S. HRG. 98-138

THE 1983 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

NINETY-EIGHTH CONGRESS

FIRST SESSION

PART 2

FEBRUARY 3, 14, AND 15, 1983

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
20-983 O WASHINGTON: 1983

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Congress)

CONTENTS

WITNESSES AND STATEMENTS

Thursday, February 3, 1983

Monday, February 14, 1983

Tuesday, February 15, 1983

SUBMISSIONS FOR THE RECORD

Thursday, February 3, 1983

Monday, February 14, 1983

Tuesday, February 15, 1983

THE 1983 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 3, 1983

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

The committee met, pursuant to recess, at 10:10 a.m., in room 6226, Dirksen Senate Office Building, Hon. Roger W. Jepsen (chairman of the committee) presiding.

Present: Senators Jepsen, Abdnor, Mattingly, and Sarbanes; and Representatives Scheuer, Wylie, Holt, Lungren, and Snowe.

Also present: Bruce R. Bartlett, executive director; James K. Galbraith, deputy director; Charles H. Bradford, assistant director; and Louis C. Krauthoff II, Marian Malashevich, Sandra Masur, and Robert J. Tosterud, professional staff members.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

Senator JEPSEN. I wish to welcome today's distinguished witness, Ambassador William E. Brock, the U.S. Trade Representative. The challenges we are facing in international trade grow greater and greater with each passing day, and we will need innovative solutions if we are to take full advantage of the benefits trade can offer.

In 1982, due to worldwide recession and unfair foreign trading practices, the deficit in U.S. trade grew to an alarming $44 billion. It is expected to soar to new heights in 1983. This means lost sales opportunities here and abroad, idle plant capacity, and fewer jobs for Americans here at home.

The picture for agriculture, normally the brightest spot in our trade performance, is not much better. In 1982, agricultural exports declined nearly $5 billion from the previous year. That was the first year-to-year decline in more than a decade and USDA is projecting a further $2 billion decline in 1983, with obvious results for farm prices, farm revenues and the health of our farming community.

If we are going to reverse those declines in industrial and agricultural trade, we are going to have to become tougher with our trading partners and tougher in our trading efforts.

The administration made a good start last year and in 1981 by supporting the passage of the Export Trading Company Act and by reducing the taxes American citizens have to pay when working overseas.

But more—much more—remains to be done. Due to high interest rates, the U.S. dollar is still seriously overvalued, and U.S. goods and services are virtually priced out of the international marketplace.

The Japanese market remains closed to U.S. exports, particularly beef, cars and services, and insurance. The Europeans continue to subsidize their exports of agricutural products to the Middle East, the Far East, and Latin America, driving the United States out of markets we have traditionally supplied. The developing countries continue to impose prohibitive duties on imports from all countries, denying us legitimate export opportunities and distorting trade.

All of these actions and more must be addressed in Congress and by the administration—and they must be acted on now, or we will see our trade position erode further and our prospects for significant employment growth fade away.

Our Trade Representative has had a very distinguished career and has an important task before him. Ambassador Brock, we look forward to your comments on where we are going in the international arena.

Before we proceed, I would ask if there's anyone on the committee who desires time for an opening statement.

Representative HOLT. I have no opening statement.

Senator JEPSEN. Senator Mattingly.

Senator MATTINGLY. Not at this time.

Senator JEPSEN. Congressman Wylie.

OPENING STATEMENT OF REPRESENTATIVE WYLIE

Representative WYLIE. Thank you very much, Senator Jepsen.

Mr. Ambassador, welcome to the Joint Economic Committee. Our service together began on the House Banking Committee several years ago so I know something of the distinguished career you have had that was referred to by Senator Jepsen.

May I say that you have one of the toughest jobs in Washington from my objective. We had Chairman Volcker, for example, of the Federal Reserve before our Banking Committee yesterday and he was asked some of the same questions that you will be asked today, I'm sure. You have to sell American goods and services abroad in the face of tremendous obstacles—a cavalier attitude among many business and government leaders that export markets are not all that important to the large U.S. economy, a strong U.S. dollar that pushes up U.S. export prices, inadequate financing terms and conditions, aggressive selling techniques by foreign competitors, and restrictive trade practices and export subsidies by foreign nations. All of this contributes to your very significant problem as I see it. These present some pretty formidable challenges. We all have a common goal to make the United States a strong and viable competitor in world markets. I hope we can come up with some answers this morning. I look forward to your testimony.

Thank you very much.

Senator JEPSEN. Congresswoman Snowe.

Representative SNOWE. I have no statement. Thank you.

Senator JEPSEN. All right. Senator Abdnor, who will join us later on this morning, has requested that his opening statement be inserted in the record, without objection.

[The opening statement of Senator Abdnor follows:]

Opening Statement of Senator Abdnor

Welcome, Ambassador Brock. If you recall, Mr. Brock, a couple of months ago you and I had a heart-to-heart discussion concerning my perception that this administration was being less than aggressive in meeting foreign trade challenges. You advised me that this was not the case and to expect proof in the near future. You can imagine how pleased I was to hear about the flour sale to Egypt. Earlier this week Secretary of Agriculture Brock commented before this committee that this one sale of 1 million metric tons of flour generated $850 million in additional economic activity and created over 9,000 jobs. Now, that's a jobs program.

But that's the good news. As you are well aware, Mr. Ambassador, this is a "what have you done for me lately" town. My concern, of course, is in regard to the administration's recent decision to impose restrictions on textile imports from the People's Republic of China which has led them to retaliate against our agricultural exports to their country. According to the Department of Agriculture there is only one major growth market for wheat and wheat flour in 1982–83—China. USDA also sees only one major growth market for course grains—China. Mainland China also has a projected import need of 400,000 tons of soybeans during 1982–83. During 1981–82 China purchased 400,000 tons of soybeans from the United States. These sales represented the bulk of Chinese imports last year.

Now I do not know the magnitude of benefits that the textile industry of this country may realize, but they are going to have to be sizable so as to offset the immediate, long-run, and perhaps permanent, costs of this decision on agriculture.

Frankly, Mr. Ambassador, our trade policy—if indeed we have one—does not appear to be that of leadership but rather of counterpunching. I agree entirely that the United States must take the lead toward freer world trade, but a parade with but one participant is a pitiful—and many of our competitors consider a laughable—sight. I am confident that this Congress is more than willing, even anxious, to provide you with whatever policy tools you need to successfully defend the interests of U.S. businesses in the international marketplace.

I look forward to your remarks.

Senator Jepsen. All right. With that then, welcome, Mr. Ambassador, and you may proceed.

STATEMENT OF HON. WILLIAM E. BROCK, U.S. TRADE REPRESENTATIVE

Mr. Brock. Thank you, Mr. Chairman. I first want to express my gratitude for being given a chance to come back before the committee on which I served with great pleasure in the 1960's. I do value greatly this committee and its work and I appreciate the willingness of the members to serve on it because it is one of the fundamental committees of the Congress and one that helps us maintain a larger perspective outside the areas of specialization that the Congress has to engage in most of its committee work.

If I may, Mr. Chairman, I will make a very brief statement and submit a more complete prepared statement for the record.

The creation of millions of new jobs is dependent upon our ability to compete in the rest of the world. In recent years four out of five of the new U.S. jobs in manufacturing have come in foreign trade. Two out of every four acres planted by American farmers is produced for export; and we have only begun.

With $2 trillion of goods and services already being traded around the globe, the new opportunities for our workers are almost unlimited. We are the most creative, productive, and competitive people in the world. We have, with all of our present troubles, the strongest free enterprise system ever developed in the history of mankind. The future is ours—and we must seek it.

However, in this Nation, as in other countries, there are those who propose a "fortress" mentality—the adoption of policies that, in effect, would pull up the drawbridge, insulate our markets from world competition, and protect our industries from change. I believe that this is a self-defeating course of action. Nations which protect their economies from adjustment today will pay the costs by a decline in productivity tomorrow. Inevitably this would mean less economic growth, fewer jobs, a lower standard of living and more government intervention to divide up an even smaller economic pie.

All major trading nations are feeling the impact of momentous changes in the structure of their economies—in a movement toward technologically more advanced industries that are more capital and less labor intensive. Over the short term, these changes may cause painful social and economic adjustments, but if successfully managed, over the long term they will lead to greater economic opportunities—to more and better jobs, to the greater production of goods and services and to a higher standard of living.

Efforts to deflect and slow down the adjustment process would, if successful, mortgage our future and that of our children and grandchildren to an outmoded, unproductive, and inflationary economy. We would run the grave risk of falling far behind those nations which have the foresight and discipline to successfully navigate their way through the rapidly changing world economy.

I believe the correct course lies in the other direction—toward more open markets, greater competition among nations and trade expansion. While we believe we are the most open of the major trading nations, we are, all of us, far from perfect. Subsidies, tariffs, and even nontariff barriers remain in this country and even more so among many of our trading partners. In either case, they raise our prices, limit the creation of new jobs, and stifle improvements in our standard of living.

As we seek to minimize negative steps at home, we must recognize that others will choose a different course. In the real world governments do intervene in the marketplace, and unless we respond, Americans may be injured unfairly. Together with the Congress, we will provide:

One, economic policies at home that allow the U.S. economy to adjust to wealth-creating innovations;

Two, effective enforcement and, where necessary, strengthening of U.S. trade laws to help insure that U.S. industries compete on a fair and equal basis in international markets; and

Three, effective and persistent negotiations with other countries to remove trade barriers and unfair trade practices abroad which burden U.S. exports.

Domestically, the challenge is to fashion economic policies that will generate sufficient growth to allow the Nation's economy to adjust to rapidly changing technological and competitive conditions. As economic recovery proceeds, American industries will emerge leaner, more efficient and better able to compete at home and abroad.

