchasing power or undigested plans for transforming the revenue side of the fiscal accounts.

Acting after the election rather than in haste over the coming weeks would also allow us to gain a much better understanding of the economy's evolution into recovery, a much better view of trends and decisions on federal spending, and a firmer consensus on other economic measures needed to improve the economy's performance over the new decade.

Nevertheless, the opportunity to examine in depth the important issues before this Committee is greatly appreciated. In order to do so, it is proposed to review long- and short-term economic developments, to suggest appropriate criteria against which to evaluate any future tax program, and to outline some of the major choices in establishing tax policy.

NEED FOR LONGER-RUN PERSPECTIVE

There is a natural tendency to place emphasis on short-term economic policy even though the underlying problems are long-term in nature. The adverse trends in inflation and productivity which we are experiencing did not occur overnight. They have been developing for at least the last fifteen years. Therefore, we need to give serious attention to the origin of these and other economic problems as a basis for dealing with them effectively.

The 1950's and the early 1960's were a period of strong U.S. economic performance in both domestic and international markets. Throughout much of the period, U.S. productive strength was unquestioned and the dollar was strong. It has become a more difficult world during the 1970's and early 1980's. Inflation has become a clear and present danger. Energy prices have been pushed up very sharply by the oil exporting countries. The international financial system has been placed under great strain. International trade has become increasingly competitive, and domestic industries sometimes bear a heavy burden of adjustment. We face a range of complex economic problems at home and abroad. There are no simple solutions, no easy ways out. These problems can be mastered—but only if we face them squarely and resolutely, eschewing easy answers based purely on hope or rhetoric.

Significant gains have been made in the last few years. There is an increasing realization throughout the country that many of our economic problems are structural in nature and long-standing in origin. The energy problem is being attacked now in a coordinated way for the first time. Fiscal and monetary policies are being formulated with greater discipline to bring inflation under control. New approaches are being explored to reinvigorate the industrial sector of our economy. Substantial progress has been made in reducing the burden of government regulation on the private economy.

At the present, a great deal of attention is properly being focused on the economic downturn. There have been six previous periods of contraction since World War II and on average they have lasted a little less than one year. The weight of informed economic opinion—inside and outside of government—is that the current period of contraction will end late this year or early next, and will not be as deep as in 1973–75.

The current recession was not deliberately sought. It has inevitably caused real suffering, which we are acting to mitigate. The downturn, also inevitably, will result in some reduction in the rate of inflation. Recovery must proceed without reigniting inflationary forces.

As we contemplate recovery over the coming year, economic policies should therefor be shaped in the interest of longer-run stability. The economy needs to perform much more strongly in the future in the key areas of capital formation, productivity growth, and international competitiveness, so that employment gains can be sustained, without generating new waves of inflation. That will not be accomplished by a hasty, across-the-board tax cut. Any tax program to reinforce recovery should be carefully constructed to be consistent with overall economic objectives.

If our difficulties were simple or of recent origin, the straightforward countercyclical use of fiscal policy might meet the needs of the situation. But our problems are deepseated. They have developed over a long period of time. Simply pumping purchasing power into the economy will not raise the capital-labor ratio, increase the rate of growth of potential output or improve U.S. competitive ability in foreign markets.

The range of policy options that we should have under active consideration can best be appreciated by reviewing the general trend of economic events that forms the background to the current situation.

THE POST WAR ERA, 1945–65

The roots of our current economic problems go back several decades. During the 1950's our economy performed significantly below its potential. As a result, in the early 1960's we were able to improve our economic performance by exploiting under utilized resources. We did not have to face difficult trade-offs, but were able to have more of everything by running the economy closer to capacity. Our current problems began after the mid-1960's when we tried to continue this approach long after we were running up against economic limits. Policies of economic stimulus began to be reflected primarily in rising prices, not in rising output.

In the first twenty years of the postwar era, the U.S. international payments position was strong and we were able to assist in the rebuilding of war-ravaged foreign economies. Thereafter we have been faced intermittently with balance of payments difficulties in an intensely competitive international economic environment. In the earlier period, energy was cheap and readily available. As a result, U.S. production methods and patterns of consumption were heavily conditioned by low relative prices of energy. Subsequently, a difficult and painful adjustment has had to be made in an environment of energy scarcity.

Relatively Stable Prices.—During the period from 1947 to 1965, the GNP deflator rose at a 2.3 percent annual rate and the consumer price index at a 1.9 percent annual rate. There was a sharp run-up of prices at the time of the Korean War, but relative stability in the price level was characteristic of much of the rest of the time. During the same 1947 to 1965 period, compensation per hour (wages plus fringes) in the private business sector rose at an average of 5.1 percent annually, but there was a strong 3.2 percent annual rate of increase in productivity, which held the rise in unit labor costs to a relatively modest 1.8 percent annual rate of increase. This was about in line with the rise in the price level. Cost-push factors were no particular problem and inflation was held fairly well in check.

Longer-term price movements over this period masked some shorter-term swings. For example, the period 1955 through 1957 was one of moderately accelerating inflation and relatively high rates of resource utilization. The capacity utilization rate in manufacturing was pushed into the range generally associated with accelerating rates of inflation. Considerable concern was expressed at the time over the threat of inflation. However, the ensuing period from 1957–1963 was one of relatively low resource utilization and decelerating inflation. The manufacturing utilization rate dropped to 80 percent and the rate of unemployment averaged 6 percent during those years. As a result, the annual rate of increase in the GNP deflator fell back to 1½ percent, about one-half of the rate experienced in the 1955–57 period. The following two years, 1964 and 1965, saw a transition to a fully utilized economy, and by the mid-1960's the postwar period of relatively low rates of inflation was drawing to a close.

Strong Growth in Productivity.—The early postwar decades featured a return to the fairly steady rates of growth in productivity which had been characteristic of much of U.S. 19th and early 20th century economic experience. Between 1947 and 1965, output per hour in the private business sector rose at a 3.2 percent annual rate, or at a 2.6 percent annual rate with agriculture excluded. Real nonresidential fixed investment averaged in the 9 to 10 percent range as a percentage of GNP throughout the period. There was a relatively strong rate of growth in the stock of capital employed in the private business sector, about 3½ percent per year on a gross basis and more than 4½ percent per year on a net basis (after allowance for capital replacement). These rates of growth in the capital stock were substantially higher than have been achieved in subsequent periods.

The civilian labor force grew at a relatively modest rate by current standards, only 1.2 percent annually over the years from 1947 to 1965. The combination of a rapid rate of growth in the capital stock and a relatively slow rate of growth in the labor force meant that the capital-labor ratio showed strong gains during the first two postwar decades, rising at a 3 percent annual rate on a net basis over the 1947–1965 period.

There is general agreement that the growth in economy-wide productivity reflects many influences. However, there has been a close association in the postwar period between the capital-labor ratio and the rate of growth in productivity. The more rapid application of capital into the productive process means that labor works on the average with more and better tools of production. This generally results in improved productive performance.

By the early 1960's, there was some expression of concern that the U.S. rate of investment was beginning to lag, particularly in relation to that of some other major industrial countries. Through much of the early postwar period, however, the capital stock had expanded steadily and the rate of growth in productivity was relatively satisfactory. Difficulties in this crucial area only surfaced in unmistakable fashion during the 1970's.

Cheap and Readily Available Energy.—In the early postwar period, domestic energy production was able to supply the needs of the economy at relatively stable and even falling prices. Total energy consumption rose at about a 3 percent annual rate and the ratio of energy per unit of GNP drifted down slightly. Gasoline, heating oil, and electricity prices rose less rapidly than the consumer price index, thereby encouraging energy consumption rather than conservation. Natural gas prices rose faster than the consumer price index, but on a heat-content basis, natural gas use rose faster then heating oil throughout the period. The average price of electricity dropped and electricity consumption expanded.

The average fuel costs to the electrical generation industry can be used as a proxy for industrial energy prices. Between 1950 and 1965, coal costs decreased 9 percent in current dollars and fuel oil costs rose only 5 percent. Natural gas costs on a heat-content basis were less than oil, and less than, or about the same as, coal throughout the period. In the 1950's, natural gas was still largely an unwanted by-product of oil production and exploration.

Between 1950 and 1965, crude oil reserves grew from 25.3 billion barrels to 31.4 billion barrels. Quotas limited the importation of foreign oils, which undersold domestic production. Nevertheless, imports of petroleum grew from 550,000 barrels per day in 1950 to 2.3 million barrels per day in 1965. Natural gas reserves grew from 185 trillion cubic feet in 1950 to 287 trillion cubic feet in 1965, and natural gas distribution systems and consumption expanded rapidly during the period. Coal production was limited only by demand.

In general, the energy situation in the early postwar period was conducive to rapid economic growth and relatively low energy prices encouraged its consumption. Supplies of energy increased rapidly and there were periods of overproduction and falling prices. No serious constraints to growth had emerged by the mid-1960's, although it was becoming apparent by then that the long period of cheap and abundant U.S. crude oil resources was coming to an end.

Strong Dollar Internationally.—In the immediate postwar period, the dollar reigned supreme. This was the era of "dollar shortage" during which foreign countries resorted extensively to capital and exchange controls to protect their currencies. Full currency convertibility was only established for the European countries in the late 1950's.

The U.S. balance of payments situation was very strong from 1946 to 1949 with a merchandise trade surplus averaging about $7 billion a year and a favorable balance on current account averaging nearly $4½ billion, even after massive unilateral transfers to enable other countries to rebuild their devastated economies. From 1950 to 1959, the merchandise trade surplus averaged only about $3 billion a year, and the favorable balance on current account averaged less than $1 billion annually. Subsequently, in the 1960 to 1965 period, the U.S. payments position swung back in the direction of improvement with an average annual trade surplus of nearly $5¼ billion and a favorable balance on current account of nearly $4¼ billion annually. By the end of this period, some signs of strain began to emerge, but chiefly on capital account where low U.S. interest rates and freely accessible capital markets encouraged a high rate of U.S. lending to foreign borrowers.

Exchange rate adjustments throughout the first two postwar decades were on the initiative of foreign countries against the dollar, which remained at the center of the international financial system in a fixed relationship with gold. Following the reestablishment of currency convertibility in the late 1950's, the dollar appreciated gradually against other major currencies until the late 1960's and early 1970's. By 1965, although some signs of balance of payments strain were emerging, the dollar remained the anchor of the world monetary system.

Rising Standard of Living.—Economic expansion yielded sizable gains during the first twenty years after World War II, despite interruptions to growth during four recessions. From 1947 to 1965, real gross national product rose at about a 3.9 percent annual rate. Real disposable personal income (personal income after taxes and corrected for inflation) rose at about a 3.7 percent annual rate, and at nearly a 2 percent annual rate on a per capita basis. Median family income in real terms was more than 60 percent higher by 1965 than it had been in 1947.

The combination of strong economic growth, rapid rates of increase in the private capital stock and rising productivity contributed to gains in real income. Energy supplies were adequate and a reasonable degree of success in containing nflation kept the dollar strong at home and abroad.

THE ERA OF TRANSITION, 1965–76

The transition to more difficult times began after 1965 when production was expanded for a war effort without cutting back in other areas. Indeed, a sizeable—although long overdue—expansion of domestic social programs was undertaken at about the same time.

In the early 1970's, new demands were placed on the economy for environmental quality without making trade-offs to give up something else. There was a continued belief that we could have more of everything when this was no longer possible. The oil boycott and oil price shock added to the difficulties. Inflation was the inevitable result. An ill-fated effort to apply mandatory wage-price controls in the early 1970's only worsened the underlying situation.

Partly as a consequence of domestic inflation, the dollar weakened in foreign exchange markets and came under speculative attack. The dollar was devalued twice in the early 1970's, and then was permitted to float, more or less freely, against major currencies. In late 1973 the OPEC oil embargo and subsequent cartel pricing signalled the end of an era of inexpensive energy and placed this country in a position of dangerous dependence on uncertain sources of foreign supply.

The 1965–1976 period was a rude awakening to economic reality. New demands were added onto the economy faster than the capacity to satisfy them was expanded. More and more was demanded from the economy and by the end of the period the capacity to produce in the future had been eroded substantially.

Deteriorating Price Situation.—The period from 1965 to 1970 was one of excessively high rates of resource utilization. The rate of unemployment averaged below 4 percent and demand pressures were more or less chronic during most of the period. Inflation as measured by both the GNP deflator and the consumer price index averaged over 4 percent, more than double the rate in the first half of the 1960's. During the period from 1970 to 1975, the after effects of excess demand pressures from the late 1960's combined with a series of shocks, including the OPEC boost in oil prices, to produce additional acceleration in inflation. Inflation as measured by both the GNP deflator and the consumer price index averaged about 6¼ percent during the 1970–76 period and peaked in the double-digit range prior to the 1974–75 contraction.

Compensation per hour (wages plus fringes) in the private business sector moved up to a 7.6 percent rate of increase in the 1965–1976 period, some 2¼ percentage points above the 1947–1965 average rate of increase. In addition, the rate of growth in productivity fell off by more than a full percentage point to a 1.9 percent rate of growth between 1965 and 1976. As a result, labor costs per unit of output rose at a 5.6 percent annual rate in the 1965–1976 period, nearly 4 percentage points above the increase between 1947–1965. Cost-push pressures became firmly imbedded in the wage-price structure by the mid-1970's, making the permanent reduction of the rate of inflation a difficult task.

Declining Rate of Growth in Productivity.—During the 1965–76 period, the strong rate of productivity growth established in the first two postwar decades began to taper off. Output per hour in the private business sector grew at a 119 percent annual rate, or 1.6 percent with agriculture excluded. This represented a significant decline from the 3.2 percent, or 2.6 percent rate with agriculture excluded, recorded between 1947 and 1965.