Other steps are also required by all of us. Education, training, and retraining are as fundamental to our success as are research, development, and productivity. Labor, management, and government at all levels can and must participate in improving these tools of growth. Tax policy, regulatory practices, and government programs all need constant reevaluation in terms of our competitive opportunity. In the final analysis, every American has a role, and a stake, in international trade.

Open and fair competition for U.S. industries requires rigorously enforced U.S. and international trade codes. This administration has been aggressive in pursuing unfair trade practice complaints against our trading partners for their violations under the GATT. We will continue to be vigilant and forceful in defending U.S. workers against unfair predatory practices. We also will review the adequacy of our trade laws, and work with the Congress in strengthening them where required.

Let me reaffirm that this administration stands committed against the siren call of protectionism, but all should understand clearly that we will not sit on our hands if other governments act in such a way as to injure U.S. workers and industries. Just as we do not intend to shift our unemployment to other countries, so do we not intend to allow other countries to shift their unemployment to us. We will act to defend and advance the legitimate interests of the United States and all free nations in the international trading system.

Internationally, the United States will continue its vigorous efforts to strengthen international agreements. Our leadership is essential. We must stop the drift toward short-term, inward looking policies that would cause the nations of the international trading system to repeat the disastrous history of the 1930's, when protectionism and trade wars eventually led to unprecedented suffering. As a leader of the free world, the United States cannot and will not accept this result. We will provide this leadership by act, and by example.

Our success will be measured not in laws or lofty statement, but in jobs, growth, and real income. We can compete with anyone, and our potential is almost limitless.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Brock follows:]

Prepared Statement of Hon. William E. Brock

The creation of millions of new jobs is dependent upon our ability to compete in the rest of the world. In recent years 4 out of 5 of the new U.S. jobs in manufacturing have come in foreign trade. Two out of every four acres planted by American farmers is producing crops for export. And we have only begun.

With 2 trillion dollars of goods and services already being traded around the globe, the new opportunity for our workers is almost unlimited. We are the most creative, productive, and competitive people in the world. We have, with all of our present troubles, the strongest free enterprise system ever developed in the history of mankind. The future is ours - and we must seek it.

However, in this nation, as in other countries, there are those who propose a "fortress" mentality - the adoption of policies that, in effect, would pull up the drawbridge, insulate our markets from world competition, and protect our industries from change. I believe that this is a self-defeating course of action. Nations which protect their economies from adjustment today will pay the costs by a decline in productivity tomorrow. Inevitably this would mean less economic growth, fewer jobs, a lower standard of living and more government intervention to divide up an even smaller economic pie.

All major trading nations are feeling the impact of momentous changes in the structure of their economies -- in a movement toward technologically more advanced industries that are more capital and less labor-intensive. Over the short-term, these changes may cause painful social and economic adjustments, but if successfully managed, over the long-term they will lead to greater economic opportunities -- to more and better jobs, to the greater production of goods and services and to a higher standard of living.

Efforts to deflect and slow down the adjustment process would, if successful, mortgage our future and those of our children and grandchildren to an outmoded, unproductive, and inflationary economy. We would run the grave risk of falling far behind those nations which have the foresight and discipline to successfully navigate their way through the rapidly changing world economy.

I believe the correct course lies in the other direction -- toward more open markets, greater competition among nations and trade expansion.

While we believe we are the most open of the major trading nations, we are, all of us, far from perfect. Subsidies, tariffs, and even non-tariff barriers remain in this country and even more so among many of our trading partners. In either case, they raise our prices, limit the creation of new jobs, and stifle improvements in our standard of living.

As we seek to minimize negative steps at home, we must recognize that others will choose a different course. In the real world governments do intervene in the marketplace, and unless we respond, Americans may be injured unfairly. Together with the Congress, we will provide:

1. Economic policies at home that allow the U.S. economy to adjust to wealth-creating innovations;

2. Effective enforcement and, where necessary, strengthening of U.S. trade laws to help ensure that U.S. industries compete on a fair and equal basis in international markets;

3. Effective and persistent negotiations with other countries to remove trade barriers and unfair trade practices abroad which burden U.S. exports.

Domestically, the challenge is to fashion economic policies that will generate sufficient growth to allow the nation's economy to adjust to rapidly changing technological and competitive conditions. As economic recovery proceeds, American industries will emerge leaner, more efficient and better able to compete at home and abroad.

Other steps are also required by all of us. Education, training, and retraining are as fundamental to our success as are research, development, and productivity. Labor, management, and government at all levels can and must participate in improving these tools of growth. Tax policy, regulatory practices, and government programs all need constant re-evaluation in terms of our competitive opportunity. In the final analysis, every American has a role, and a stake, in international trade.

Too, open and fair competition for U.S. industries requires rigorously enforced U.S. and international trade codes. This Administration has been aggressive in pursuing unfair trade practice complaints against our trading partners for their violations under the GATT. We will continue to be vigilant and forceful in defending U.S. workers against unfair predatory practices. We also will review the adequacy of our trade laws, and work with the Congress in strengthening them where required.

Let me reaffirm that this Administration stands committed against the siren call of protectionism, but all should understand clearly that we will not sit on our hands if other governments act in such a way as to injure U.S. workers and industries. Just as we do not intend to shift our unemployment to other countries, so do we not intend to allow other countries to shift their unemployment to us. We will act to defend and advance the legitimate interests of the United States and all free nations in the international trading system.

Internationally, the United States will continue its vigorous efforts to strengthen international agreements. Our leadership is essential. We must stop the drift toward short-term, inward looking policies that would cause the nations of the international trading system to repeat the disastrous history of the 1930s, when protectionism and trade wars eventually led to unprecedented suffering. As a leader of tne free world, the United States cannot and will not accept this result. We will provide this leadership by act, and by example.

Our success will be measured not in laws or lofty statements -- but in jobs, growth, and real income. We can compete with anyone, and our potential is almost limitless. It is time we begun.

Whatever the short-term problems and even crises we may face, we must keep our policies fixed on the goal of maintaining an open, flexible economy that allows our industries and workers to adjust to rapidly changing economic and competitive challenges. We must resist the adoption of a "fortress mentality" -- the adoption of policies that, in effect, pull up the drawbridge, insulate our markets from world competition and shield our industries from innovative change. Nations which protect their economies from adjustment today will pay the price of a decline in competitiveness tomorrow.

I believe that if we can develop an understanding of the long-term forces that are working in our economy -- if we can get the fundamentals right, in other words -- then we can avoid unwise and self-defeating measure to impede adjustment toward a more efficient -- and more equitable -- society.

U.S. Trade Performance in the 1970s

There can be no doubt that in the three decades after the Second World War, international trade, spurred by successive rounds of liberalizing trade negotiations, generated substantial additional growth in the internal economies of all trading nations. World trade grew much faster (7.1 percent) than world commodity production (4.9 percent), and developing countries as well as industrialized countries benefitted (the GNP of 60 middle-income countries grew 30 percent faster than industrial nations between 1950 and 1980, though real per capita GNP grew at about the same pace as that of industrial nations).

How has the United States performed since the mid-1970s; what is our situation now, and what are the prospects for the future? Well, to revert to the popular vernacular, there is both good news and bad news. Let me take the bad news first.

Certainly during the 1970s the U.S. economy performed poorly in comparison with earlier decades. Partly, this was due to adjustment to the rise in oil price, partly to certain long-range trends that for this decade had a negative impact, and partly the blame must be laid at the feet of the government itself, which through mismanagement of fiscal, monetary and regulatory policy produced a situation of growing inflation, persistent deficit and declining investment.

The result of these combined negative forces was that real GDP grew at an annual rate of 3.1 percent compared with 3.9 percent in the 1960s, inflation averaged 7.1 percent for the decade but soared to 13.8 percent in 1980, and productivity growth slowed to only half (1.5 percent) of what it had been in the 1960s.

Yet for all the problems the U.S. encountered during the 1970s, a closer examination of some key economic and trade indices reveals that compared to the record of most of our trading partners, the U.S. economy performed quite well. And indeed, in some cases the problems of the 1970s have silver linings in the 1980s. It is true, for instance, that because of the huge influx of relatively inexperienced people into the workforce in the 1970s labor productivity declined temporarily. But it is also true that the United States created 20 million jobs during this decade, while the European Community nations added only about 3 million new jobs during the same period. During the 1980s, there will be far fewer young people and, after 1983, fewer women entering the work force for the first time. For instance, the number of men and women in the 16-24 age group will decrease by 1.5 million during the 1980s. Thus, the U.S. work force will increasingly be composed of more experienced, skill workers, and this will have a positive effect on productivity.

Further, over the past decade, U.S. wage rates in manufacturing became much more competitive with other developed nations. Though there remain industries and sectors where wages are a significant factor in a decline of U.S. competitiveness, U.S. manufacturing wages as a whole between 1970 and 1980 rose far more slowly than those of other industrialized nations. For instance, manufacturing wages in West Germany increased at a rate ninefold than that of the United States: for France and Italy, about eightfold; for Japan almost sevenfold; and for Great Britain, almost sixfold.

Part of the real and continuing strength of the U.S. economy has been veiled by shifts in exchange rates during the past decade. U.S. exports have grown rapidly during periods when the dollar was depreciating (1971-74 and 1977-1980) and exports actually declined while the dollar appreciated between 1974 and 1977. The upswing in the value of the dollar beginning in late 1980 again has adversely affected U.S. exports.

However, declining U.S. interest rates and signs of a stronger world economy are beginning to be felt. The dollar has declined substantially against the currencies of all our key industrial trading partners except Great Britain in the past three months, augering well for renewed U.S. export competitiveness.

The sensitive debt situation of many of the developing countries also has had a negative effect on U.S. trade. The International Monetary Fund, the private banks, the United States and other industrial countries are

20-982 0 - 83 - 2

working to help major debtor countries adjust to the realities of living within their own means.

To accomplish this adjustment such major LDCs as Mexico, Brazil, Argentina, as well as other developing debtor countries, have embarked on adjustment programs of great austerity. They will need to continue to increase their net export earnings in order to correct their growing balance of payment problems.

However, even during times of fluctuating exchange rates, an uneven dollar abroad, and the LDC debt problem, the United States has managed to maintain its share of the total world trade and total world exports. In fact, our share of the world's exports has actually grown from 11.9 percent in 1977 to 13.3 percent last summer.

Looking at manufactured items alone, we see that the volume of U.S. exports climbed almost as rapidly as that of Japan and faster than that of the EC countries during the 1970s. The U.S. share of OECD exports of manufactures was two percentage points higher in 1980 than in 1970.

From 1970 through 1981 the United States was in a strong current account position and our overall trade performance was credible. In that period the United States earned far more than it paid out in its current international transactions (goods, services, return on capital invested abroad, and private remittances).

For these 12 years our cumulative surplus exceeded $60 billion, more than that of any other industrial country. Moreover, this reflected the growing importance of trade in the U.S. economy as the share of exports and imports as a percentage of GNP roughly doubled over this period to 17 percent.

Administration's Management of the Economy

Despite the fact that compared to other countries we did not do that badly during the 1970s, this Administration faced a serious and deteriorating economic situation when it took office at the beginning of 1981: government spending was out of control, inflation and interest rates were rising and productivity was falling.

Reversing the policies and trends of three decades has not been an easy task but I think we have made a good beginning in the past two years. With the help of Congress, we have cut the rate of growth of Federal spending from 17.5 percent in 1980 to 10.4 percent in 1982. The combined effects of the 1981 and 1982 tax bills are freeing up substantial sums for consumers to spend and for business to invest. Hundreds of burdensome Federal regulations have been eliminated or revised.

Over the last few months, the prime rate, which had peaked at over 21 percent in early 1981, fell to the range of 11-12 percent. Inflation for 1982 dropped to 3.9 percent, the lowest in a decade. We have reversed the decline in productivity -- in the last two quarters of 1982, productivity rose at an annual rate of 30 percent.

In his State of the Union message, the President announced a series of measures to spur that recovery and to reduce prospective deficits that could impede future economic growth. These include:

- a comprehensive freeze on Federal spending;
- structural reform to control the growth of entitlement programs;
- and a standby tax program to insure against continued high deficits.

The President also announced that he will announce a broad trade strategy -- "one that increases the openness of our trading system and is fairer to America's farmers and workers in the world's market place." The new proposals include:

- new funding authority for the Export-Import Bank to allow it to meet the terms of export subsidies of other nations;
- a program to upgrade our port facilities, in order to enhance our export position, particularly with regard to coal;
- a comprehensive employment bill to address the problem related to long-term, structural unemployment;
- clear authority for the President to negotiate new agreements regarding trade in services, high-technology products and foreign investment.

The Future

Looking ahead, what are the major factors that will influence U.S. trade policy in the coming months and over the next few years, and what are the policies that will guide us through this period?

In the first place, as the President said in the State of the Union Message, while we still "have a long way to go, America is on the mend." The fundamental elements of the Administration's economic policies are right, and our perseverance is beginning to pay off in solid, non-inflationary growth. For December, the index of leading indicators rose by a strong 1.5 percent, the largest increase in more than two years. Although long-term projections are dangerous, we believe that by the second half of 1983, the economy will be growing at a rate of about 4 percent and that we will sustain this rate of growth through the succeeding four years. Inflation should hold in the 5 percent range for 1983 and average slightly less than that through fiscal 1988.

Against this background of steady growth and lessening inflation, however, there will be continuing problems that we should anticipate and understand in order not to be stampeded into short-term, economically senseless policies and programs. For instance, the United States will lead the way out of the worldwide recession, but as growth takes hold, our trade balance will almost certainly worsen. Initially, as a result of our advanced position, we will import more from other nations, while our exports will lag as these nations continue their efforts to revive their economies and to solve their difficult balance of payments problems. The continuing high value of the dollar is also likely to increase our trade balance deficit for some time.

In time, this situation will improve itself, but we will need to vigilant against the siren call of proectionism because denying our markets to other countries would result in prolonging the worldwide recession and quite possibly stifling a recovery.

At home, we will continue to face difficult and challenging questions regarding some of our basic industries that are going through a long-range adjustment to changing domestic and international competitive conditions. It is my hope and expectation that the worst times for basic industries such as steel and automobiles are behind us. In the past three years, each of these industries has been buffeted not only by the impact of long-term adjustment problems but also by the swift and wrenching impact of the recession. This has resulted in a 30 percent decline in employment in both industries. As we come out of the recession, demand and employment will rise, but we should not expect to reproduce the past glories -- permanent adjustment factors will preclude this, including lower demand as a result of energy conservation, the introduction of more efficient capital equipment and the growing competitiveness of the basic industries of other nations.

Once again, while acting to ameliorate the social costs and to retrain and relocate our work force through such measures as the 1982 Job Retraining Act which will aid 2 million people next year, we must continue to follow policies that will encourage capital and labor to move into more productive and competitive industries and sectors.

In keeping our goals fixed on the necessity for change and adjustment, however, this Administration will not hestitate to counter unfair trade advantages practiced by any of our trading partners. "Beggar-thy-neighbor" policies, which injure our industries and workers, will not be tolerated.

Opportunities for Growth: I have tried to be very frank with you regarding what are likely to be continuing problems for U.S. basic industries and the prospect for negative trade balances over the next couple of years.

But while there are potential difficulties and even dangers for the United States to avoid, a more fundamental and important point is that with 2 trillion dollars of goods and services already being traded around the globe, the new opportunities for our entrepreneurs and workers are almost unlimited. The key to our continued leadership and success are policies that encourage our economy to adapt to change toward technology-intensive industries and toward the provision of the services that support a technologically-advanced society. We must build on our strengths, particularly in four areas where the United States has already established a strong competitive record and where even greater opportunities lie in the future: trade in high-technology products, trade in services, trade in agriculture, and trade with developing nations.

High-Technology Industries -- The United States stands on the brink of a technology-based, Second Industrial Revolution that will dramatically alter the kinds of goods the nation produces, how they are produced and where they are produced. Industries on the cutting edge of this revolution constitute the most dynamic element of the U.S. economy -- and the key to future U.S. competitiveness in world trade in manufactured products.

A recent study by the President's Cabinet Council on Commerce and Trade (CCCT) found that 9 out of the 10 fastest growing industries in the United States in the 1980s will come from the high-technology area. These include: communications equipment, drugs, and medicines; electronic components; aerospace; industrial chemicals; professional and scientific instruments; engines; turbines and parts; computers and office equipment; and plastic synthetic materials.

The CCCT study also points out that since 1930, the rate of growth in high-technology industries (adjusted for inflation) was more than twice the average rate of all U.S. businesses (7 percent versus 3 percent). During the 1970s, productivity in high-technology industries grew, on the average, six times faster than average productivity in all businesses.

Possessed of a highly-skilled labor force, abundant capital for investment, technological know-how and experience, a huge internal market and worldwide marketing networks, the United States is uniquely positioned to lead the way in high-technology trade -- and indeed we are doing so. Trade in high-technology goods has become a central element in the U.S. trade and current account balances. During the 1970s, the positive balance of technology-intensive products increased greatly, reaching over $52 billion in 1980. Machinery made up half of this positive balance, including exports of computers, mining and well-drilling equipment, internal combustion engines, and construction equipment. Chemicals made up about a quarter of the favorable balance, with aircraft and parts accounting for about 20 percent.

From advanced electronic equipment manufacture to communications services, technological change will require and generate new kinds of jobs. By the year 2020, as many as one-half of U.S. workers would be employed at jobs that do not exist today. Our high technology industries clearly present existing new possibilities. These opportunities could be denied us if we do not address potentially serious trade problems.

Virtually all nations view high-technology industries as critical to their economic growth and international competitiveness. Technology-intensive industries, thus have become the central focus of national industrial policies and a broad range of interventionist policy instruments have been adopted to protect and foster high-technology sectors.

Some countries, for instance, have identified and targeted priority industries for special treatment, including low-interest loans, tax subisides, direct grants and government-industry partnerships. Others have encouraged or forced rationalization of industries through mergers or other means. Foreign companies have been directly affected through coproduction requirements, compulsory licensing and patent agreements and local content requirements. Government procurement policies and rules have been skewed toward domestic high-technology firms.

These are problems we intend to address multilaterally in the GATT, bilaterally with our principal trading partners, and unilaterally in the development of our policies.

Trade in Services. The U.S. service sector, like the high-technology sector, has become a central element in both the U.S. economy and the current account balance. Composed of widely differing industries from telecommunications to tourism, from education to banking and insurance and from advertising to construction work, the service sector is the hallmark of an advanced industrial society. In the United States, today, services account for over 65 percent of our GNP, and service industries, including the government, employ 7 out of 10 workers. Further, the service sector was responsible for most new jobs created in the 1970s. Between 1970 and 1979, 18 million new jobs were created in that sector, while only 2.5 million new jobs were generated by the production of goods.

The growing importance of services to the U.S. economy is not confined to domestic economic activity. Exports of services have become a major source of export earnings, and helped offset the increasing deficit in U.S. merchandise trade. In 1981, the surplus in services amounted to over $41 billion, and between 1975 and 1981, U.S. international service transactions provided a net surplus of over $190 billion.

Service industries rank with high-technologies industries as growth areas for international trade in the coming decades. The value of worldwide insurance transactions in 1982 totaled $435 billion, with expansion averaging 10 percent annually for the past several decades. The world market for telecommunications services exceeded $180 billion in 1980 (the U.S. accounted for 40 percent of this), and is expected to expand to almost $450 billion by 1990 (U.S. expected share: $159 billion).

Despite the growing importance, international trade in services is threatened by growing barriers to trade and the absence of international rules covering services trade.