Growth in the civilian labor force picked up speed, rising 2.2 percent annually in the 1965–1976 period in contrast to 1.2 percent between 1947 and 1965. Growth in the stock of private business capital was relatively well maintained, although showing some retardation in growth on a net basis and after exclusion of pollution abatement expenditures. As a result primarily of the more rapid rate of growth in the labor force, the capital-labor ratio grew much more slowly in the 1965–1976 period than it had in the first two postwar decades.

It is not possible to identify the exact point at which the U.S. rate of productivity growth began to decline. Some of the slowdown may have arisen gradually over time. Some may have been occasioned by the sharp rise in energy prices after 1973. It is clear that the rate of growth in productivity had slowed drastically by the close of the 1965–1976 period.

Energy Shock.—In 1973, events in international oil markets, in particular the oil embargo, pushed world oil prices far above those for domestic controlled oil. The resulting shock to the U.S. was substantial since imports and consumption of oil had been rising rapidly while domestic production of oil and gas had been declining after 1971.

From 1965 to 1973, total U.S. energy consumption grew at a 4.4 percent annual rate, compared with a 3.1 percent annual rate during the previous fifteen years. The energy to GNP ratio rose to a peak by 1970. Motor gasoline consumption was stimulated by the completion of thousands of miles of interstate highways, increased motor car ownership, and rising personal income.

Supply problems began to appear in the energy field in the early 1970's. The use of coal was inhibited by environmental regulations and other factors. Natural gas deliveries could not keep up with demand and reserves began to top out in 1972. Domestic crude oil production peaked in 1970 and reserves would have fallen appreciably by 1975 except for the discovery of the Alaskan North Slope fields. Domestic oil production could no longer expand to meet demand and imports filled the gap. Imports increased from 2.3 million barrels per day in 1965 to 6 million barrels by 1973 and then dropped slightly by 1975.

The OPEC oil embargo hit with particular force because of the growing dependence of the U.S. economy on oil imports. Imported oil prices rose from $2.14 per barrel in 1966 to $3.37 per barrel in 1973. Following the embargo in the winter of 1973–74, imported oil shot up to $11.45 per barrel in 1975.

Gasoline prices rose 83 percent and heating oil prices by 144 percent in the 1965–1975 period, compared to a 71 percent rise in the consumer price index. Most of the oil price increases were in the last two years of the period when gasoline prices increased by 27 percent and heating oil prices by 71 percent. Natural gas prices increased by 66 percent between 1965 and 1975, with a 33 percent increase between 1973 and 1975.

Industrial energy prices rose much faster than consumer prices during the 1965–1975 period.

Coal prices advanced 254 percent, with a 106 percent increase between 1973 and 1975.

Natural gas prices for industrial use increased 201 percent, with a 113 percent increase between 1973 and 1975.

Fuel oil prices advanced 509 percent, with a 195 percent jump between 1973 and 1975.

A Weakening Dollar.—The 1965–1975 period was one of intensifying pressure on the U.S. dollar. At the beginning of the period, the U.S. was running a surplus of about $5 billion both on merchandise trade and on current account. By the early 1970's both of these surpluses had been wiped out and the international competitive position of the dollar was severly impaired. The international financial system was fundamentally changed in August 1971 when the United States announced suspension of the convertibility into gold of dollars held by foreign monetary authorities. Following this action, major exchange rate alignments, coupled with devaluation of the dollar in terms of gold, were negotiated in December 1971 and February 1973. Subsequently, the international monetary system moved to a regime of managed floating.

Between 1969 and 1974, the U.S. dollar depreciated about 16 percent on a trade weighted basis against the currencies of other major industrial nations. Cyclical improvement in the U.S. balance of payments and other factors led to some temporary strengthening of the dollar and by 1976 the trade weighted depreciation was about 10 percent relative to the base rates on May 1970. By the end of the 1965–75 period, the U.S. trade account had moved back into a $9 billion surplus and the current account was in surplus by $18 billion. Exchange rate adjustments and temporary cyclical factors were largely responsible for the improvement. However, the longer run balance of payments outlook was clouded by the existence of a rapidly rising bill for oil imports.

Standard of Living Continues to Rise.—Despite the sharp adjustments occurring after the mid-1960's, standards of living continued to rise. In the 1965–1976 period, real GNP rose at a 2.9 percent annual rate, a little below the postwar average rate of increase. Real disposable income rose at a 3.5 percent annual rate and at about a 2.5 percent annual rate on a per-capita basis. However, constraints on growth were much more evident at the end of the period than at the beginning, and the rate of inflation had accelerated. A sharp decline was developing in the rate of growth in productivity which would limit the potential for future gains.

RECENT ECONOMIC PERFORMANCE, 1976–80

By the last half of the 1970's, the Nation faced a watershed in its economic history. The world economy was changing at a revolutionary pace. The adverse trends which had developed with respect to inflation, productivity growth, and international competitiveness moved to center stage in the Nation's discussions of economic policy. The Nation responded to these challenges by moving to break important deadlocks in a number of important areas of economic management.

This process has involved painful choices. Changing the Nation's course on matters of such fundamental economic importance as energy policy and control of federal spending could not be accomplished overnight or without intensive debate. We have not succeeded completely on every front: there remains a significant agenda of unfinished business. But in many key areas of economic policy, a new strategic consensus has been forged, laying the basis for improving our basic economic performance over the next decade.

Some of the key areas in which progress has been made include:

Fiscal prudence: The Administration and Congress have made the containment of domestic spending growth a major priority of economic policy. Working together, we have strengthened budget procedures and discipline and provided for rigorous annual review of "off budget" items through the new Credit Budget. Real growth in non-defense spending has been dramatically reduced from the high rates registered over the previous decade.

Domestic monetary policy: The Federal Reserve Board has improved its control over the long-term growth of monetary aggregates as a means for bringing down the inflation rate.

Wage-price policy: The Administration has disavowed mandatory controls and has instead developed a structure of voluntary wage-price standards. Econometric tests indicate that the inflation rate is now 1 to 1.5 percentage points lower than it would have been without the program.

Energy policy: Programs for implementing the phase-out of price controls on crude oil and new natural gas are now in place. Massive new initiatives have been adopted to develop alternate energy sources and spur conservation of oil. The new Synthetic Fuel Corporation will help create a huge, new industry of energy supply, drawing upon the Nation's abundant coal and shale oil resources.

Deregulation: Regulations have been substantially reduced with respect to airlines, trucking and financial institutions. Large portions of the U.S. economy have been returned to the discipline and opportunities of competitive market forces.

While considerable progress has been made, in many areas continuing efforts will be required over a number of years. F 'ure policies must place great stress on controlling inflation and stimulating pr..uctivity. In reviewing the record of recent years, it is important to recognize accomplishments, but even more important the need for continued progress.

Real Growth.—Substantial gains have been made in recent years in terms of real growth. From the trough quarter of economic activity early in 1975 through the first quarter of 1979, real GNP grew at an annual rate of 5.1 percent. From the end of 1976 through the first quarter of 1979, that growth rate was 4.8 percent. In the next four quarters, real growth slowed to about a 1 percent annual rate, and in the second quarter of this year real growth declined sharply—at an 9.1 percent annual rate according to the preliminary estimates released recently. However, even after this decline, real GNP is about 20 percent above the early 1975 low.

This is a strong performance by past standards, but it obviously reflects cyclical gains to a considerable extent. Real growth since the last cyclical peak in the fourth quarter of 1973 has been about 2½ percent annual rate. This corresponds more closely to estimates of the economy's current trend rate of potential economic growth. Potential growth has been estimated by CEA as having been about 3 percent between 1973 and 1978 and likely to fall to a 2½ percent annual rate between 1979 and 1982. This stands in marked contrast to an annual trend rate in potential of about 4½ percent from 1947 to 1953, and about 3½ percent from 1953 to the early 1970's. Aside from cyclical movements, the real progress of the economy is inevitably limited to its trend potential.

Tax cuts designed simply for fiscal stimulus do little to enhance the economy's potential to produce goods and services. Attention needs to be directed toward tax policies to promote long-term growth potential, i.e., to raise the economy's ability to produce goods and services. The lesson of the recent expansion is that the economy encounters real barriers to expansion, reflected in an acceleration of inflation, long before unemployment can be reduced to desirable levels. Efforts should therefore be directed at the supply side of the economy, including selective programs to attack structural unemployment.

Productivity and Investment.—Productivity fell off sharply in the 1973-75 recession, and then made a strong cyclical recovery in 1975 and 1976. During 1977 and 1978 productivity increased by an average of only 1 percent per year. Over the past year, productivity has actually declined by about 1½ percent. During the early stages of a recovery, growth in output tends to exceed increases in labor input by wide margins, but productivity gains tend to slow rather markedly as the expansion ages. The more disturbing feature of productivity experience is the apparent lower trend since the late 1960's. Between 1948 and 1968, productivity in the private nonfarm business sector of the economy rose 2.6 percent per year; between 1968 and 1973 that growth slowed to 1.7 percent per year; and during the 1973 to early 1980 period growth slowed still further to less than ½ of one percent.

The causes of the apparent secular decline in productivity are still the subject of academic inquiry and difference of opinion. Some of the more important causes of the slower trend growth in productivity that have been advanced are:

Demographic factors have been important since the mid-1960's, as the proportion of new, young and inexperienced workers in the labor force increased.

An increasing proportion of capital investment has been diverted in recent years to meeting government regulations directed at improving the health and safety of workers and the environment. Labor resources have also been diverted. While these are essential efforts they do not contribute directly to measured output in productivity. These programs will continue but are unlikely to increase at the rates of the recent past.

A variety of other factors—such as the increase in energy prices and a decline worker motivation—have also frequently been cited as adverse influences.

In the opinion of many observers, the most important single factor has been a dramatic slowdown in the rate of growth of the capital-labor ratio. More capital per worker generally contributes to higher productivity, and the sharp fall in that ratio is a matter of real concern. In the 1976-79 period, the ratio of the capital stock to the civilian labor force edged up only slightly on a gross basis and actually fell on a net basis. This stands in marked contrast to average gains in the net capital-labor ratio of 3 percent annually from 1945 to 1965 and nearly 2 percent annually from 1965 to 1976.

It must be emphasized that business fixed investment has made a strong cyclical recovery in recent years. The problem is to assure that these are sufficient incentives to boost the amount of capital investment in the permanent fashion that is required to raise productivity and the trend rate of potential growth. That should be one of the major objectives of tax and other policies over the years ahead.

Employment.—Growth in employment has been a major achievement of the Carter Administration. Since late 1976, civilian employment has increased by nearly 11 million persons, even after allowance for the cyclical employment declines of recent months. The ratio of employment to working age population has reached record levels, although receding from its peak in recent months. On the other hand, the rate of unemployment has remained higher than desirable, reaching a low for the expansion in the 5½ to 6 percent range, before rising rapidly in recent months. The rise in the unemployment rate in the current contraction has been heavily concentrated among blue collar jobs which are predominantly held by adult men. This cyclical rise in the unemployment rate will be reduced when the economy turns up again. However, more remains to be done in combatting structural unemployment if the average level of unemployment over the cycle is to be reduced to more acceptable levels.

The largest employment gains have been made by women and minority groups. Employment of adult women has increased by nearly 16 percent since late 1976, compared to about 5½ percent for adult men. Employment of blacks and other minority groups has increased by 12 percent compared to a 9 percent rise for all groups.

Employment gains are an important measure of the performance of the economy. However, it is also crucial that productivity advance rapidly so that increased employment will mean rising standards of living.

Energy.—Considerable progress has been made in reducing the Nation's reliance on insecure sources of foreign oil. Programs now in place should yield increasing returns in the period ahead. Already some tangible signs of progress can be seen. Between 1975 and 1979, total energy consumption grew at a 2.4 percent annual rate, slower than at any time during the previous 15 years. The energy/GNP ratio dropped steadily during the 1975–1979 period, and indications are that the ratio will drop further in 1980. Gasoline consumption peaked in 1978 at 7.4 million barrels per day and dropped to 7.0 million in 1979. In 1980, gasoline consumption could drop to about 6½ million barrels per day if present trends continue.

Domestic energy supply has increased over the period. Crude oil production edged up to 8.53 million barrels per day from 8.38 million barrels per day in 1975. Much of the increase was due to the production of the Alaskan North Slope fields beginning in 1977. Oil production in 1980 is expected to increase due to more Alaskan production and in response to the phasing out of crude oil price controls. Natural gas production stayed relatively flat during the 1975–1979 period rather than continuing the decreases exhibited in the preceding years. Production in 1979 exceeded 1978 levels. Coal is making a comeback, with 1979 production 18 percent above 1975, and 1980 production running well above 1979 to this point.

The heavy impact of rising oil prices on the domestic economy and U.S. balance of payments has continued throughout the period. The price of imported oil (f.a.s.) rose by 63 percent from $11.45 per barrel in 1975 to $18.67 per barrel in 1979. The price of imported oil in 1980 will be $31.50 to $32 per barrel or about 70 percent higher than in 1979. Net oil imports rose from 5.9 million barrels per day in 1975 to 7.9 million barrels per day in 1979, with a peak of 8.6 million barrels per day in 1977. So far this year net imports are about 14 percent below the levels of last year. In general, the trends toward slower growth in energy consumption, increased domestic production, and reduced imports are all in the right direction.

Recent experience demonstrates that higher energy prices significantly reduce energy demand. There is no realistic alternative to reliance on the price system to insure that scarce energy resources are employed most efficiently, and that adequate incentives are offered for future domestic energy production and conservation.

Inflation.—The most discouraging feature of recent economic performance was the acceleration of inflation in the late stages of the current expansion. The worst of the inflationary fever has now been broken, by the policy measures taken at mid-March and by the onset of recession. The task that lies ahead is to insure that the next period of economic expansion does not simply ratchet the rate of inflation to still higher levels, but instead that recent progress can be continued in a methodical trend toward genuine price stability.

Between 1976 and 1979 on the basis of annual averages, the GNP deflator rose at a 7.4 percent annual rate and the consumer price index at an 8.4 percent annual rate. These compare with 5½ percent annual rates of increase in the 1965 to 1976 period. More recently, rates of inflation have reached even higher levels, before turning down. Over the past six months or so, consumer prices have risen at about a 15 percent annual rate, producer prices at about a 12½ percent annual rate, and the GNP deflator at about 10.

As a result of recent inflationary pressures and workers' attempt to maintain real incomes, compensation per hour (wages plus fringes) has been boosted to the 9 to 10 percent range. Because productivity growth has been negative, unit labor costs have been averaging about a 12 percent annual rate of increase for the past year and a half.

Those who favor an across-the-board tax reduction to stimulate the economy should ponder the implications in terms of inflation. Over the past 15 years, every period of economic expansion has driven the rate of inflation to new heights at the top of the cycle. The ensuing periods of contraction have temporarily lowered the rate of inflation, but each time the rate of inflation at the trough has been higher than before.

The International Position of the Dollar.—A major objective of the Administration's international monetary policy has been the maintenance of global confidence in a sound and stable dollar. The program to strengthen the dollar, initiated by President Carter in November 1978, represented a watershed in the U.S. exchange market policy. This program combined domestic measures to improve the U.S. balance of payments—by curbing inflation and reducing dependence on imported oil—with more active intervention in the foreign exchange market to maintain orderly conditions.

The November 1978 program demonstrated a clear-cut U.S. commitment to a sound dollar and stability in exchange markets. Since that program, the dollar has increased in value on average in terms of other major currencies. The U.S. balance of payments has, moreover, scored major gains, despite large increases in oil prices and consequently in oil import costs.

It must be recognized, however, that the strength of the dollar depends, in the last analysis, upon our demonstrated ability to keep the domestic economy strong and to reverse the inflationary trend of the past 15 years.

CURRENT ECONOMIC SITUATION AND THE BUDGET REVISIONS

Change in Economic Assumptions.—At the turn of the year when the January Budget estimates were being completed, the economy was continuing to show far more strength than most economists had expected. In fact, some additional momentum appeared to develop late in 1979. A mild recession was generally expected, based on the downturn already underway in housing and the prospect that consumers would slow their rate of spending. The timing of a recession was uncertain, however, and few signs of an imminent downturn were in evidence. Retail sales, production and employment all rose in January.

The economic climate shifted rapidly through early March. The shift was triggered by a number of factors. The long projected recession failed to materialize. As evidence began to build that the first quarter would show positive real growth and January retail sales turned in an especially strong showing, some economic and financial market participants began to question whether a recession was really in prospect. Because of heightened international tensions, financial markets began to anticipate an increased defense effort, in consequence much larger budget deficits, more inflation, and higher interest rates. There was an upsurge of speculative activity in commodity markets which was both a cause and a result of shifting anticipations as to the future course of inflation. Rapidly rising energy prices plus rising mortgage interest rates helped cause the CPI to shoot up by 1.4 percent (18 percent annual rate) in each of the first three months of the year.

These developments combined to generate a dramatic shift in inflationary expectations. Businesses began to post price increases in anticipation of higher rates of inflation and the fear that wage-price controls would be imposed. Excluding food and energy, producer prices jumped at a 15 percent annual rate in the first three months of the year at the finished goods level and a 17 percent rate for semi-finished goods. Interest rates began to shoot upward. Yields on commercial paper, which had averaged about 13 percent in December, were well above 16 percent in early March.

The intensified anti-inflation package announced on March 14 was designed to reverse these developments. Its principal components were increased fiscal discipline, including a reduction of some $17 billion from fiscal year 1981 planned outlays, a program of credit restraint, and structural reforms directed at improving the longer-term performance of the economy. The package also included proposals in the energy area and steps to strengthen the wage-price guideline program.

The program, along with actions taken by the Federal Reserve, reversed the inflationary psychology. Interest rates continued to rise into early April, but then declined dramatically. Commercial paper rates moved above 17½ percent in early April, but subsequently fell to the 8 percent range. By early June, commitment rates for conventional home mortgages had fallen 300 basis points from the 16½ percent of early April to 13½ percent. The Treasury bill rate temporarily fell below 7 percent in contrast to an early peak near 16 percent. From its peak of 20 percent, the prime rate has fallen back near 11 percent. These interest rate declines are laying the foundation for the recovery of the economy.

Meanwhile, the greater than expected strength in activity early in the year led most economists to mark up their projections or real activity, at least for 1980. However, as figures became available for March, April, and May, it became evident that demand and production had been dropping rapidly. New car sales plunged (from a 10.8 million annual rate in the first quarter to a 7.7 million rate in the second), total retail sales took a record drop, industrial production fell by 4½ percent between February and May, and orders placed with manufacturers of durable goods plummeted by 17 percent from January to May.

Again, forecasts for 1980 were revised to incorporate these new realities. The tabulation below shows the shifting consensus forecast of about 40 top private business econmists.[1]

FORECASTED 1980 CHANGES IN REAL GROSS NATIONAL PRODUCT

[In percent]

Forecast date	4th to 4th	Year to year
January	−1.0	−1.0
March	−.4	+.1
July	−3.3	−1.4

The economic path underlying the Mid-Session Review of the Budget registers the downturn in activity that is now underway and parallels the change in assessment of near-term economic events that has taken place among private economists. Real GNP is now projected to decline by 3.1 percent between the fourth quarter of 1979 and the fourth quarter of 1980, with the steepest part of that decline in the second quarter of this year. The economy is expected to move downward still further in the second half, but at a more moderate rate, with the slide perhaps bottoming out late in the year.

The projected course of the economy would carry the unemployment rate up to the 8.5 percent range by the turn of the year, and the very moderate recovery of real GNP and employment thereafter would do little to bring the unemployment rate down over 1981. As measured by the GNP deflator, inflation is projected to moderate from 10.1 percent for this year to 9.7 percent in 1981, both measured fourth quarter to fourth quarter.

It is important to emphasize the great uncertainty associated with all of these projections. Throughout this year, economic forecasts from virtually all sources have undergone major revisions on nearly a monthly basis.

Nevertheless, it is clear that the projected course of economic performance is not satisfactory. As the recovery develops, policy steps to improve the economy's performance, both in 1981 and for the longer term, may well be appropriate. The Administration is reviewing the various possibilities and welcomes the opportunity to consult with the Congress about them.

However, the steps need not and should not be taken in haste. The economy's structural problems require carefully designed structural answers.

Turning to the nearer term, we expect that the natural forces of recovery will begin to manifest themselves.

The consensus expectation of economists, inside and outside of government, is that the upturn will occur late this year or early next. This would conform in a rough way to the postwar cyclical pattern. The average duration of periods of contraction in the six previous postwar recessions has been 11 months, although 1973–75 was longer, and the peak of the recent expansion has now been dated by the National Bureau of Economic Research as having occurred in January 1980.

[1] Blue Chip Economic Indicators," Capital Publications Inc., various issues.

A recent survey [2] of 40 private economists at major banks, corporations, and private research organizations sees successively smaller declines in real GNP during the third and fourth quarters of this year and a return to positive growth early next year. This is the generally expected pattern. It may not occur exactly as predicted. Economic forecasting is a very imperfect art. The important point is that the official forecast accords reasonably with the consensus of private forecasts and constitutes a realistic appraisal of the near-term outlook.

Recent readings on the economy suggest that the decline is still continuing, but not at the accelerated pace of the early part of the second quarter. The economy is still moving downward, the third quarter will almost certainly register another decline in real GNP. However, there are signs that the rate of decline has slowed markedly.

Retail sales scored a 1.5 percent increase in June. Excluding autos, sales rose slightly more than inflation.

New car sales in early July bounced up from their depressed second-quarter pace (though we should not attach too much significance to this rise until confirmed by additional data).

Seasonally adjusted initial claims for insured unemployment have fallen back in early July from their earlier peaks.

Housing starts and permits rose strongly in June, reversing the trend of earlier months. Housing activity appears to be benefiting already from the interest rate declines in recent months.

The composite index of leading indicators rose sharply by 2.5 percent in June. While an encouraging sign, the series is subject to revision and more than one month of increase would be needed to establish a trend.

Businesses have been making a determined effort to keep inventories under control. The decline in business inventory holdings in May indicated some success in these efforts, lean inventory positions would imply that when demand turns up, production would shortly follow.

The Revised Budget Estimates.—The Mid-Session Review shows substantial changes in budget estimates. The basic numbers are presented in the table below.

BUDGET TOTALS

[In billions of dollars]

	1979 actual	1980 estimate			1981 estimate		
		January	March	July	January	March	July
Receipts	465.9	523.8	532.4	517.9	600.0	628.0	604.0
Outlays	493.7	563.8	568.9	578.8	615.8	611.5	633.8
Deficit, current estimate	−27.7	−39.8	−36.5	−60.9	−15.8	16.5	−29.8
Budget authority	556.7	654.0	665.8	653.7	696.1	691.3	707.2

The 1980 deficit is now estimated to be $60.9 billion, up from $36.5 billion in March. Outlays are currently estimated at $578.8 billion and receipts at $517.9 billion. The current estimate for 1981 is for a deficit of $29.8 billion, rather than the $16.5 billion surplus estimated in March. Outlays are currently estimated at $633.8 billion and receipts at $604.0 billion. Both the increase in the 1980 deficit and the shift from surplus to deficit in 1981 are mainly the result of changes in the economic situation, though the estimates also reflect legislative events, higher spending on defense and emergency relief programs, and some minor technical changes.

The 1980 deficit is now estimated to be $24.4 billion higher than in March. Of this amount, about two-thirds, or $16.6 billion is due to the change in economic conditions. Receipts are down nearly $11 billion and outlays up $7 billion for this reason alone. Policy changes and Congressional action have reduced receipts by $4 billion in 1980 and $8.4 billion in 1981, and are partially offset by technical re-estimates and other factors. In addition to the effect of changed economic conditions, outlays are running somewhat higher because of defense outlays and increases for disaster relief, alien assistance, and other unavoidable events.

The larger budget deficits do not reflect an upsurge in discretionary federal spending. Congressional responses to the President's proposal for spending restraint have been constructive. While there are some differences in program priorities, the Congressional budget efforts to this point are generally consistent with the policy of fiscal stringency proposed by the President.

[2] "Blue Chip Economic Indicators," Capital Publications Inc., July 10, 1980, vol. 5, No. 7. esp. p. 3.

Financing the Deficit.—Policy steps over the next 18 months could of course alter the economic and budgetary projections released this week. We have, however, analyzed the financing requirements implicit in these projections.

The Treasury's fiscal year 1980 and fiscal year 1981 financing requirements while much heavier than projected in mid-March, are not expected to place undue strain on the credit markets, particularly when viewed in the context of total funds raised in the U.S. credit markets. Private demands for credit will likely be more than correspondingly reduced as a result of continued weakness in economic activity for the remainder of 1980.

Even with the Treasury's increased borrowing in the months ahead, the ratio of public holdings of Treasury securities to GNP is not likely to rise much above the current level of about 26 percent. In fiscal year 1976, when a budget deficit of over $66 billion was financed, this ratio rose to nearly 30 percent.

Looking ahead to fiscal year 1981, our borrowing needs will probably be heaviest in the first two quarters of the fiscal year. The use of a wide variety of borrowing options currently available to the Treasury should minimize any undesirable impact of this increased financing.

The recovery in the economy is expected to begin late this year or early in 1981 but in the absence of other actions the upturn is projected to be relatively slow. Private credit demands are typically slow to rise in the initial stages of an upturn and the expected moderation in the rate of recovery may further hold down private borrowing.

Financing policy is not greatly challenged when the automatic stabilizers in the economy tend to result in deficits in periods of slack economic activity. But the string of deficits experienced in the postwar period in boom years as well as in periods of slack, has imposed an added burden on the performance of the economy and its financial markets. If the monetary authorities financed such untimely deficits, excessive growth of credit is generated, and an inflationary atmosphere is created. If, on the other hand, the monetary authorities decline to make credit available to finance the deficit, the available pool of savings and capital formation and productivity suffer. The solution must be a move toward budget balance over the course of the cycle. Sizable surpluses in periods of prosperity may well be desirable, particularly if tax and other policies are successful in promoting more robust private investment performance. We are making progress toward such a long-term fiscal policy, but continuing efforts are required.

TAX POLICY AND AN APPROPRIATE FISCAL STRATEGY

In turning now to the issue of appropriate fiscal policy under present circumstances, several basic considerations should be kept in mind.

First, Congress has been making progress in restraining the rate of growth in expenditures. This basic fiscal discipline must be maintained. Too often in the past, expenditure control has been a short-term enterprise which was soon abandoned. Now that the painful decisions have been made, we should follow through in a clear demonstration that a new fiscal course is being followed. Failure to do so runs the risk of dissipating all the gains that have been made to this point. Domestic financial markets are functioning smoothly at home and the dollar is showing encouraging stability abroad. Both domestic and international financial stability require that we continue to pursue a responsible fiscal course.

Second, it is difficult to predict the exact course that the economy will follow. Interest rates have fallen much more sharply than most observers expected. This could induce an earlier upturn in credit sensitive sectors of the economy. If the economy were to rebound more quickly than expected, fiscally stimulatory actions might prejudice our progress in bringing down inflation.