Trade in services has increasingly been distorted by a growing number of nontariff barriers, including restrictions on access to markets, though outright denial of entry, discriminatory licensing requirements; mandatory joint ownership; restrictions on financial operations, such as discriminatory taxation and denial of remittance of revenue; and restrictions on competitive equality, through such means as discriminatory government procurement and restrictions on employment of non-nations.

The list of examples of the use of such barriers against U.S. service companies is almost endless: Australia forbids screening of commercials made abroad; some European countries do not allow U.S. airlines access to computer reservations systems; U.S. law firms cannot open branch offices in Japan; and the Norwegian government refuses to license any foreign insurance firms.

Though often "invisible," these trade barriers together exert a major impact on world trade, and concurrently on U.S. jobs and potential earnings.

The absence of effective international agreements is something we must correct. We assigned a high priority to this issue in the GATT Ministerial, and we will continue to do so.

Agriculture

We have been blessed with a unique combination of soil, climate, and dedicated people to make us the most effective producers of temperate agricultural products in the world. Our productivity is the envy of many around the world who struggle to produce to meet minimum needs. In a world where trade distortions did not exist, we would be able to take advantage of that enormous productivity to supply the food demands of much of the world. But, unfortunately, distortions do exist in the form of import barriers, export subsidies, unreasonable health and sanitary restrictions, overly stringent customs procedures, and a myriad of other devices that tend to reduce incomes for our producers and raise costs for consumers in other countries.

We are at the point where farmers use almost 40 percent of their cropland to produce for export; and they have come to depend on exports for one-fourth of their marketing income. Obviously, if we are to maintain the health of our national economy we must give a boost to its agricultural component by maintaining and expanding foreign markets. One way to do this is to actively seek removal of devices that distort trade.

As a result of the GATT Ministerial, we have established a Committee on Trade in Agricultural Products within the GATT context. That group will hold its first meeting in Geneva in early March. We look to it as a way of addressing a number of problems that exist in agricultural trade today. We will not rely entirely on this mechanism, however.

We will continue our intensive bilateral discussions on agricultural trade issues with the European Community and Japan. I will be in Tokyo next week and will be discussing the whole range of agricultural issues that we have outstanding with the Japanese. We must have the total elimination of the restrictions that they maintain on agricultural products that we could ship them.

At the same time, my Deputy, David Macdonald, will be in Brussels meeting with officials of the European Community in an attempt to resolve a number of trade disputes that involve both export subsidies and market access. Our sale of wheat flour to Egypt has given us a degree of credibility in dealing with the Community that did not exist before. I think that we have demonstrated that the President's commitment to actively seek foreign markets for our agricultural products is a very real one. We are also examining other possible markets in an effort to regain the share of the world market for agriculture that we think we would have if it were not for the unfair trading practices of some of our trading partners.

I do not mean to imply that we have trade problems in agriculture with only Japan and the EC. Quite the contrary; but I highlight those two only as examples of the way in which we are actively seeking to get a fair shake for a very important sector of our economy.

<u>Trade with Developing Countries</u>. One of the most significant developments of the last decade has been the rapidly growing importance of the LDCs as a factor in the U.S. trade balance. High growth rates in the developing countries (particularly the NICs) and a bonus of dollar earnings from petroleum exports for the OPEC nations, provided the means for these countries to gain a larger share of world trade; and the United States emerged as a major beneficiary. By 1980, total U.S. trade with the developing countries amounted to more than that with Europe and Japan combined.

The expanding export capacity of the NICs contributed greatly to the increase in the LDC share of U.S. imports of manufacturers from 14 percent in 1970 to 24 percent in 1980. Conversely, earnings from exports and demand for plant and equipment related to development needs have led to an increase in the LDC share of U.S. exports of manufacturers from 29 percent in 1970 to 39 percent in 1980. Further, in the high-technology area, LDCs also became important U.S. customers, taking about 40 percent of our high-technology exports as we entered the 1980s. Overall, the U.S. maintained a favorable balance of trade over the entire decade, with the surplus reaching $26 billion in 1980.

There are both short- and long-term problems that loom in our trade with developing nations. For the immediate future, the problems associated with the worldwide recession since 1980 and the steeply rising debt burdens of many developing countries constitute the greatest threats to continued growth of trade with these countries. The debt burdens have forced many

LDCs to expend large amounts of scarce export earnings on debt service payments; and the continued drag of the recession has increased pressure to embark on aggressive export promotion and import-restriction policies.

We must ensure that our monetary aid and trade policies work together to address the short-term financial problems without causing damage to our longer-term trade and financial interest. We must also devise new negotiating approaches that will enable us to negotiate new trade commitments of long-term benefit to both the United States and the LDCs.

Policy Alternatives

The United States will need a coherent, but multi-faced response to the wide-ranging trade issues it will face for the balance of the decade, a strategy that combines a vigorous defense of U.S. interests through the use of existing mechanism with the exploration of new tactics and policies.

First of all, we should get our own house in order. This means a careful scrutiny of our domestic ~~laws and~~ policies -- antitrust, R&D, the environment -- to determine their impact on our competitive trading position. We must also see to it that our trade laws themselves are responsive to changing conditions -- the President, for instance, has asked Congress for a clear mandate to negotiate agreements on technology and service trade issues.

Beyond this, we will continue to enforce rigorously the trade laws that are already on the books. We currently have 42 countervailing actions in effect and an additional 44 pending. This is an increase of nearly 22 cases over 1980 and an increase of 37 over 1981. We also currently have 87 antidumping actions in effect and 20 actions pending. This is more than at any previous time. While we intend to facilitate the adjustment of our own basic industries to competition from other nations, we will not sit on our hands if these nations employ dumping or other unfair practices that injure our workers and companies.

Where there are gaps or a lack of clarity in international rules of competition, the United States will utilize bilateral negotiations to achieve its goals. To that end, we are now involved in detailed discussions with the Japanese regarding trade in high-technology goods and services.

Multilateralism still provides the central framework for the pursuit of U.S. trade goals, and the institutions and rules of the GATT constitute the best hope for the achievement of global, non-inflationary economic growth.

It was for this reason that the United States took the lead at the GATT Ministerial Meeting in attempting to persuade the major trading nations that the real and grave problems facing the international economic system should be dealt with honestly -- and that emerging issues such as in the areas of technology and services should be placed on the agenda for future research and ultimately for incorporation in the rules of international trading.

Looking back now, I feel strongly that given the economic and political atmosphere in which the Ministerial took place, perhaps our great achievement was in keeping the GATT system together at all and in reaffirming the political commitment of all of the Contracting Parties to abide by their GATT obligations, and to "refrain from taking or maintaining any measures inconsistent with the GATT." The Contracting Parties further committed themselves to make determined efforts to "resist protectionist pressure in the formulation and implementation of national policy and in proposing legislation." The most ambitious part of this political statement is the promise not to take or <u>maintain</u> any measures inconsistent with GATT, as this refers to measures the Contracting Parties already have in place.

Over the coming months and years, the depth of commitment made in Geneva in November will be greatly tested -- but as we go into this period of testing, we should not underestimate the importance and the influence that the very achievement of this reaffirmation -- under the most difficult conditions -- can have in defending and advancing the principals of open, competitive international markets.

<u>Conclusion</u>

In summary, it is the policy of this government to strengthen the competitive opportunity for U.S. firms and workers in the world markets to ensure that U.S. firms and workers are not unfairly disadvantaged by the predatory actions of our trading partners, and to forge a multilateral trade framework for the further expansion of world trade.

Our trade policy is built on the close cooperative relationship with the Congress and the private sector. A strong U.S. trade position must be, and will be, a national priority. It is vital to our domestic well-being; it is essential to our capacity to provide leadership to the free world.

Senator JEPSEN. Thank you, Mr. Ambassador. In your prepared statement you just touched on one of the most potentially explosive political issues I think we are faced with and I think based on understanding and appreciation of what really happened in 1932 or what's likely to happen in the event we do succumb to the siren call, as you call it, of protectionism, it does not bode well for anyone in this age of Concordes and 3 or 4 hours distance to any part of the globe, not to mention the fact that our base industry is changing.

The transition from heavy industry to service and high technology is something that I think is coming on and has not yet been fully understood, verbalized, or presented to the American people. It's my understanding in reports I read the other day that some 61 percent of all the people employed today are employed in the information services in this country. Between 6,000 and 7,000 articles on high technology and science are published and printed daily. If we don't believe this is the age of the computer and high technology, we haven't been looking in the right places, and it's something that all of us working together must realize, and that brings to a focus point something that is very near and dear to my heart, because it's near and dear to my constituency, and that's agriculture.

We saw what happened just recently when discussions—and that's what they were—broke down in the textile industry. Those of us in agriculture, who represent it and are involved in it, know very quickly because, due to our huge amount of agricultural exports, we still are the breadbasket of the world and we do have, thank God, the most productive food producers in the world and the Lord has blessed this country with the most productive land and the most resources in that area—something we need to attend to and conserve as it's the very key to our economy not only today but in the future.

But one of the first things that happened when those talks ended happened the other day, and that is we're going to shut down the imports of soybeans. Agricultural products are so widely distributed and traded that they're the first ones that seem to get hit in reprisal or whatever you may want to call it.

I understand that on February 9, there's a meeting in Europe with regard to this. Would you tell us a little bit about this meeting and what you feel you might hope to expect come out of this meeting; describe what the meeting is?

Mr. BROCK. Yes. We have had, Senator, 10 years of talks on agriculture with the European Community. During that 10 years the EC has gone from the world's largest importer of food products to the world's largest exporter just in dollar value, if not in volume, because of the degree of subsidization which they provide in order to bring their price down to the international market price. We simply have not resolved that problem.

As you know, it was the most contentious issue at the GATT ministerial meeting in November. I do think we made some progress there, but only in setting up a process that can lead to a solution which will take a couple years. So we didn't solve it. We set up a procedure for dealing with it.