The Venice Economic Summit reinforced our view that relaxation of demand management policy in the major world economies would be premature. The Venice communique clearly stated that "the reduction of inflation is our immediate top priority . . . Determined fiscal and monetary restraint is required to break inflationary expectations." Global inflation rates are still unacceptably high and we have not yet succeeded in reducing inflationary expectations. Too early a retreat from restraint, might re-ignite inflationary expectations and erase the hard-won gains we have just begun to make.

Third, the kind of future tax program that should be developed, with full consultation between the Administration and the Congress, will necessarily involve some complex issues and controversial decisions. There are enough choices and technical problems in depreciation reform alone to consume more legislative time than is now remaining before scheduled adjournment. Even proposals that start with apparently simple formulas would not be easy to enact into law, especially in a politically-charged environment. The only program that is simple enough—slashing rates according to a formula—would be counterproductive.

Fourth, it would be unwise to try to complete a large tax cut program in this session of Congress. The effort to do so would be caught up in all of the political cross-currents of an election year. It would be subject to the full weight of pressure from every faction that has an interest in special relief. If any agreement were to emerge from this environment, it would very likely be a melange of special interest provisions—just the opposite of what is needed.

A tax program may well be appropriate for next year. Anticipating this possibility, now is a good time to set out criteria and to begin to consider the outlines of such a program.

Criteria for a tax reduction program

Accord with fiscal discipline and spending restraint.—A tax program should be considered in the context of the restraint demonstrated on the spending side. Any tax reduction agenda must consider the revenue effects for at least five years, not just for the first year. This budget planning should be based on reasonable projections for expenditures and economic conditions, including realistic economic responses to any tax changes. They should not be based on hopes, wishes, or magic formulas.

Combat inflation.—An anti-inflation tax program should have at least two main attributes. First, in the short run it should not create excessive additional demand pressures or rekindle inflationary expectations. Second, it should help encourage investment and, thereby, improve productivity and reduce unit labor costs. If, at the same time, the program could directly contribute to cost reduction, that would be an added plus.

Maintain confidence in financial and foreign exchange market.—In recent months, the program of fiscal restraint has gone a long way to reassure investors at home and abroad that the long upward trend of inflation has been broken. It is important that any major fiscal program be perceived as one that maintains a steady course. Deliberate development of a program aimed at long-run objectives can reinforce this perception. In contrast, an abrupt shift toward stimulus could disturb financial and currency markets, complicating the recovery.

Focus on improving productivity growth and international competitiveness.—We must give more attention to the supply side of the economy. The realization of our public and private goals—a strong defense, expanding employment, growth in real income and opportunity, energy independence, and improved international accounts—depends on increasing the rate of investment to modernize the capital stock and increase capital per worker. This requires that tax incentives be concentrated on capital expansion, not dissipated in special interest provisions that only move capital from place to place.

Promote the most effective use of available resources.—It is not enough to expand the size of the capital stock and increase jobs. The jobs and capital should go where they will have the highest payoff. This is the least costly way to achieve real economic expansion.

The best judge of the prospective payoff is not the government; it is private markets. Reducing taxes where they interfere the most and avoiding the creation of new tax distortions are the keys to the effective allocation of jobs and capital.

Preserve the progressivity of the tax structure.—Inflation and reduced energy supplies have further restricted the choices for families with modest incomes. The payroll tax also takes a disproportionate share from wage earning families of low and moderate income. Although "bracket creep" has occurred for every class, those with lower incomes are least able to absorb or avoid the higher rates. Any plan for reducing individual tax rates must carefully consider the effects on the progressivity of the system.

Reflect close consultation with Congress.—The criteria offered here indicate priorities and suggest an agenda, but there are large choices within them concerning methods and degrees of emphasis. The Administration wishes to work out these choices in close consultation with this and other committees and with individual members of Congress. Your knowledge and experience are vital to the process of constructing an effective program.

MAJOR TAX POLICY CHOICES

The principal objectives of economic policy and the current structure of the tax system indicate that any future tax changes should be pointed in two major directions. The first would be to reduce the burden of taxes on households and on labor costs. The second would be to provide incentives for productive business investment. A strong case can be made for a number of tax policy options. Putting a tax program together, however, involves choice. Revenue simply is not available to make all the changes everyone would like.

Reducing the tax burden on labor income

The taxation of wage earners is mainly determined by the structure of individual income tax rates and the rate of payroll taxes for social security. The purpose of the graduated rate structure in the income tax is to apportion the tax burden equitably among households of differing means. A by-product of this structure is automatic tax increases resulting from year-to-year increases in money incomes. This tendency—often called "bracket creep"—has led Congress to make periodic adjustments, especially in periods of inflation.

Over the period from 1969 to 1979 legislated adjustments to the rate schedule produced nearly the same effect as indexing for middle-income families. A family of four of median income ($24,400 at 1980 levels) would have paid income tax of 10.0 percent in 1969 and 10.4 percent in 1979, if its income had just kept pace with inflation over those years. However, rapidly increasing money wages continue and more households have begun to encounter the steeper portions of the rate schedule that was enacted in 1978. Consequently, the same family of median income will pay 11.4 percent in federal personal income taxes for 1980 and 12.1 percent in 1981.

Increasing individual tax rates and, particularly, the higher rates that apply to any additions to family income are felt especially by families with two wage earners. Consideration should be given to the marriage penalty in connection with individual rate adjustment.

The other main element in the taxation of labor income—the payroll tax—has been increased steadily to provide funding for increasing real benefit levels to a growing population of social security recipients. In combination, the income and payroll taxes add substantially to the differential between the cost of labor to businesses, on the one hand, and the after-tax pay of workers, on the other. At current rates of income and payroll taxes, an employer must pay $1.52 in wages and payroll tax to add $1 to the after-tax pay of an employee in a median income family. This represents a combined marginal tax rate on labor income of 34.1 percent.

Scheduled increases in the payroll taxes will increase these marginal rates of tax by nearly a percentage point in 1981, considering the increases for both employer and employee. In seeking equitable ways to reduce the taxation of labor income, attention should be given to the added burden on labor costs from payroll tax increases and also to the funding needs of the Social Security system.

One approach to this problem is to allow an income tax credit for a portion of social security taxes paid. The credit could be refunded to employers and employees who owe no income tax liability. This method would offset the increase in payroll taxes without interfering with funding for the social security system.

Another approach that would produce a similar result is to match individual income tax cuts to the payroll tax increases. Other proposals to reduce the burden on wages also deserve exploration. However, direct reduction of the payroll tax should not be considered except in the context of a comprehensive analysis of trust fund financing issues.

Tax treatment of saving

Taxation of income from ownership of property has also generally been increasing. This is partly because the average individual saver who receives interest, dividend, rental or business income has also moved up into higher income tax brackets. Another reason is that inflation leads to over statement of business profits. But these increases are by no means uniform. The many sources of property income are subject to a great variety of tax treatments. For example, income from corporate equity may be fully subject to corporate taxes and also subject to individual taxes when distributed as dividends to shareholders. At the other extreme, the first $400 of interest income, interest from municipal bonds, earnings on individual retirement accounts, and vested pension funds are all effectively tax exempt. Still other kinds of property income, such as from real estate, minerals, and appreciation of corporate stock are only partially subject to tax.

While many of the savings incentive provisions adopted piecemeal over the years may have been intended to increase availability of capital, some are extremely inefficient and may even be counterproductive. The ability of taxpayers to switch their assets from one form to another, or to borrow in order to invest in a tax-preferred asset, has reduced, if not eliminated, the ability of many of these provisions to increase overall savings. Revenues lost because of tax preferences for certain types of income require increases in rates of taxation on all taxable income. The approach of providing "saving incentives" to certain narrowly defined uses of funds or special kinds of investments should be rejected in favor of more direct, broad based and efficient incentives for investment.

Another important result of the uneven treatment of property income is to divert saving and investment away from the relatively high-taxed industrial sector. Industrial corporations and public utilities are those most likely to bear the full corporate income tax and produce taxable dividends. They also are hardest hit by the erosion of depreciation allowances resulting from inflation. This causes depreciation—a major cost of using capital goods—to be understated and inflates taxable profits.

Depreciation reform

Among choices for encouraging capital investment and raising productivity, acceleration of depreciation allowances offers the greatest potential for success. In general, such a provision would reduce the tax bite on the return to successful investment and also enable higher returns to be paid to direct or indirect suppliers of capital, whether they are lenders, shareholders, members of pension funds, or depositors in financial institutions. As compared with tax breaks to particular types of saving, the benefits of accelerated depreciation are more directly tied to productive investment and less susceptible to "gaming" by simultaneous borrowing and lending transaction and other shifts in individual portfolios.

The particular program for accelerating depreciation that emerges should avoid the kinds of problems that afflict the 10–5–3 proposal. That proposal would quickly become very expensive. It is uneven and haphazard in the way it spreads benefits among types of assets and industrial sectors. Its transition phase is needlessly complicated and may promote investment delays.

Most proposals to accelerate depreciation for newly acquired assets will generate revenue losses that grow more rapidly than the economy for several years. Careful budget planning is required, therefore, for any depreciation program. The reason for this increasing cost is that each year's investment adds increased depreciation deductions on top of the higher deductions still being taken on investments made before. The 10–5–3 proposal exaggerates this pattern by specifying a phased reduction in lives over the first 5 years. For example, in the first year machinery and equipment would be written off in no more than 9 years, the next year in 8 years, and so on down to 5. This may entice the Congress by offering a very low downpayment. But the revenue cost under this approach would grow about twelve-fold in the first five years, from less than $5 billion to nearly $60 billion.

The 10–5–3 proposal becomes so expensive because it would eventually allow the same combination of deductions and investment credits for nearly all classes of machinery and equipment. These allowances would be more generous than those for even the shortest write-off periods in present law. This approach greatly increases the value of deductions for long-lived kinds of equipment such as those used in power plants and ship building. In contrast, the increased allowances for equipment that wears out rapidly or becomes quickly obsolete (such as tools used in metal fabricating and electronics) would be relatively small. For owners of commercial and industrial buildings the value of additional tax saving is, in turn, much larger than the average increase for investors in machinery and equipment. Thus, the 10–5–3 formula indiscriminately favors the movement of capital to structures as well as to long-lived equipment, a pattern not clearly related to any criteria for cost effectiveness in adding to productivity or other economic goals.

The Administration will support at the appropriate time a more even-handed approach to accelerating depreciation allowances. A connection should be retained between deductions for depreciation and the actual depreciation experience for assets used in different kinds of production activities. Such an approach would be superior to 10–5–3 in a number of important respects:

It would flatten out the trend in revenue losses, providing the tax reductions earlier and having much less impact on future budget options.

It would not require the kind of phased introduction scheme that imposes additional accounting burdens and weakens the investment incentives at the time they are most needed.

It would introduce less distortion into the pattern of investment incentives. Additional capital made available by the promise of increased returns and by prudent budget policy would be generally attracted to industries with profitable investment opportunities not directed to particular kinds of property.

A capital recovery system that involves simpler accounting, greater certainty, and reduced administrative complexity can be designed without the cost or distortions of 10–5–3.

CONCLUSIONS

During the next five years, the U.S. must take the steps required to build a strong foundation for superior economic performance and increased economic security. We must show the discipline to make the sacrifices needed to strengthen our economy for the long run, while at the same time providing assistance to those most adversely affected by short-run economic disruption.

The U.S. stands at the threshold of a new economic era. What we do over the next five years will determine whether this new era brings an unparalleled standard of economic well being or a slow drift to mediocrity. To make the most of this opportunity, we must not only build on past gains, but also be willing to reverse past errors. Many of the economic problems now facing us stem from an unwillingness, stretching back at least 15 years, to confront directly difficult trade-offs and choices. Hard choices must be made if the U.S. econony is to thrive in an increasingly competitive world.

There are four major objectives for economic policy for the next five years: First, to improve our economy's productive capacity so we can enjoy stronger growth in real incomes. Second, to return to longer run price stability, which will permit us not merely to reach a high employment level but to sustain it. Third, to enhance our competitive position internationally. And, fourth, to reduce our vulnerability to externally generated shocks, such as energy interruptions.

A tax program, properly timed, and consistent with the criteria outlined above can make a significant contribution to attaining these objectives. If we move in that direction patiently and responsibly, we will be able to improve greatly our economic outlook for the balance of this century.

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Exhibit 1

U.S. vs Major OECD Countries
1976-79

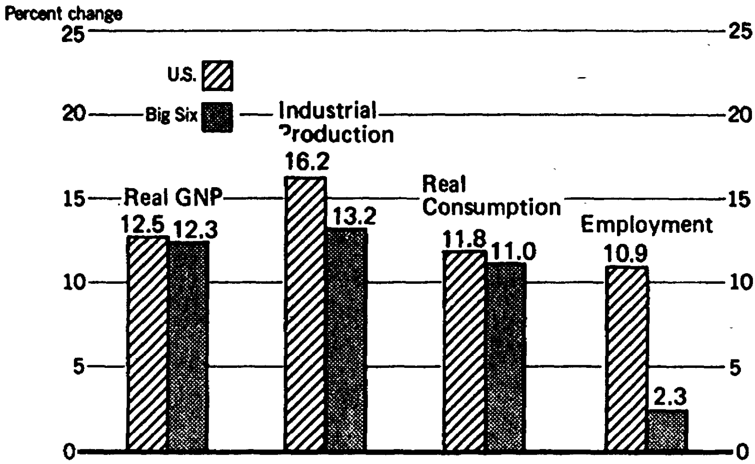


Exhibit 2

Duration and Depth of Business Cycle Contractions Since World War II

Contraction period	Duration in months	Peak to trough Decline (—) in Real GNP[1]
1948-49	11	—1.4%
1953-54	10	—3.3
1957-58	8	—3.2
1960-61	11	—1.2
1969-70	10	—1.1
1973-75	16	—5.7
Average	11	—2.6
Outlook for current recession:		
Consensus of 42 private forecasts[2]	12	—3.5

1/ Actual peaks and troughs in GNP.
2/ Blue Chip Economic Indicators, June 1980, Vol. 5, No. 6, pg. 8.