As a consequence of the intensity of the American feelings, five of our Cabinet members went to Brussels in December following that meeting in Geneva to meet with the European Commission and try to see if we couldn't move the process ahead a bit on a bilateral basis. Out of that meeting, which was very constructive and very positive, we agreed to take the next 90 days—in other words, January through March—and have a series of technical working level meetings to look at the specific component parts of the problem and see where we might improve the situation.

We told them at that time that during these talks the United States would continue to act to defend its vital interest and that if we felt it necessary we might engage in governmental support to retain traditional U.S. markets. We subsequently did that, as you know, in Egypt with the wheat flour program.

The first talk occurred in January. It was, in my judgment, a very solid, good conversation. We did not seek specific answers yet. We're trying to lay down the framework for those answers. The second meeting will occur, as you have noted, on the 9th of February in Brussels. We frankly have a good deal of hope for that meeting and the ensuing meeting in March, that they can achieve some tangible solution to specific problems.

I don't know how to tell you what might come from it because we don't yet know how far the Europeans might be able to move, where we might find areas of compromise; but I can tell you that both sides are entering into these talks and participating in I think the best frame of mind that I have seen on this subject since I've been in this job and I gather that that's true of some years before as well.

So there is hope of improvement but no guarantee. We do have a time leash on it, a short time leash, and we will evaluate our progress in March.

Senator JEPSEN. Because of the obvious interest in trade and this area by members of this committee—certainly on our side of the aisle—because of the numbers, we will go on the 5-minute rule so that we can all have an opportunity to have questions, and we're getting off to a good early start since the Ambassador was a little briefer in his presentation than most, which gives us an opportunity to share an exchange. We appreciate that and I'll start now with Congresswoman Holt.

Representative HOLT. Thank you, Mr. Chairman.

In September 1981 the National Broiler Council filed a petition—I'm going to be parochial at this point too—with your office complaining about the injurious effect of European subsidies to poultry exporters there. It's been nearly 2 years and there's no resolution to the issue.

What do you anticipate? Are we going to see some progress on unfair European and Brazilian poultry subsidies? And along that same line, do you believe the recent agreement between the United States and the Egyptian Government will discourage subsidizing wheat flour or is this a new approach on the part of the administration, and can we send a message? Do you think it's going to work?

Mr. BROCK. Well, I have been very careful not to describe the actions that we have taken as being retaliatory in nature or sending a message. I think what we have done, as the Congress asked us to do with the passage of the appropriations bill last year, is to take actions to defend what we consider to be our vital interest and to compete. We have asked for competition on the market premise of nonintervention by government. Other members of the trade community have a different approach and I think what we have said effectively, without being explicit, is that we will compete one way or the other. We would prefer to compete on a market basis without government intervention, but we will compete one way or the other.

I think the willingness of the United States to take specific action will lead to progress in resolving problems like this.

On the specific question of poultry, which I would say to my friend from Maryland is not a parochial issue—it may be of particular importance to Maryland but it is supported by a lot of States, some of which have represented on occasion, and it is a fundamentally difficult issue. We have a GATT complaint filed as a consequence of the case that was presented to us by the poultry industry. We have a case filed against the European Community. Last year we expanded that case to bring in Brazil which was also subsidizing. We held consultations with both the EEC and Brazil and are trying to move that case forward.

It frankly did get delayed a bit because of the advent of Brazil into the subsidized approach and that required us to resubmit our case on the basis of a more inclusive complaint. But that shouldn't slow us down now. We are holding those talks and we should proceed through the GATT mechanism with reasonable expedition.

Representative HOLT. When? What do you think should be the time to resolve it? When should we become anxious?

Mr. BROCK. I have given up predicting when GATT will issue decisions. We have been constantly frustrated by the delays. We should have had a decision on wheat flour last July. We have yet to get it, to the point where I have written a very strong letter to the representative of GATT saying we simply can't live with these constant delays.

Representative HOLT. Is the wheat flour arrangement working? What kind of reaction are you getting on it?

Mr. BROCK. Well, the Egyptians love it. I think farmers love it. There are those who are somewhat distressed who felt that that was their market.

Representative HOLT. Do they feel that we're being unfair?

Mr. BROCK. I don't think that's a legitimate charge. I'm sure some feel that way, but we have done absolutely nothing that has not been done by our trading partners and that has been described as entirely GATT legal by those trading partners who debated with us in Geneva on whether or not this was legal. They said it was. Once they made that statement, I think they almost invited us to do that which we have done.

Representative HOLT. Let me ask you about the Eximbank. The budget proposal asked for authority for a level of $3.8 billion and the supplemental direct loan authorization of $2.7 billion. Is the $3.8 billion sufficient and when would you use the supplemental?

Mr. BROCK. Because of the decline in U.S. interest rates—not nearly enough, as the chairman has suggested—but to the point where our borrowing costs are presently slightly lower than the OECD arrangement or agreement on trade and because we do have the agreement on subsidized credit, we felt that the direct loan program of $3.8 billion was probably going to be enough and that the expansion should occur in the guarantee areas so we could increase our commercial credit. But we recognize that the OECD arrangement is up for renegotiation and that conditions might change. So the President has committed the support of an additional $2.7 billion if competitive circumstances require that.

The process by which we will reach that decision is that once we have gone through a sufficient portion of the $3.8 billion and begin to sense that we may need more, there will be constant contact with my office, Eximbank, the Commerce Department and others. The matter will be brought and processed before the Cabinet Council on Commerce and Trade and we will evaluate the request and if it is required submit that to the Congress. It might be $2.7 billion. It might be that we receive something more than that. We maintained as much flexibility as possible.

I like the approach for two reasons. First of all, we have maintained a minimum drain on the budget which is important these days and, second, we have publicly notified our trading partners that we are willing to compete, and if necessary we will compete, but the better route is to maintain and improve the OECD credit arrangement which reduces the level of government subsidy. If we can improve that agreement in negotiations next month, then we probably won't need any of the $2.7 billion, and I hope that's the case.

Representative HOLT. Thank you.

Senator JEPSEN. Congressman Scheuer.

Representative SCHEUER. Thank you very much, Mr. Chairman.

Welcome, Mr. Ambassador. I'm very happy to have you here.

Your Assistant for Industrial and Energy Policy, William Krist, said in the January 22 issue of the National Journal that in high technology industries the use of concessional export financing subsidized resection of outlets and other modes of assistance to target industries could theoretically have benefits that far outweigh the apparent short-term loss and he concluded by saying that the United States ought to pay more respect or attention to the international trade implications of the industrial policy decisions of its trading partners.

I was over in Japan not many months ago with Senators Roth and Hawkins of this committee and we were tremendously impressed at the very structured environment that the Japanese Government created for industries that they had targeted, the assistance in research and development, the assistance in putting together a consortium of corporations in targeted industries, the lack of any restraints on cooperation and the positive encouragement.

Since there's so much intellectual comments about this in so many articles and magazines and studies and the rest and since we have the examples of all kinds of assistance that our global competition is providing in these targeted industries, if you look at the threat to U.S. competition abroad in steel, pharmaceuticals, computers, and automobiles, you have to wonder whether something isn't missing in our industrial policy.

Have you formulated in your own mind and perhaps suggested to the President as a part of your program to create an industrial policy as Japan and other countries have done really to help our industries make it in global competition?

Mr. BROCK. There are those who suggest Congressman, that we have an industrial policy today, but it is not one that is targeted. I think what you will find as you analyze it—we have a very hot issue pending before us right now for decision in the tool and dye case. It is a remarkably thorough petition in which the petitioners analyzed the Japanese Government support of the machine tool centers and punching tools and traced the actions of the Japanese Government in totally protecting the machine industry. The petition documents that substantial sums of credit are allocated to the industry, along with Government support of the cartelization of the industry, and the segmentation of products out to different firms. This process insures that there's no wasteful excess in the competitive environment.

In other words, once the Japanese Government has fully developed an industry then they go into the intenational market as they did, taking an industry that had less than 5 percent import penetration of this market 6 years ago and taking it to 40 percent penetration in one category and 60 percent in another. It has been effective and we have spent a lot of time analyzing how we can address that problem.

Our remedies are somewhat limited because U.S. trade law primarily deals with an unfair subsidy. There is an element of subsidy in some of these cases, but in others there is not. It's just the industrial policy which may allocate credit but you can't call that in normal terms a subsidy; it's just the availability of credit.

The cartelization may be a violation of the U.S. law but it's not a violation of the Japanese law. Things like that are very hard to deal with.

I do think that this administration would find it very difficult and it would be extremely reluctant to start adopting a target industry concept or approach. I think the idea of the U.S. Government picking winners and losers is so foreign to us all. I am sure you agree with me that we simply do not have the wisdom in Washington to do that, nor would we want the power to pick winners over losers.

But having said that, it is the function of Government to look at its existing laws to see whether they have a negative impact on the ability of our industries to compete. I'll give you a couple examples. Our antitrust laws are designed, as you well know, on the basis of what competition occurs domestically, but we don't live in a domestic economy. We live in a global economy and we are engaged in evaluation of our policies on antitrust to see if in fact they are adequate to this world competitive environment.

Second, I think it was a fair question to ask all of us, those in the Congress as well as in the administration, whether or not we are doing enough to encourage research and development in this country through tax changes, other Government policies, both State and the Federal level; and last, be very sure we have adequate credit available.

I should mention one other thing. We are in an enormously fragile world environment because of the structural changes that are occurring so fast, the state of flux in our economy is mirrored everywhere. If we're going to compete, we simply have to pay attention to our educational base, and I don't mean high schools and colleges; I mean education as a lifetime process—the upgrading of people's skills; men and women, of the work force, the opportunity for shifting skills has to be carefully drafted by Government, by business, and by labor.

All of those things I think are an effective response if done in a global competitive sense. But I would be very cautious about moving toward, as I said, the winners and losers concept. I'm not sure that the American people would buy that.