Exhibit 3

Comparison of Mid-Session Budget and Private Economic Forecasts

	Real GNP		Unemployment rate		Consumer price index		GNP deflator	
	1980	1981	1980	1981	1980	1981	1980	1981
	(Percent change, 4th to 4th)		(Percent, 4th quarter)		(---- Percent change, 4th to 4th-----)			
Four leading models Average	–3.6	3.6	8.6	8.3	12.6	9.2	9.6	8.9
Consensus of business forecasters (July)	–3.3	3.5	8.8	8.3	12.0	8.9	9.4	8.6
Mid-Session Review path	–3.1	2.6	8.5	8.5	12.0	9.8	10.1	9.7

Exhibit 4

Recent Movements in Short-Term Interest Rates and Prices

(CPI at an annual rate; interest rates are monthly averages)

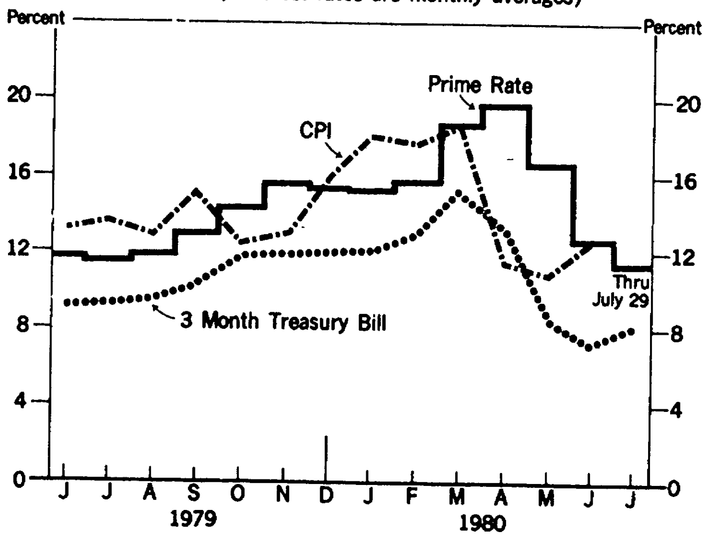


Exhibit 5

Some Better Signs

- June **Housing Starts and Permits** up to highest since February.
- July **Initial Claims for Insured Unemployment** (sea. adj.) sharply below earlier peaks.
- May decline in **Business Inventory Holdings.**
- July **Auto Sales** (sea. adj.) bounced up from depressed second quarter.
- June **Retail Sales** (ex. autos) rose slightly more than inflation.
- June **Leading Indicators** jumped sharply after extended weakness.

Exhibit 6

Four Major Economic Challanges Facing U.S. in the 1980's

- **Productivity.**
- **Price Stability.**
- **Energy Security.**
- **Improved International Position.**

Exhibit 7

Unit Labor Costs and Productivity Private Business Sector

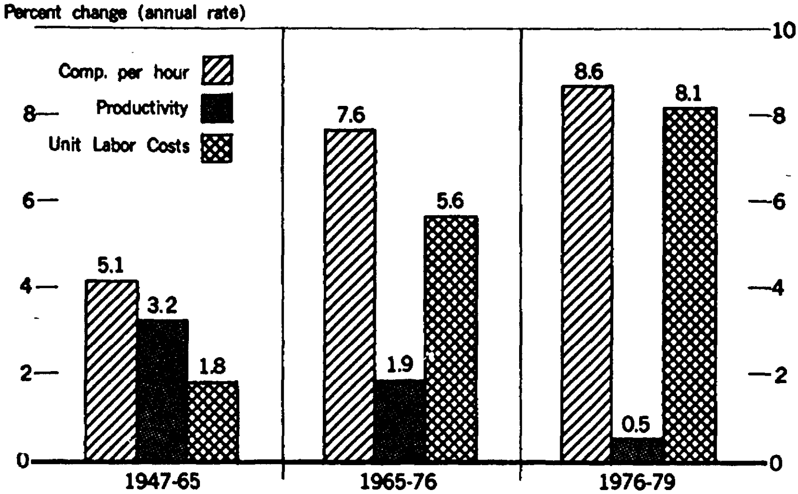


Exhibit 8

Cost of a Barrel of Imported Oil in 1972 Dollars, 1949-1979

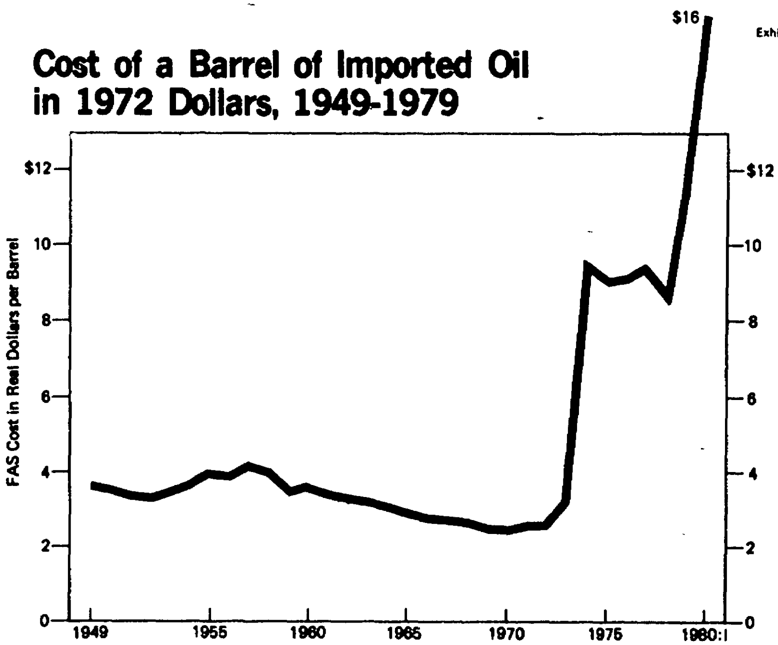
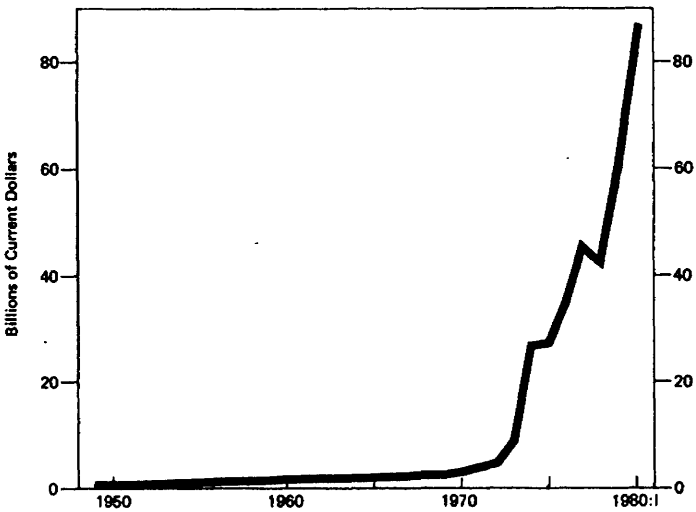


Exhibit 9

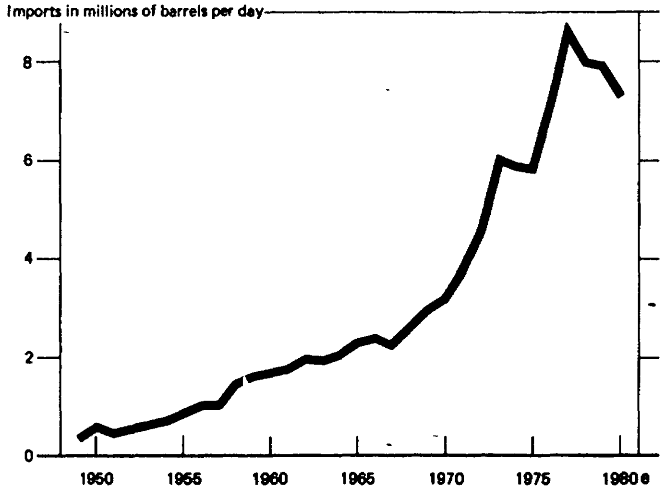
U. S. Oil Import Bill*, 1949-1980:I



*Balance of Payments Basis

Exhibit 10

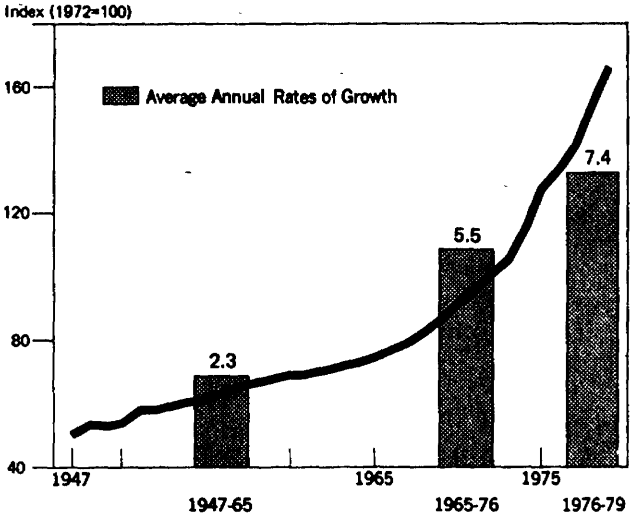
Volume of Petroleum Imports, 1949-1980 *



* millions of barrels per day on the DOE net trade basis

Exhibit 11

Price Performance *



* Implicit GNP price deflator.

Exhibit 12

U.S. Exports and Imports as Percent of GNP

1947 - 80:I

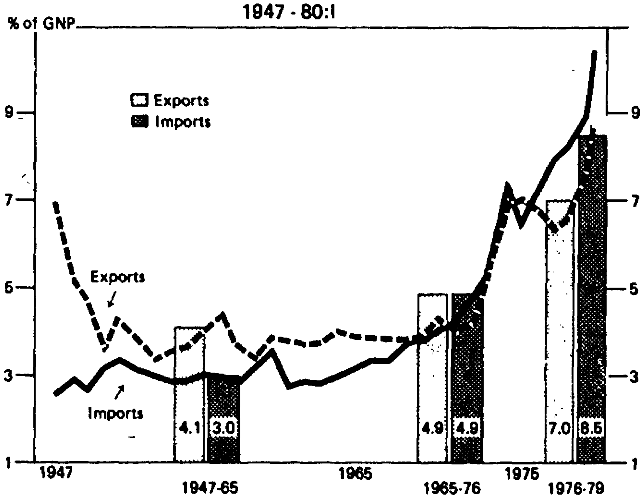


Exhibit 13

Components of Comprehensive Long-Term Economic Strategy

- **Productivity**
  - -- Increased Investment
  - -- Regulatory Reform
- **Price Stability**
  - -- Monetary and Fiscal Restraint
  - -- Voluntary Wage-Price Restraint
- **Energy Security**
  - -- Reduced Reliance on Imported Oil
    - Decontrol
    - Alternative Sources
    - Conservation
- **Improved International Position and a Strong Dollar**

Exhibit 14

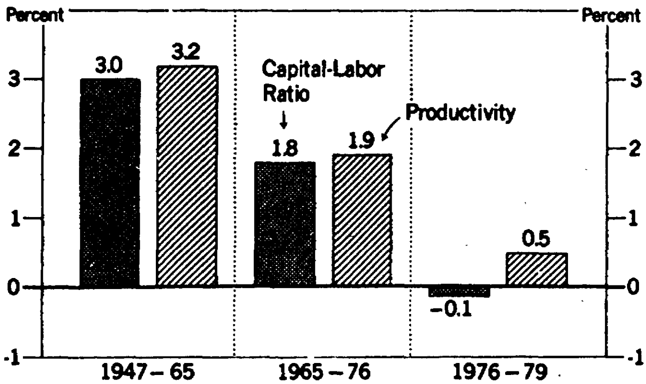
Factors Contributing to Declining Productivity Growth

- **Economic Shifts**
  - -- Business Cycle
  - -- Sectoral Shifts
- **Slower Growth in Capital-Labor Ratio**
- **Other**
  - -- Energy, Labor-Force Changes
  - -- R.&D. Spending

Exhibit 15

Rates of Growth in the Capital-Labor Ratio and in Productivity

(annual rates in percent)



Note: Capital-labor ratio is real net capital stock (gross stock less replacement requirements and pollution abatement expenditures) in the private business sector divided by the civilian labor force.
Productivity is output per hour of all persons in the private business sector.

Exhibit 16

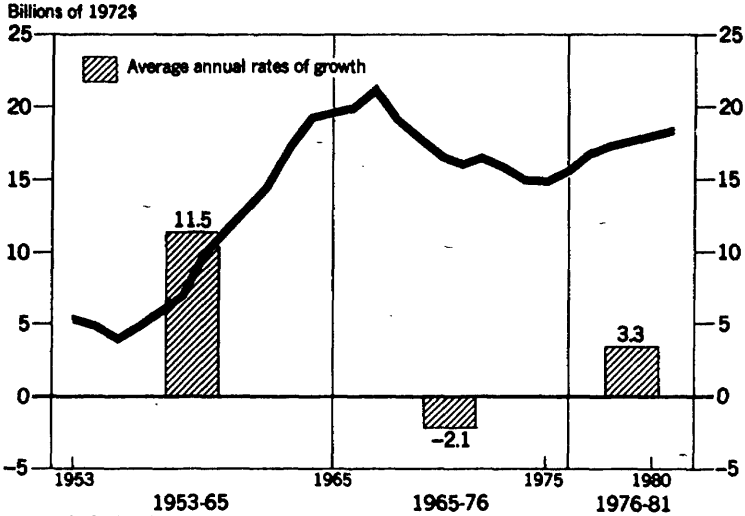
Investment and Productivity

- An increase of one percentage point in the share of GNP of business fixed investment would:
  - -- Raise the real net stock of business fixed capital by about 5 percent by the end of 5 years.
  - -- Raise the level of productivity by about 1½ percent by the end of 5 years.
  - -- Substantially increase real standard of living over decade.