Representative SCHEUER. Leaving apart the winners and losers concept, is there some kind of an industrial policy that we can adopt that would put into place the various components of what would be an acceptable industrial policy for our country, at least not inhibiting the winners from winning and competing effectively in global trade, perhaps taking some of the shackles off our antitrust laws that were designed almost a century ago for a whole different world and they're rather irrelevant to today's realities.

Mr. BROCK. I think the Congress and the administration both have been sufficiently concerned. We have begun to move, but there are more things that need to be done. You passed last year the Export Trading Company Act. That does give us the chance to set up a different competitive structure for oversea competition than that which we tolerate for domestic competition. It allows firms of any description, including banks, to get together to be more competitive.

I wonder how much more business we would be doing overseas if we had done that 10 years ago? I think we should have. And the same applies to the antitrust laws.

Representative SCHEUER. I'm sorry my time has expired, and I don't want to impose on my colleagues, but I appreciate your very forthcoming and thoughtful answer and I hope we have time to continue this discussion in some other forum.

Mr. BROCK. I appreciate your interest because it's a fundamentally important subject.

Representative SCHEUER. Thank you.

Senator JEPSEN. Senator Mattingly.

Senator MATTINGLY. Thank you, Mr. Chairman.

Was the wheat flour transaction termed in GATT legal?

Mr. BROCK. Our trading partners have to believe so. They were arguing for that throughout the Geneva conference.

Senator MATTINGLY. I assume that is GATT legal then.

Mr. BROCK. For the moment.

Senator MATTINGLY. Right. The PIK export section that we're talking about would be relatively GATT legal with the introduction of regulation; is that right?

Mr. BROCK. Any subsidy, according to the European Community, for agricultural goods is GATT legal. They believe that it's a total exception from the GATT rules on industrial goods.

Senator MATTINGLY. I'm thinking about Congresswoman Holt's question, which I'm sure you knew would come back to me, the legislation we introduced last year and we are pursuing once again this year would exclude corn from the CCC commodities would seem like an appropriate target, as was Egypt on wheat flour. I think sometimes it's sort of good to telegraph your punches and properly so in the trade world. Do you think that would probably be a fair industry to look at to not only aid this country but to in fact change the direction of some of the illegal subsidies?

Mr. BROCK. Senator, as I think I said in my prepared statement, we are prepared to look at any product and any market to see what steps might be taken to improve the competitive opportunity.

Senator MATTINGLY. You also made a comment about our acts or examples and we just hope the next act or example is the poultry. If we were going to cast two votes right now, we would cast them that way, but it is an industry that really has been devastated in the last 2 years and we would hope that you would look closely at that.

One other small comment that I want to make. Everybody talks about Japan and I think that it depends upon whether you have a surplus or deficit in the country how we look at some of it with a jaundiced eye. I try to put that aside because somebody has got to have a surplus and somebody has got to have a deficit in these trading relationships. The main question has always been the free trade issue, but I think trying to formulate also whether it's fair trade. I think therein lies one of our biggest problems with GATT and I think you have done an outstanding job, but I think we have a fuzzy trade policy in this country because until lately, the functions of trade in the United States are out in too many different agencies.

I think it's wonderful that you can accomplish anything, when you had to go through the State Department, Agriculture Department, Commerce Department, and several others. I just wonder what your opinion is about Senator Roth's bill which is to establish a new Secretary of Trade or a Trade Department, which to me seemed to be something that could enable us to have a clearer trade policy. To me the trade issue is on an equal or par level with tax policy, monetary policy, and regulatory policy.

Mr. BROCK. I very much agree with your emphasis upon the importance of the issue. The fact is that there's trading world economy out there and we're only doing about 13 percent of it and we ought to be doing a lot more than that. If we simply took our share of the world in competitive terms to a level of our present ability without any improvement, we would create 5 or 6 million additional jobs in this country and a couple hundred billion dollars more of real net income for American workers. Now that's a lot of improvement in an economy that's suffering right now. So the opportunity is there and it ought to be sought.

I'm a little cautious about responding to your question on reorganization. There is a value for having the trade function in the Office of the President and as a coordinating office and not in a standard agency. I guess my answer would depend on what kind of agency might be developed and how strong the congressional mandate was that established that agency in terms of its authority over the trading area.

If it becomes simply a competitor in the field, it might not aid and it might further confuse the process. If it is truly the agency that has to deal with a comprehensive and a strong mandate, then that might help. But I'm a little cautious yet because we're having serious conversations about the subject and we haven't reached a decision. I'm not sure any of us are sure that we have the appropriate answer yet.

Senator MATTINGLY. Having been around Government a long time, you probably realize there's no perfect answer.

Mr. BROCK. Not many.

Senator MATTINGLY. My time is up, but I would just say that the trade issue not only must rise in its importance, which I think the President did in his speech make it come out to a higher level—but I think in order to have an expeditious and clear policy that you need to be able to make the decision at a faster rate and not only free trade but I think in order to make sure that we have fair trade. There's great confusion within the media about protectionism between free trade and fair trade, but I think those that understand trade policy understand what I'm speaking about.

Mr. BROCK. Free trade is fair trade, Senator.

Senator MATTINGLY. Exactly. Thank you.

Senator JEPSEN. Congressman Wylie.

Representative WYLIE. Thank you, Mr. Chairman.

Mr. Ambassador, there are a lot of cross currents in the foreign trade issue right now. It is very complicated. We want to help you do whatever is necessary to do the right thing, to do what is necessary for our economy.

Yesterday we heard from Chairman Volcker and he asked us to increase the quota of the International Monetary Fund. He says this is essential so that some of our trading partners can continue to be trading partners, and I must say that I agree with that. He also said that high interest rates are probably one of the biggest problems vis-a-vis foreign trade right now, that the current trade deficit reflects to a large extent the rise in the value of the dollar.

Is that taken into account in your trade talks or considered in your trade talks?

Mr. BROCK. Absolutely. If you look at the pattern of trade over the the last 10, 12, or 15 years, you can see an absolute correlation between our trade situation and the relative value of the dollar. When it was excessively high, twice—two 3-year periods in the 1970's—we went into a negative balance. When it was remarkably low on two other occasions we had a substantial surplus. Over a period, this Nation on its current account basis had about a $60 billion surplus in the 1970's, so we didn't do bad. Frankly, we are not doing badly today. It's remarkable, given the excessive value of the dollar, and it is extremely high now—it is remarkable that we are maintaining and slightly improving our competitive position in the world. Our firms have done a pretty good job internationally despite having an overpriced dollar and for an overpriced product, but it is going to create, as the chairman noted in his opening remarks, a very sizable trade deficit this year, as it did last year, and that's painful. There isn't any easy way around it.

The problem is in large degree the excessive interest rates that have been around this country in real terms since the late 1970's when as you recall they hit a high in 1980 of about 21 percent on the prime, and I'll tell you it is not possible with any combination of Government policies to bring down the value of the dollar when your interest rates are that high. You just can't do it. They've got to come down.

Representative WYLIE. You said that it's important in our trade policies that there be a minimum drain on the budget, with which I agree. Is there a relationship between the current Federal budget deficit and the balance of trade deficit?

Mr. BROCK. Absolutely. The budget deficit is by definition a drain upon our productive assets. Government is taking money from the economy through the process of debt which would otherwise be available for export sales, for R&D, for job creation, and when you're sopping up here in Washington 70 or 80 percent of the newly created wealth every year in this country into the hands of Government, you do not leave the private sector the ability to deal with these problems and compete. It forces your interest rates up. It drives up your capital pool. It creates enormous burdens on the economy.

Representative WYLIE. Well, we agree, and I knew exactly what your answer would be.

Do you have any advice to us as to where we might reduce the deficit in the budget?

Mr. BROCK. Everywhere.

Representative WYLIE. Across the board.

Mr. BROCK. There should be no sacred cows.

Representative WYLIE. And no department is sacrosanct?

Mr. BROCK. The President has recognized that as I think all of us do.

Representative WYLIE. Do you have an estimate as to the amount of reduction in exports which might be due to the, if I may use the phrase, overvaluation of the dollar and undervaluation of the yen? I'm sure that's difficult.

Mr. BROCK. It's a very difficult question to answer precisely.

Representative WYLIE. Is the yen undervalued?

Mr. BROCK. Yes, and the dollar is overvalued. That requires, in my judgment, action on the part of both governments.

Representative WYLIE. And you have been involved in talks on that particular issue. Do you have any advice to the Federal Reserve as to how they might help us on that? I meant to ask Chairman Volcker yesterday. Maybe you ought to just buy them out. I'm not suggesting that. Well, there are a growing number of my constituents—and this was alluded to by Chairman Jepsen earlier—who are concerned about protectionism, union officials, business leaders, calling for restrictive trade practices to protect American industry and jobs, and we have seen the "Buy America" amendment passed by the House and the local content legislation. And you referred to that in your statement as being harmful to trade, with which I agree.

Do you have any suggestion or would you want to expand on the devastating impact of trade policies of that kind? I really need some answers to answer my letters with.

Mr. BROCK. I really would. The problem of protectionism is that it always hurts us more than anybody else. I don't understand how a Member of Congress can say, "I'm going to protect this person's job and jeopardize someone else's job." And that's what you invariably do when you put protectionism on a particular commodity or industry. You're saying, in effect, I'm willing to trade one person's security for another's security.

The Senator from Iowa has an enormous stake in agricultural exports as does your own State. The gentlewoman from Maryland has an enormous stake. Almost all of us do. You put all those products in jeopardy if you start this process. You put your pharmaceuticals in jeopardy. You've got to remember, we still export more than we import in all the major categories—in manufacturing, in services and in agriculture. We have something to lose, not to gain, from protectionism.

And to me it is so short-sighted to talk about taking the negative step when we have the alternative of taking a positive step. The Congress could act to pass the Foreign Corrupt Practices Act today. That has been a significant barrier to trade, but while it passed in the Senate it's not passed the House. There are steps like that that can be taken that open up the opportunity, and I'd like to keep us focused on that opportunity. Protectionism will do great violence to those Americans whose lives are totally dependent upon this Nation's international sales.