- The additional productivity could help offset inflationary pressures but would not be a short-term cure.

Exhibit 17

Federal Obligation for Research and Development*(in 1972$), FY 1953-81



* Including defense

Exhibit 18

Actual and Potential Gross National Product

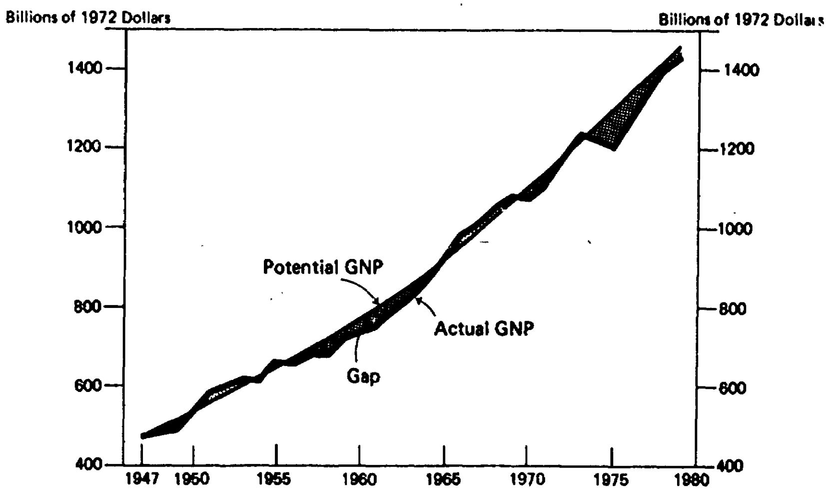
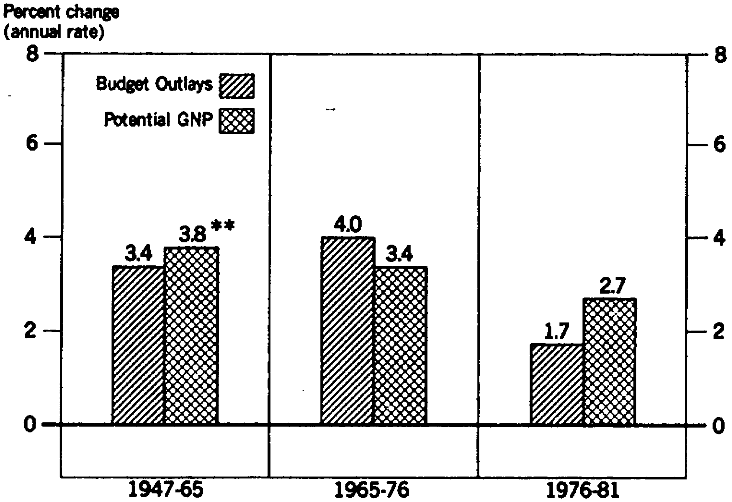


Exhibit 19

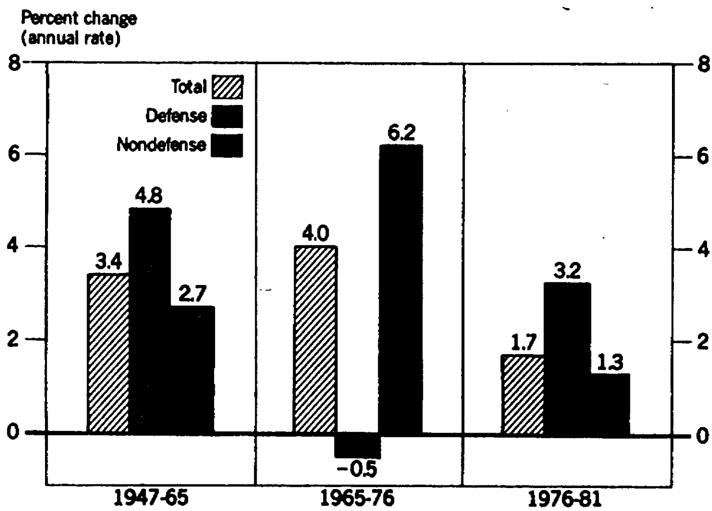
Real Growth in Budget Outlays* and Potential GNP



* Fiscal Years
** 1948-65

Exhibit 20

Real Growth in Budget Outlays*



* Fiscal Years

Criteria for a 1981 Tax Program

Exhibit 21

An effective tax program for 1981 should:

- Maintain budget discipline.
- Combat inflation.
- Maintain confidence in financial markets.
- Improve productivity growth.
- Strengthen international competitiveness.
- Promote effective use of resources.
- Preserve progressivity.
- Reflect close consultation with Congress.

Exhibit 22

Elements of a Program to Liberalize Depreciation

- Simplify accounting, reduce audit uncertainty, and streamline administration.
- Avoid phase-in that may delay investment.
- Provide tax benefits as large as fiscal prudence allows.
- Retain connection between tax allowances and actual depreciation experience.

Senator BENTSEN. Mr. Secretary, when you agreed to appear before us this morning, we agreed to get you out of here by 11 o'clock.

I would ask the members of the committee to limit their questions on the first round to 5 minutes.

Mr. Secretary, I certainly agree with a lot of the objectives you are talking about in your testimony. Your testimony is very helpful to us.

But we disagree on one fact. You say we are subjected to political pressures at this point, and therefore, shouldn't consider a tax cut now.

This Congress has shown an amazing discipline prior to an election on this budget. For the first time in many years in working with the administration, we have been able to cut the percentage of Government spending as related to the GNP.

I think we can do the same thing on a tax cut. We are not talking about reducing taxes. We are talking about moderating the increase.

The Joint Committee on Taxation says that we are going to have a $47 billion increase in taxes in 1981.

The Congressional Budget Office says it's going to be $80 billion increase in taxes.

So we are talking about lessening the increase. I certainly agree it ought to be directed toward productivity, that it ought to lessen the increase in the burden because of the increase in the social security tax.

But if you have a $30 billion tax cut structured toward increased savings, toward improving productivity, toward lessening the increase from the social security tax, that can't be an inflationary tax cut.

It is a moderation of a tax increase. The other problem we run into again is on timing. If you are going to pass a tax cut, it has to be a carefully considered one, just as you have stated.

But if we wait until next year, we have a new Congress, we are organizing a new Congress, we are assigning people to the Finance Committee, to the Ways and Means Committee.

We have our parade of witnesses to decide how it's going to be structured. And it probably won't be done until July.

And the history of this Congress has been that we pass tax cuts as we are coming out of a recession.

And often it's been the kind of tax cut you are talking about. But I don't see that now.

And I don't see it expressed on this Joint Economic Committee.

Will you respond to that?

Secretary MILLER. Mr. Chairman, I am certainly delighted there is no such sentiment, because what has been proposed and tacked onto various bills passed through is the Kemp-Roth idea, which would indeed provide a stimulation to demand and be a highly inflationary tax cut. If that is what is in the prospect, I think we would be well-served, one, if we not ever adopt it and, two, certainly if we do not adopt it at this time.

The statement that we could come up with a targeted tax program that addresses productivity and also in directed at reducing the burden of social security tax increases and perhaps a few other structural problems is very attractive. But the actual situation is that we have major tax proposals that don't do that. I have listened very carefully to the testimony before the two tax-writing committees in the last few weeks. First, there is a preponderance of very respected opinion that we should not try to act now on a tax cut. Second, there are many, many ideas. I don't believe that can be digested in 30 days.

Senator BENTSEN. Let me interrupt you. We have a vote on the floor and I only have 5 minutes here. Let me say that the great preponderance of evidence and of witnesses' testimonies before the Joint Economic Committee and before the Finance Committee is that we should have a tax cut in 1981.

Now, there has been some question as to whether we can get it done prior to an election. I think if we had the help of the administration, we could do that.

Let me ask you my second question, if I may. We see an increase in housing starts, an increase in automobile sales, a lessening in unemployment claims. Now, do you believe that we are bottoming out on this recession?

Secretary MILLER. Mr. Chairman, we believe we are bottoming out. We are not suggesting that there is a recovery underway now. But we believe the signs for recovery starting sometime in the fourth quarter are being laid down; yes.

Senator BENTSEN. What do you see as the quality of the recovery with this recession?

Secretary MILLER. We see the recovery being too sluggish if we take no action. As I said before, we do not intend, however, to accept this outlook. We intend to work for a combination of recovery program that is consistent with the long-term objectives we are mentioning.

We do not favor, as you undoubtedly have noted, a tax cut, a tax program that would simply be one of stimulus, a countercyclical tax cut. What we favor instead is a combination of economic policies that will get Americans back to work, but to do so in ways that will sustain their jobs over the long term and not just be an off-again, on-again countercyclical program which will let inflation start again. Rather, policies should provide a foundation for continued growth through the 1980's.

We believe that there is a high probability that a tax program for 1981 would be appropriate in reinforcing recovery if it's done in a way that is directed at permanent improvement of the structure of the economy and not just at creating demand before we have the ability to produce.

Senator BENTSEN. I yield to Senator Sarbanes.

Senator SARBANES. I appreciate it, Mr. Chairman. We have to go and vote, Mr. Secretary. I won't be able to come back to pursue the questioning. I simply want to make one comment.

For the life of me, I cannot understand how you can set out the major economic challenges which you feel face the United States in the 1980's, and I don't quarrel with any of the ones you set out, and omit from the list full employment and the effective use of our human resources and the effective use of our plant and equipment.

There appears to be a premise here that there is no employment challenge facing the United States in the 1980's. If that is the premise, how does it square with the unemployment rate figures you cite? I don't want you to substitute it for the other challenges, or necessarily to lower them in importance. I just don't understand how you can give us this chart and omit employment from the list.

Secretary MILLER. This presentation, Senator Sarbanes, is based on the premise that our economic objectives are full employment, balanced growth, and price stability. The steps outlined have represented the strategy to get there.

Senator SARBANES. I understand.

Secretary MILLER. But you get full employment through this technique.

Senator SARBANES. You list price stability as one of the challenges which you have just stated as one of the objectives along with full employment. I don't know that you can play it both ways.

All I want is to have full employment included on that list of objectives. I don't see how you can leave it off the list. If its omission reflects the attitude that the employment problem, is not worthy of being included in the list of major challenges, then I don't understand the thinking that leads to that conclusion.

Secretary MILLER. Senator, in the first place, these are long-term challenges. In terms of employment, as I was endeavoring to point out, the United States has the best record in the world of creating jobs. In the 3½ years of the Carter administration, more Americans have been put to work, over 10 million, than in any 3½-year period in our history.

And today we have the highest percent of the adult population at work that we've ever had; higher than we had at the peak of the last upturn. In terms of performance, we are certainly absolutely with you. The whole thrust of this program is to create the base on which we can continue to achieve those kinds of gains.

We have had a remarkable performance in terms of bringing more Americans into the workforce and finding jobs for them—better than other industrialized nations. We intend to continue this.

Senator SARBANES. Is it your view that full employment is not one of the major economic challenges facing the country?

Secretary MILLER. Over the longer term, it is absolutely both a challenge and an objective.

Senator SARBANES. Shouldn't it be on this list?

Secretary MILLER. It is a matter of strategy.

Senator SARBANES. I would be greatly cheered if, by the end of the hearing this morning, you amended the list to include a fifth item.

Secretary MILLER. I think you are correct and I will be happy to do that. It was not intended to be omitted in terms of objectives.

The primary purpose of everything we are doing is to create full employment.

Senator BENTSEN. Mr. Secretary, if you would excuse me, I have to leave.

Representative BROWN. Mr. Secretary, this is unfortunately the season when people get quoted back to themselves. I want to present to you a couple of quotes. On January 29, 1979, the Chairman of the Council of Economic Advisers, Charles Schultze, said in a hearing before this committee: "We must slow the pace of economic growth to avoid overheating in the period ahead."

In October of that same year, you said: "The main objective of all of our economic policies has been to wring out inflation." And in a hearing before this committee on May 28, 1980, you said: "The administration's present policy was set to achieve slow growth."

I can only conclude from the record of our hearings our economy is in the midst of literally, an induced recession. The purpose of this administration has been to try to counter inflation with increased unemployment.

If this statement is inaccurate, I will be glad——

Secretary MILLER. Well, it is completely inaccurate. My policy has been well explained over my 2½ years in Washington and has been quite clear. It has been that inflation is a clear and present danger; it threatens real values; it threatens the investment that creates jobs; it creates recession and causes other problems. We must wring it out if we are to achieve our economic objectives. At the Federal Reserve and Treasury, I have said over and over that we would pursue a comprehensive range of policies to wring out inflation and that we would do so without bringing on a recession.

Our purpose was to dampen inflationary forces, to slow excess demand and excess speculation within the economy so as to dampen inflation. But we did not seek a recession.

The recession came, and you can trace it to the drawing off of purchasing power and wealth by the oil price shock of 1979–80. It just drew off more than any tax that you have been talking about.

Representative BROWN. What about the withdrawal of purchasing power and wealth by the increase in taxes? This administration has increased taxes rather massively and has set up a program for further increase of taxes into the future. The administration has undertaken rather "Hooveresque" policies in the face of this recession and made the recession much worse.