Representative WYLIE. Thank you very much. My time is up.

Senator JEPSEN. Congresswoman Snowe.

Representative SNOWE. Thank you, Mr. Chairman.

It's nice to see you here today, Mr. Ambassador. I wanted to raise a question concerning the ability of small industries to petition some of these remedies, to go through the process of petitioning for remedies to alleviate the problems we've had with trade in the past and, as you know, we've had numerous conversations concerning shoes, potatoes, fishing, and lumber.

The process, at least it's becoming apparent, is very lengthy and convoluted and complex and it really takes a long time for any industry to prove its case. And I think we can be in agreement about the fact that the small businesses have had difficulties in obtaining relief under the present trade remedies.

A number of my industries in the State of Maine have certainly had difficulty in petitioning, as you know. I have just enumerated those industries.

What would be your suggestion as to possible improvements in our trade laws so we can get over these obstacles so the small businesses will not be at a disadvantage when they're trying to seek economic redress from unfair competition?

Mr. BROCK. I think first I want to agree that the problem exists. It is there and it is real and I'm concerned about it. We have begun an exploration of the current trade laws to see what changes in this and other areas might be worthwhile to ask the Congress to consider this year. There are a number of bills that have been introduced in the Congress, as you well know because you have been involved, to deal with this problem in one fashion or another.

I'm willing to look at almost anything. I'm not wedded to a particular bill, but I do think we have to be very sure that our laws are so carefully crafted that they are available to all and not simply to large corporations who have a battery of corporate attorneys available to them. That's not the case for a lot of medium and small businesses.

I would be happy to work with you and other members who share this concern to see if we can improve that.

Representative SNOWE. Well, I can assure you I will be seeking your support. I am introducing legislation today to establish a small business trade assistance office.

Shoes, potatoes, fish, or lumber—all of those industries are seeking some sort of redress from the Federal Government, but it's taking years to do so. So that's why I'm introducing legislation. Frankly, I think it's going to be a primary issue in the Congress this year and what I have noticed, just in my experience in dealing with industries who are seeking this redress and certain remedies from the Government is the fact that other nations have an advantage over our Government because they have domestic laws to protect their industries. They can immediately respond to a given situation, as we've noticed with Canada in the past, in protecting our industries in the State of Maine. So I think in order for us to have leverage and in order for us to have an advantage, that we have got to have comparable domestic law. I'm introducing this legislation specifically so they can assist small businesses financially, and in every other respect, because as it stands at this point the potato industry, for example, is spending over several hundred thousand dollars to prove its case and Canadian imports have increased 50 percent this year over last year's imports. That's just an example. Shoes is another case.

In fact, I think it was very necessary that the President extend those import quotas of June 1981, and he failed to do so, so now the shoe industry is going through a petitioning process at this point in time to prove its case, and I've noticed just in the State of Maine alone, which is foremost in producing shoes in this country, that it's losing several thousand jobs because those import quotas were not extended, and I know the ITC supported the extension.

I think it's unfortunate that our industries are having to go through this time and time again to prove its case and seek remedies from the U.S. Government. It takes years, if in fact they can even afford to do so.

Mr. Brock. Yes. Well, first of all, I commend you for the obvious attention and efforts you put into the issue. I agree with you on both problems. One is the financial problem and the other is the time problem.

If your bill is introduced today, we will begin our evaluation today and we will have very thorough discussions in the administration on that approach.

I might add one thought on the shoe question. One of the things that the shoe industry has done—and I have appreciated it and for which I have great respect—and that is the petition which they have submitted to us was not so much a protection petition but one that was challenging the openness of other markets and the access to those markets. The petition alleged that trade was not a two-way street. I happen to believe that's a very forthcoming and proper approach and that's why we said in the petition that we think there's leverage there and we are pursuing that.

Representative Snowe. What is happening with the shoe industry? They have a petition. When do we expect that action will be taken? I know it is discretionary on the part of the President. Do you expect to see any action will be taken?

Mr. Brock. I don't think it's fair or right for me to predict what specific steps might be taken. I can simply say that I took their petition very seriously, as I told them when I met with them. It might produce some positive results, but I'm going to be cautious about being very precise in my answer.

Representative SNOWE. Thank you. Unfortunately, my time has expired.

Senator JEPSEN. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Ambassador Brock, I take it you were a full participant in the meetings that the President had with the prime minister and other officials of the Republic of Japan recently.

Mr. BROCK. Yes, I was.

Senator SARBANES. To what extent in those talks was the question of the relative value of the two currencies discussed?

Mr. BROCK. A good deal. I think it's such an important issue, I'm not sure that I would ever be satisfied with the completeness of the discussion, but the Japanese Government heard from virtually all of us on this subject. The Secretary of State, as I recall, mentioned it; the Secretary of the Treasury; and it is a matter of continuing conversation. I will be discussing it again on my trip next week to Japan.

Senator SARBANES. By what percentage do you think that there's an artificial price discount in the valuation of goods as a consequence of an artificial imbalance between the currencies?

Mr. BROCK. If you accept, as I do, the belief that the dollar is overvalued and that the yen is undervalued, it increases the disparity. My own instincts would argue that that range could be somewhere in the 15 percent category, maybe somewhat more, but it is substantial.

Senator SARBANES. In other words, leaving to one side for the moment a comparison of access to one another's markets and not on that issue, even if you were equivalent there, our people could be laboring under let's say a 20-percent price discount; is that right?

Mr. BROCK. Yes.

Senator SARBANES. How can you expect anyone to compete when confronted right up front with a 20-percent price discount?

Mr. BROCK. Well, I think it's pretty obvious that we are suffering as a consequence both in terms of domestic market competition and competition in third markets as well as competition in Japan. That is in fact a global problem for us.

As I think I said perhaps just before you came in, it is somewhat remarkable that we have done as well as we have. We have increased our share of world trade in the last couple years despite the global recession. But with all that, we are going to have an astonishing and unfortunate level of trade deficit this year.

Senator SARBANES. What do you expect that level to be?

Mr. BROCK. I'm a little reluctant to put numbers on something because the level of deficit is pretty much dependent on the rapidity of our recovery. If we have a rapid recovery, as I think we will, the deficit could reach somewhere between $60 and $70 billion.

Senator SARBANES. That would be hands down the highest we have experienced in the entire postwar period, wouldn't it?

Mr. BROCK. I think that's correct, but, Senator, if I can add one important caveat, at least 90 percent of that still will be in one category and that's imported oil.

Senator SARBANES. But to some extent, we have always confronted that problem. Accepting that response for the moment, what does it lead you to conclude?

Mr. BROCK. It doesn't lead me to conclude anything other than what I have been saying all morning, and that is the need to do a better job of competing internationally, to get our interest rates down and the relative value of the dollar down. Those are actions we can take domestically.

Senator SARBANES. In other words, you're suggesting that despite pinpointing it specifically, the remedy for it still lies in a broad range of general policies?

Mr. BROCK. Yes; we have taken a step on oil that we needed to take, but it took us almost 10 years to decontrol oil. Had we done that when the problem arose, we would have much less of a difficult situation now.

Senator SARBANES. I'm not sure that follows. We have decontrolled, which you look to as the solution, yet you have just stated that the largest portion of the deficit still flows from that area. Isn't that correct?

Mr. BROCK. Decontrol, Senator, doesn't deal with levels of deficit. It deals with levels of production and consumption, and the intervention of this government in the marketplace in energy in the last 25 years has been an egregious error, in my judgment.

Senator SARBANES. What is your program that would move this trade deficit toward a better balance, and what is the likelihood of that happening? You're telling us that you expect the trade deficit to increase markedly, to an unprecedented level; is that correct?

Mr. BROCK. That's correct, this year.

Senator SARBANES. And what will happen the following year?

Mr. BROCK. I would frankly expect a good deal of improvement in 1984 and even more in 1985. What we have is, as you have correctly pointed out, a particular problem that beset us on two different occasions in the 1970's, and that's an overvalued dollar. That's part of it. That will be addressed as our interest rates come down and the deficit frankly will help to address that problem. The biggest single problem we've got is the global recession and as the global economy begins to recover, as we manage the debt prices which I believe we are doing fairly well at the moment, if the Congress will support us in the IMF funding and similar actions, then 1984 can be a year of reasonable growth in the world economy and in 1985 even better.

We will lead that growth, but as the world process improves we are in a far better position to take advantage of that market growth than any other country in the world. We are emerging from this recession in a position to be very competitive over the next half dozen years and that argues for restoration of the kind of process that we had in the 1970's with a relatively stable dollar.

Senator SARBANES. Well, Mr. Ambassador, all I can say is that it sounds like that old refrain of staying the course and the course seems to be going in the wrong direction.

Mr. BROCK. Senator, I think the course went in the wrong direction a few years ago. We're trying to correct it.

Senator SARBANES. Well, thank you, Mr. Chairman.

Senator JEPSEN. Congressman Lungren.

Representative LUNGREN. Thank you, Mr. Chairman.

It's good to have you here, Mr. Ambassador. I was thinking when I walked in the room of the fact that it was 12 years ago last month that

I started to work for a fellow who was just sworn in, in the Senate. Senator Brock of Tennessee. I worked half a day here and went to Georgetown and went to class. There were only two Republicans in most of our classes and we were in the minority. I want to tell you it feels a little better to have a few more around these days.

Mr. BROCK. It's nice to be looking up to you, Congressman.

Representative LUNGREN. Coming from a district that very much depends on the export and import market with two major ports and having the opportunity now of having the Toyota Motors of the United States headquartered in my district, I probably have a pretty good understanding of the consequences of protectionist legislation on jobs in the United States. For that reason and for many other reasons, I vigorously oppose domestic content legislation and have tried to see where in fact we can duplicate or replicate the Japanese experience, in their taxing policy and capital formation, so we can learn from some of their proper actions.