Secretary MILLER. Let me ask you a question. You are wrong, because the drawing off of purchasing power because of oil price increases has been far greater than tax increases. We had tax reductions. You are looking ahead, and you are saying that next year there will be tax increases. However, we are not foregoing the possibility of reducing taxes. I think we cannot judge what will happen next year.

Representative BROWN. I have to interrupt to correct a point. Bracket creep and the social security tax increase overtook any reduction in taxes set up in 1978, and the taxes on the average American actually went up during this period of time. Did they not?

Secretary MILLER. No; you are projecting, as the chairman was a moment ago, what will happen next year.

Representative BROWN. No; I am talking about what happened in 1978. I am talking about bracket creep for Americans as a result of inflation; I am talking about the increase in social security taxes that occurred in the following year; the fact of the matter is that Americans in 1978 paid more taxes on average in spite of the fact that there had been a modest cut.

Secretary MILLER. There was a slight increase in taxes, but far less than the oil price increase. Was the increase in taxes as great as oil? I am saying no, it was not. The oil price increase has been a major drain and drag on the economy. Drag will develop next year from tax increases unless we make a correction. That is true. But through the period of 1979, when this oil shock hit us, the taxes were not the main factors. The primary factor was the oil price increase.

Representative BROWN. Mr. Secretary, let's look at just one fact. From 1976 to 1981, taxes, that is, the revenues of the Federal Government in the country, have doubled. They have gone up from $300 billion to over $600 billion.

Now, the impact of this sharp jump in taxes has something to do with the fact that we are in economic trouble. Also, while you were the chairman of the Fed and prior to your chairmanship of the Fed, the effort was made by the Federal Reserve to accommodate the increase in OPEC prices by increasing the money supply.

Frankly, I think that has a great deal to do with today's inflation.

Secretary MILLER. Well, during the period when I was Chairman of the Fed, the rate of growth of the real M–2 was the lowest for any comparable period for some time. Let me quote you from my testimony, since apparently it has not yet been looked at, regarding the very features that you are talking about. I want to cite figures on the tax burden on families.

Over the period from 1969 to 1979, legislative adjustment to the rate schedules produced nearly the same effect as indexing. Family tax burdens didn't really change. A family of four with an income of $24,400 in 1980 would have paid income tax of 10 percent in 1969 and 10.4 percent in 1979. This represents four-tenths of 1 percent change in the tax burden. Now, we say quite clearly in our prepared statement that it will go up in 1981. That is something I think we both want to address.

Representative BROWN. Mr. Secretary, my time is up. I will yield to the gentleman from Ohio, Congressman Wylie.

Representative REUSS. Well, your time is up. Is that the rule? I thought it was Democrats and Republicans. I will recognize Congressman Wylie.

Representative BROWN. Excuse me? I was asked by the chairman to go ahead while he was absent, Congressman Reuss.

Representative REUSS. I thought it was I. Anyway I will defer to Congressman Wylie.

Representative BROWN. Why don't you go ahead, Congressman Reuss. We certainly don't want to deny you the opportunity.

Representative REUSS. Well, I will wait.

Representative WYLIE. You have solved the problem. Thank you. As I understand it, Mr. Secretary, you are opposed to an income tax cut right now because you feel it might be brought into the political arena and therefore might not be as well thought out or as objective as we would like.

Secretary MILLER. Congressman Wylie, I think my reasons go deeper than that.

Representative WYLIE. And the second reason is that it increases demand at a time when demand would increase inflationary pressure.

Secretary MILLER. One of the first reasons is that I am concerned about financial markets. You see, we had the terrible experience we had in the first quarter, with runaway expectations of inflation, with speculation, with excess demand for credit. Then we took corrective measures, and we have seen interest rates drop very substantially, and we have seen inflation rates drop substantially. If we now send a message to the world markets that the disciplines being put in place of controlled spending are no longer being dealt with seriously, but rather we are turning to tax cuts and turning away from discipline, I think we will see interest rates go up. In that case, a key factor in the economy, lower interest rates and better ability of businesses and families to borrow, will be impeded, and we will lose ground. That is one reason.

The other reason is the timetable and——

Representative WYLIE. I think you may be right as far as a big income tax cut right now in that it might be inflationary. And I notice that your emphasis is on increased savings for investment, if I might——

Secretary MILLER. Correct.

Representative WYLIE. To increase productivity which you think will restrain inflation. And I notice in your testimony some emphasis in your remarks on accelerated depreciation.

Secretary MILLER. Yes, sir.

Representative WYLIE. Also, in your remarks you suggested that the dollar rate of depreciation not be on existing or partially depreciated investments, and that it be on new investment, or new equipment.

Secretary MILLER. Correct.

Representative WYLIE. Would you explain that for just a moment?

Secretary MILLER. Well, in the first place, I believe the best tax policy, the best use of reduced tax revenues or tax expenditures to encourage investment, is one in which the tax dollar is related to a new investment. If we relate a dollar of tax reduction to an existing investment, of course, we gain nothing in the economy. We merely retain the status quo and send out more money. So, if we say that our fiscal condition is such that our tax program should be limited to x amount, then we should use that x amount to get action in the economy, to get the biggest bang for the buck. For that reason we favor tax incentives being applied to new investment.

Incidentally, we do have right now in the tax laws that the Congress has passed a very favorable increased depreciation for rehabilitation of old plants. So if someone wants to improve an existing facility now, there are some existing tax benefits. The primary thrust of what we are looking at here should be directed toward using our tax resources wisely and prudently to create the biggest impact that would support the growth of economy through new investment.

Representative WYLIE. Again I have to think you may be right. But on that question, as far as the investment, or depreciation, schedule is concerned, do you favor a so-called 10–5–3 bill?

Secretary MILLER. No. We think the philosophy of 10–5–3—that is, liberalized depreciation—is correct. We don't disagree with the purpose. We have several problems with the actual application. One is that the 10 of the 10–5–3 means we would have very, very liberalized depreciation of structures, so unrelated to actual depreciation that we would probably get, in fact we would encourage, capital to flow excessively into structures. I don't believe we are going to build our economy by creating tax shelters to husband and hold real estate in the form of shopping centers. We need shopping centers, but we don't need to encourage people by tax shelters to put up a lot of buildings that aren't necessarily going to be as effective as more modern machinery and equipment. That is where we really need the effort. We don't disagree with some change. We just think the balance has to be better.

We are also concerned about the regional aspect of excessive depreciation on structures because there will be an encouragement for plants to relocate out of urban areas, out of the older manufacturing areas, out of the Northeast and North Central, because the cash flow would be so great from a new building that there would be a tendency to relocate. That increases the likelihood of deciding to relocate.

Representative WYLIE. I have been told my time is up. Maybe I can get back to the delay and implementation of the tax cut. Thank you very much.

Representative BROWN. Congressman Reuss.

Representative REUSS. Mr. Secretary, you have said that the deepening of the recession was not sought. I have a somewhat different view, and I would like to get your view of it. It is now recognized, I believe, that the recession started in the first quarter of 1980. Way back last October the Federal Reserve warned the banking system away from inflationary loans for speculation in commodities, and several other things, but didn't do what I and others asked it to do; namely, to monitor the situation to see if that warning was, in fact, acceded to. In February and March, although it wasn't known at the time, the banking system, or rather seven or eight large banks, lent the Bunker Hunt group almost a billion dollars to be used for their speculation. That wasn't known to the Federal Government because there had been no attempt to check up; it wasn't known until some months later. That swollen speculative lending caused a jump up for total figures for bank business lending in the whole country on the order of 10 percent.

The way I read the comment of the Open Market Committee meetings of mid-March, everybody panicked, because it looked as if you had a classic credit inflation, too much money chasing too few goods, a big jump-up in bank lending. The result was very tough anti-inflationary controls were imposed—on March 14 the whole sweep of credit controls, and on March 18, a big decrease in the monetary aggregates, a decrease so sharp that in the next couple of months, April and May, money by any measure not only didn't increase, it actually went into a decline. And following that you have the melancholy story of increased unemployment, so that today the unemployment is the worst that it's been since 1975.

My question is, didn't the administration and the Federal Reserve intensify and deepen in March a recession that was already taking place, bringing with it the train of misery which the Nation is suffering from, and couldn't that have been avoided if the administration and the Fed had checked up on the banking system and made sure they didn't help Bunker Hunt and his friends to corner the world silver?

Secretary MILLER. Congressman Reuss, I think the facts are perhaps a little different. As we know, there were a number of factors that led to the unsettled conditions in the first quarter. One was the oil price increases which were beginning to hit the marketplaces in great escalations. These caused very substantial alarm about inflationary expectations. Second was the Russian invasion of Afghanistan which led to considerable comment that our defense expenditures were suddenly going to go through the roof and that the budget was out of control and that we were not going to have Federal spending under control.

The third thing, of course, was general talk about wage and price controls which caused many businesses to start raising prices. And many users of credit to begin to take down and arrange credit lines, not for speculation, but just because they were afraid they would be cut off from it because of the talk of controls. Then there was some real speculation going on. All of this led to a frenzy of excess demands for credit, commodity prices skyrocketed, and inflationary expectations went up.

The administration did not act quickly, instead it consulted over several weeks with Congress at the time. If we look back, people were saying, why don't you do something? It was because we felt that what should be done should be done carefully with thorough concentration. I should add that by that time, the bond markets were in disarray in New York, and that was another consideration. Looking at all those conditions and the fact that the psychology was so disturbing, joint consultations with Congress led us all to believe that we should take the March 14 initiatives. They may have been bitter medicine and perhaps a little bigger dose than was required.

But the alternative of not having an insurance policy would have been to let the wave of uncertainty and speculation continue, and this could have led to a bigger bubble and a bigger break at some other time. I believe the net of it is that over a two-quarter period it wouldn't make any difference. The economy will adjust itself and we will not see any difference. You will recall the credit control features were carefully designed and targeted so that they were not directed at automobile credit or housing. Rather, they were directed at speculative credit, at some of the personal use of credit, unsecured lines, and they were marginal. The credit control program didn't set up a bureaucracy to control individual credits. Instead, they merely tried to control the aggregates, and they were easy to install and easy to remove. That program did work and did dampen psychology. History will tell us that perhaps we could have achieved much of what we achieved in a slightly different way. But that is hindsight. At the time the body of opinion was so strong that inflation was out of control, that budgets were out of control, that the action, I believe, was necessary.

I might point out that some very beneficial effects followed in the aftermath of the program. The bond market this year will allow corporations to raise more long-term funds than in any year in history, while if we had not done something, I don't think that would have been possible. Interest rates are significantly lower, which, I think, will form a base for recovery and will speed recovery. Inflation rates, thanks to breaking the psychology and breaking the expectations, are coming down sharply. I think the medicine has had some beneficial effects, and we shall have to look at it probably a little later to see what the net result is.

Representative REUSS. Well, my time is up. I would just comment that I certainly don't suggest that the administration or Fed is responsible for OPEC price increases or the Afghan invasion. However, I wish the Government had kept surveillance over bank speculative loans, and thus, the Bunker Hunt catastrophe need not have occurred, and in my judgment we need not have put the economy into the depths it is in.

Secretary MILLER. You are certainly correct that the speculation in silver by those people and others and commodities in general, but particularly that incident, contributed to the psychology of the time, and therefore it certainly needed to be addressed, and perhaps could have been addressed earlier.

Representative BROWN. Mr. Secretary, let's take up where we left off a minute ago. In 1965, the average worker in this country, the average family, made about $9,000, and he paid somewhere between 15 and 17 percent of his income in taxes. In 1982, under projections of your Department, the average income will be $25,000, and they will pay somewhere between 24 and 28 percent of their income in taxes, at the margin. Now, prices have doubled between 1967 and 1978. Therefore, despite this rise in income, the average family isn't much better off, and they are yielding a good deal more of their income to Uncle Sam.

I would say that that slight average tax burden increase that you mention indicates that you really don't quite understand what the structure of the tax code is doing and what the impact is on the individual in terms of what happens to his pay checks at the end of the year. The pay checks at the end of the year and the extra overtime at the end of the week really have quite a slice taken out of them. Within the tax structure, there is a tendency to discourage a person from wanting to work overtime, and there is a tendency to discourage him from wanting to invest in something that would produce income for him.

The average American is betting on inflation. He is putting money into something that goes up in value, but is not terribly productive. I think the result is on that chart over there. You see unemployment rates in "good times" never quite coming back down to where they were before the "bad times." In "bad times, unemployment always seems to go higher than the last 'bad times.' "

Now, unemployment rates overrun the recession recovery almost invariably. Unemployment rates, despite their current pauses, are apt to go much higher as the fall progresses and may continue to rise into the winter. I would suggest that perhaps we now need to take some steps that look past this recession, because this recession can't be avoided. It's already here.

It has been brought on. You differ, but I use your own quotes, brought on by government that thinks that recession is the way to break inflation. I think now is the time to look at tax-cut propositions.

Let me quote you again. In December 1978, you were still Chairman of the Federal Reserve Board, and you testified on the international situation of the dollar which had undergone something of a panic at that time. You agreed with me that U.S. industries had to modernize. You agreed with me that inflation was doing severe damage to depreciation allowances, and I want to quote what you said. You said:

> Here we have got the fundamentals of one of our critical problems. Depreciation allowances now in place are insufficient to fund replacement of plant and equipment, not to mention either expansion of capacity or modernization of new teconology.

Incidentally, I think that is demonstrated by your exhibit No. 1. You went on to say:

> Now, therefore, we have a serious problem. The fact that these factors have contributed to lower investment levels in the United States for a long period of time is of deep concern to me, and I know to many of you here, because we have discussed it in some of our other hearings. Ideally, one could make a case that depreciation should be allowed on replacement value of an asset, which would help.

You used the words "critical," "serious," "deep concern," and went on to add:

I hope the Administration can come up with a solution.

Now, that was December 1978. You are now Secretary of the Treasury. There are 300 House Members and 60 Members of the Senate who have supported 10-5-3, a depreciation reduction piece of legislation. I don't think any of those Members are totally wedded to that bill precisely as it is written. However, I would suggest that the period, December 1978 to August 1980, has provided sufficient time for the administration to make adequate refinements of that piece of legislation.

Do you have any idea when the Carter administration will make a proposal in this area?

Secretary MILLER. Congressman Brown, may I answer your last question after making a couple of remarks, because I think what you have said is very helpful. As to unemployment, I don't want to leave that, because we all have a concern about it. However, there are many different factors that one would have to dig into.

One is the different demographics of the population. If you translate today's unemployment rate back to the same pattern of demographics that existed in the sixties you find the unemployment rate now is lower than current figures show. Partly it reflects teenagers, if you have more teenagers in the labor force, then there is going to be higher unemployment.

Representative BROWN. I think that is an incredible statement. How do you figure that? If you included teenagers on that exhibit, the graph would shoot off the chart and up the wall. Unemployment is over 36 percent now for black teenagers.

Secretary MILLER. I know. I am sorry. You are missing my point, obviously.

Representative BROWN. Apparently.

Secretary MILLER. If you had the same percentage of teenagers in the labor force, and 24-year-olds, and 30-year-olds, now that we had in the sixties, the overall unemployment rate would be lower. Yes; it would be. Because in that case the components that tend to have higher unemployment rates would represent a smaller portion of the labor force. We don't like that but it's true. I will send you a paper on this.

Representative BROWN. The figures are not ringing true to me, because the percentage of unemployment keeps getting higher and higher with each recession.

Secretary MILLER. If you go back and look at rates for adult males, you will find that isn't necessarily true. That is what I am trying to tell you. If you look at teenagers and when you add all the elements up, because there is a change in mix, because the pie changes, you get a different total unemployment rate. But if you look at the components, you don't necessarily find that.

Representative BROWN. Are you saying that because we have more teenagers, we have more teenagers employed?

Secretary MILLER. We have more teenagers in the population and in the labor force, and they are more likely to be unemployed, as they are moving into and out of the labor force and they have less work experience. If you have more of them, they end up with a heavier total weight. It has to happen.

Representative BROWN. I assume if half of us were 5 years old or under, we would also have more people unemployed.

Secretary MILLER. No; because we don't count under 5 years old. But we do count teenagers, and we count a teenager living at home and going to school who wants a part-time job as among the unemployed the same as if he were a head of household and unable to support himself. That is what we count. So when you have a wave of population coming through, including all the teenagers at home being supported by their families but who would like to have a Saturday job, this suddenly can cause your statistics to look differently. It's not to debate it. It's just to say that we should bear that in mind. We want the numbers lower. There is no disagreement on that point.

Representative BROWN. I don't know how we got sidetracked to teenagers when we were talking about a depreciation tax cut.

Secretary MILLER. Because you had indicated a problem relative to unemployment. I wanted to be sure that, as you looked at it, you looked at it not only in aggregate but by components. We should bring unemployment down. We all seek to bring it down. But can we be analytical in looking behind the green line and seeing what it is made up of, a simple point as I pass.

Representative BROWN. I wish you would answer my question because my time is up. My question is, when is the Carter administration going to propose an appropriate tax cut that relates to depreciation?

Secretary MILLER. The depreciation statements that I have made in the past I will stand by today. I think that this is a major area. The administration concurs.

I have testified, both as Chairman of the Federal Reserve where I spoke independently and as a member of the administration, that this is the centerpiece, will be the centerpiece of the tax program when it is felt that the time is appropriate. The reason that we have not proposed one so far is that the President, the head of the administration, for a year and a half has taken the view which I concur in, that the first thing that needs to be done, and things need to be done in a sequence, the first thing that needs to be done is that we demonstrate control over Federal spending. The President said in his January 1979 economic message that if we demonstrate control over Federal spending, we will be prepared for another look at a tax cut after 1980. He said that in January 1980. He said the same thing in March 1980.

Each time he has said if we can demonstrate control of Federal spending, we will be ready after calendar year 1980 to consider a tax reduction. That has been his timetable. I don't think that is inappropriate considering what happened in view of the increase in oil prices and the set backs we have had.

I might say that if we hadn't had the oil price increase we could have done this earlier. But because we had to come back and deal with that problem, I think after calendar 1980 is the right timing. We would prefer to submit a specific proposal later when we are nearer to the substantive time to act. We are now in the process in both tax writing committees of getting everyone's views. We have indicated our views on liberalized depreciation. We have indicated that we concur with the concept.

As you just said, and we agree with you, there are a lot of people who support 10–5–3, but they are not wedded to every specific; if we have a better idea and a better scheme, I think you would agree to it. We don't think the 10 is right. We think the 5 is applying one class of investment without distinguishing between powerplants and machine tools for the automobile industry, and that would create a distortion. Under the 5 of 10–5–3, automobile companies would lose ground while powerplants would have excessive depreciation.

We would like to spread that a little differently. We think we can come up with a plan that would allow it to be introduced on Day One. The 10–5–3 has a complicated phase in for which we think we would substitute another idea. We also think we could probably do the job at less total cost by concentrating it in areas that will affect productivity more; that is, less on commercial structures, more on plant and equipment. We might even favor a slightly higher first-year benefit, and perhaps after 5 years benefits wouldn't be as great.

Those are our general ideas. They are reflected in my testimony and I think we could work them out. Our purpose is not to submit a precise proposal until we are nearer the time when we think it would be appropriate for Congress to act.

Representative REUSS. Congressman Wylie.

Representative WYLIE. Thank you very much, Congressman Reuss.

Mr. Secretary, I would like to pursue my question on accelerated depreciation allowance that I asked a little while ago. But first off, the OMB estimates for fiscal year 1981 show unemployment will average about 8.5 percent. Does that mean that unemployment will peak in your judgment at about 8.5 percent nationwide?

Secretary MILLER. Well, the administration's projection is that we will peak in the fourth quarter at 8.5 percent under present conditions, and that rate more or less would continue through 1981. We hasten to say that that is an extrapolation. The budget update is a reestimate of outlays, reestimate of revenues and a reestimate of the economic path, assuming no new policy actions.

We do not feel that these results are acceptable. We propose that we would take policy actions that would improve the situation and lower the rate of unemployment. We would prefer those recommendations to be taken up after the election. We may make some proposals before the election.

Representative WYLIE. You have made some recommendations in your exhibit 13, and I know that you put productivity first in a comprehensive long-term economic strategy to put people to work, and to—through budgetary pressures.

I might say I agree with that. I think we need to balance the budget first, but I think there has to be heavy emphasis on productivity and back to the so-called accelerated depreciation schedule. I might say I am a cosponsor of the 10–5–3 bill.

One of the things that bothers me a little about that bill is that it is put off until 1985. I wonder if that delayed implementation might accidentally provide incentives for business to postpone investment in new plant and equipment.

You suggested it should be for new plant and equipment only and I agree with that, too. But could we have full benefit of a new depreciation schedule better if it were not delayed quite so long or put into effect at the beginning?

Secretary MILLER. Congressman Wylie, we feel the better scheme would be one in which it went into effect immediately. The staging of it carries a risk. In the first place, it's complicated accountingwise because there are 5 vintage years that will stay forever. That means the bookkeeping becomes complicated. I think also there is just a better effect, as you point out, if we can initially provide stability and certainty and leave no reason for delay in investment. I think getting it all done on the initial date is the best way.

Representative WYLIE. Have you changed your thinking somewhat on investment tax credit or an increase in the permanent investment tax credit? I thought in your earlier testimony last year or the year before that you laid heavy emphasis on perhaps increasing the investment tax credit.

Secretary MILLER. No; I think my view has been consistent for a long time, that there are three fundamental ways to stimulate investment in these kinds of policies. There are many other ways to do it with research, but in terms of cash flow, one is through the investment tax credit; one is through liberalized depreciation; and the third is subsidized interest rates which I reject as being a very important policy alternative.

Between the ITC and depreciation, I have always felt you get more bang for the buck with liberalized depreciation. ITC is up in front. You have to make it very big in order to get the same impact, while liberalized depreciation, because of the way it spreads, the way it discounts, I think is a cheaper way to go from the standpoint of revenue loss to get the same effect on the economy. I have always felt that way. I am sorry if I have ever spoken in terms of analyzing the differences in a way that would encourage anybody to think I favor the ITC over liberalized depreciation.

Representative WYLIE. Mr. Secretary, the Consumer Price Index is still raging out of control, I guess. We have heard a lot about how inflation is going to ease due to falling interest rates. I remember last year when the inflation was quite high. Aside from falling interest rates, the inflation rate was moderated somewhat because food prices did not increase maybe as much as we had expected at that time. What would be your prediction, when the slowing effect of the Consumer Price Index and falling interest rates—is there a possibility that might be offset by an increase in food prices? I am thinking of drought in the Southwest, et cetera. Has that been factored into your prediction, a drop in the Consumer Price Index?

Secretary MILLER. Congressman Wylie, there are several reasons why the CPI has run up. The effect of rising interest rates on house financing costs is one. Another, of course, has been the enormous increase in energy costs. Another has been the higher unit costs through higher wage demands which were not offset by comparable productivity gains. So there are many, many components. Food was a very significant factor behind increases for a while. Now, of course, there is energy, which was accounting directly for one-third of rise in the CPI at the first part of the year, but is now showing a moderate influence.

As you pointed out, the interest rate decline on mortgages will show up. Last interest rates included in the CPI were for loans closed as of early May. So we have quite a lag. The subsequent decline in interest rates will show up later.

In answer to your question about food, the present situation in the agricultural sector would indicate that we will have some increases of food prices later on. We do not believe that in the short term they will have a major impact on the overall CPI. They may in the first quarter next year give us again some inflationary impact.

Representative WYLIE. Thank you, Mr. Secretary. My time has expired.

Senator BENSTEN. Senator Javits, we had told the Secretary he could leave at 11 but you haven't had an opportunity to speak, we want very much to give you that.

We are operating under a 5-minute rule.

Senator JAVITS. Mr. Secretary, I will not detain you very long. So I would like to state, if I may, what I have in mind. I will not go over the same ground you have obviously gone over with my colleagues on a consumption tax cut. It so happens I agree with you on a consumption tax cut. I, myself, have been advocating a position against it for the last 3 years, during which, as you know, I have been predicting the recession we are in. But the thing that troubles me—and leave aside the argument about bracket creep and compensatory tax cut to the individual since.

I assume it has been made—the thing that bothers me is that we are not attacking the fundamental of inflation, which is productivity. The fact that we have no productivity growth and as shown by steel and oil, the American industrial machine is growing obsolete. What we really need is a targeted inducement for large-scale capital investment. That is a totally different argument. You don't have to say that will contribute to inflation because it won't. If we are convinced that American business needs to be modernized and then we need some tax incentive to do it. I am speaking trade language, but you are as familiar with it as I am. So I ask—and without in any way feeling oppositional or without trying to persuade you or you me—what is the administration's prescription? How will we modernize the American business machine, if we don't have a targeted tax inducement?

Secretary MILLER. We are in complete accord with your analysis. Low-capital investment is a principal cause. Therefore, we favor the liberalized depreciation approach, targeted as much as we can to the areas where productivity is a problem. Our differences of opinion are, I think, in the timing. I think no one, fortunately, is talking about a tax reduction of any kind for calendar year 1980, so the debate that is going on now is whether it's timely to come out with a program now that could liberalize depreciation for 1981.

Our view is that for market reasons, because of the timetable of Congress, because of the economic atmosphere we are now in—we are not sure how it's performing, it would be better off to carry on debates and discussions now, and get thinking in order, but to defer any actual action until after the election when we could do so, say, early in January, with all this background available and thus act quickly. That is what we are thinking at the moment. I think we would be in agreement with your centerpiece of what should be done.

Senator JAVITS. Well, Mr. Secretary, also looking at the congressional timetable, I believe that to vent these matters adequately, you are dealing with almost a year. This is August 1. It is going to take at least 2 months to organize the new Congress, whether you win or we win is immaterial. It still takes the time. Then you are going to get into the committee and the testimony, et cetera. You are talking about a June tax bill, June of 1981. I just don't think the world's going to stop for us that long. And what we are going to do is stabilize out of this recession at a much higher plateau of unemployment and inflation because we are being too inhibited by the political season.

I predict to you, Mr. Secretary, that the American people would regard it as a rush of fresh air if we finally grasp the nettle which is modernization, instead of protracting it, holding it over.

We could have all the debate and all the discussions and be ready to act and perhaps act. I think the people's impact, Mr. Secretary, is going to be so great when we stop fooling around with the idea of cutting the bureaucracy or cutting Government expenditures, most of which we must do, granted, is going to deal with this inflation. When we make that authoritative, I think the people will at least regard it as the truth.

I know how you feel; but I think you know that I am not a deeply dug-in partisan Senator. I never have been. Strongly urge this thinking on the administration. Strongly. Believe me. It would be salutary, healthy, invigorating to the country.

Secretary MILLER. I appreciate and respect your judgment in this and I certainly will take it into account.

We feel that it would be difficult, impossible, I guess, to isolate the productivity targeted tax cut and enact it before the election, because there are many other competing ideas that would have to be accommodated, and I am afraid what would happen would be inflationary. But you may be right and I may be wrong.

Senator BENTSEN. Mr. Secretary, we are very pleased to have you here. Thank you.

Secretary MILLER. Thank you, Mr. Chairman.

Senator BENTSEN. The committee stands adjourned.

[Whereupon, at 11 a.m., the committee adjourned, subject to the call of the Chair.]

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