But at the same time, as you have recognized, there's no doubt that we do have some problems with our friends in Japan. Just this week, as you're very well aware, the semiconductor industry has been having some meetings in Washington, D.C. As you also know, we have a large element of that industry in California. I think they articulate very well the problems that they have found in Japan with respect to Japan targeting specialized or focused areas of the semiconductor industry and at the same time protecting their markets, subsidizing their products, and basically not dealing with us in a fair trade or free trade concept.

In addition to trying to hold the line against overt protectionism and trying to educate the American public that not all of our trade woes are from the unfair practices of other nations, what do we tell people like the semiconductor industry and, more importantly, the many thousands of people working for that industry, that they ought to expect from this administration in responding to what many of us consider to be unfair practices promulgated by the Japanese Government?

Mr. BROCK. That is a fundamentally important question. I appreciate it because I want to draw the very clear distinction between protectionism, which is self-defeating and damaging to our vital interests, and actions which deal with in a positive way unfair or predatory actions on the part of our trading partners.

For myself, I will speak for no one else, I happen to be a firm believer in free trade. I'd love to see the day when it comes, but we don't live in that kind of a world. The real world and other governments have a different attitude about how they do business with their businesses and with us. We have laws and we have international agreements that can help us come to grips with an unfair trading practice and we have over a period of 2 years of this administration taken a number of steps to apply those laws affirmatively, not in a protectionist sense but in the sense of saying we simply don't expect other countries to export their unemployment to us and we won't put up with it.

An example would be the agreement we reached with the European Community on steel where we simply found subsidies, and determined they were violating both international agreements and U.S. law. So we have that capacity to respond when we can demonstrate an inequitable trading practice.

As I said earlier, one of the difficulties in the so-called industrial targeting policy of Japan is that it is not always GATT illegal in the classic sense of a subsidy below market or antidumping process. Where we have found evidence of that, we have tried to take action. We have a case pending before us now on the machine tool centers and punching tools, and the administration is in the process of evaluating the validity of the petition. But I simply want to state for you and for the record that it is an accepted role for this Government and this administration to try to come to grips with those problems in a specific fashion that says American workers will not be disadvantaged by the intervention of governments around the world.

Representative LUNGREN. One of the things you suggested we might look at is our antitrust laws. I wonder if you could be precise about the perspective we ought to use. In the semiconductor industry, for instance, there was a pooling of research allowed that would, under current law in the United States, be violating the antitrust laws. There have been discussions from people in that industry that that's what we ought to be allowed to do if we're going to remain competitive.

My question is, should we review the antitrust laws and attempt to justify changes in the antitrust practices based on the fact that this is what we have to do specifically to reciprocate in a sense what another country has done, or should we analyze it from the standpoint of the underlying competitive nature of our antitrust laws but now with an international focus as opposed to limiting the competitive definition toward a domestic focus?

Mr. BROCK. I cannot adequately express the strength of my answer to that. If we choose the latter approach we're doing it the right way. If we choose the former approach of looking at our laws only in response to an individual circumstance that exists in another country, we will be ad hocing our way through the next 20 years of trade disaster and that's just not rational. It is imperative for this country to constantly evaluate its laws in terms of its global international situation. You cannot say that you can evaluate the competitive situation of automobile manufacturing on the basis of automobiles that are manufactured in the United States, not when only 2 percent of the total market is now consumed by Japanese imports and 30 percent by imports from other sources.

We are in a global competition and our antitrust laws should focus on the global analysis and not one country.

Representative LUNGREN. Is the administration prepared to make recommendations on changes in the antitrust laws?

Mr. BROCK. We have made a number of policy changes already which led to the agreement to let the semiconductor industry have the research program. We are engaged now in an evaluation under the leadership of the Justice Department with the participation of my office, Commerce, and others, as to whether or not other changes might be worthwhile to be considered. We did take a significant step forward with the passage of the Export Trading Company law last year, thanks to you and other Members of the Congress.

Representative LUNGREN. Thank you. Thank you, Mr. Chairman.
Senator JEPSEN. Thank you. Senator Abdnor.
Senator ABDNOR. Thank you, Mr. Chairman.

Welcome, Ambassador Brock. I haven't seen you for a few weeks. I guess the last time was when you were kind enough to drop by my office to have a frank discussion on trade. At that time I expressed my feelings that I thought our administration was less than aggressive in foreign trade. You assured me that was not true and there would be proof showing up very soon, and there was; and I assume you were talking about the wheat flour sale which I was very, very pleased to learn about.

Secretary Block was before this committee and I think he made the statement that a sale of 1 million metric tons of flour would generate something like $850 million in additional economic activity and create over 9,000 jobs.

Now, to me, that's what we mean when we talk about jobs bills around here. I know in the committee we're always talking about all kinds of great programs we're going to start up, but this type of action says more in dollars and cents and bodies working than all the make-believe things that we can create here.

Now that's the good news. But you know there's a great talent around here to say, "What have you done for me lately?" And we all know as Members of Congress, they say, "Well, what have you done for me lately," and, of course, since that time the trade blowup with the Republic of China has come about. I'm sure the action we took on restricting the merchandising of Shangaiese was not your advice to the administration but obviously it happened. Again, Secretary Block pointed out that the major growth of our grain sales was China and the other day he was saying that there's only one major growth market for wheat and wheat flour in 1982 and 1983 and that's China. He also said there's only one major growth market for course grains, and that's China. And as the chairman pointed out, soybean sales in 1982 and 1983 was 400,000 tons and most of it comes from the United States and this represents a lot of sales.

And I'm just wondering—I don't know the magnitude of benefits the textile industry is going to realize, but I'll tell you it's got to be awfully good to make up for the damage we've done here in the long run on jobs and businesses. So I'm just wondering what we need to do.

I hear you say that in a sense we're losing out on $2 billion worth of income and 5 or 6 million jobs and we're not maybe getting our share of that $2 billion worth of foreign sales and it makes me think we'd better be getting on the ball.

What is the long term consequences of this action? Is it somewhat like I just said here with China because of this incident?

Mr. BROCK. I think it is an incident, Senator, not a fundamental change of pattern. We have known throughout the last year as we engaged in sporadic negotiations that both sides had a very limited range of negotiating flexibility. We signed something slightly over a year ago, the Multifiber Agreement, on textile trade, and we operate within that Multifiber Agreement as we conduct negotiations. We have signed negotiating agreements with all the other principal suppliers, China being the only one remaining. We simply are not in a position to violate the President's commitment to relate textile import growth to the domestic market growth in this one circumstance.

Senator ABDNOR. Well, exactly what is this commitment?

Mr. BROCK. Well, the President in 1980 and again in 1981 in the context of the Multifiber Agreement, did pledge to try to relate domestic import growth to the growth of the U.S. market. We have been negotiating under that mandate and negotiating I think forthcomingly good solid agreements with other countries. We have never asked another country to roll back their imports as other importers have done around the world. We have been trying very hard to keep a balance among the several nations that sell to us in that particular category. We are very tightly constrained in our ability to be flexible in that negotiation because of our commitment and because we are part of a global Multifiber Agreement.

Now I don't think that it's impossible to reach an agreement on this subject. As a matter of fact, I think we probably will. It may take a bit of time, but ultimately it is in both countries' interest to reach a negotiated settlement of the textile question. I do not believe that it is either necessary or logical to fear a long-term change in the trade pattern or any long-term negative impact on the category of farm products that you're worried about.

I might point out to you that the action that the Chinese took in response to the breakup of the talks was fairly restrained action. They did not operate across the board and they operated only in two or three categories where the trade was already in decline because of the development of their own markets.

So I think, while it's a very difficult and contentious situation, it's one that will ultimately work its way out and we intend to pursue the negotiated efforts as best we can.

Senator ABDNOR. Well, thank you. I hope it does work out that way. I know my time is up, but I want to mention one other thing here.

The President's 1984 budget proposes a 38-percent cut in the Department of Agriculture's export loan guarantee program and it went from $4.8 billion to $3 billion, and I think that could have quite an impact on agricultural exports. That's why I mention that. My good friend, Congresswoman Snowe, introduced legislation yesterday that I think would be helped by the Export Recovery Act. What it does is call upon the Secretary of Agriculture to use unexpended funds already appropriated in the Commodity Credit Corporation for this program as promotional funds for selling grain. I think we need the same kind of emphasis on foreign sales of our products as we do on cutting back in production, such as through the PIK program. We need the same kind of incentive and should not put up barriers. I think we've got to be willing to go out and compete just like you did in that flour sale.

Don't you think we, as a Congress, should take some action around here to help by promoting legislation such as mine and Congresswoman Snowe's?

Mr. BROCK. Yes, I think Congress has already taken action. It's been very supportive in the allowance of additional flexibility of the administration to use blended credits, and the provision of those funds in the appropriations bill last year.

Senator ABDNOR. I might tell you that I refused to sign the conference committee report because they changed one word from that list, if not more, and that ruined the whole bill as far as I was concerned.

Mr. BROCK. There is a modest difference in the approach.

Senator ABDNOR. There sure is, and we're going to keep reminding everyone about that, too. Thank you.

Senator JEPSEN. Mr. Ambassador, one of the most serious problems facing U.S. manufacturers of consumer goods, including home computers, is counterfeiting or illegal reproduction of U.S. products in other countries.

What is the United States doing about the counterfeiting and what happened to the policy we tried to negotiate during the Tokyo round of GATT trade negotiations in 1975 to 1979?

Mr. BROCK. We simply have not been able to convince enough other countries of the value of that kind of code, in part because some of them are involved in the practice that we found outrageous. We continue to press with those countries that do share our concern with counterfeiting practices. The more involved the United States becomes in this process of working toward a code, the more we will be able to limit the problem. But it is a difficult issue and one that is being practiced by more than one country.

There are a number of cases where manufacturers are duplicating American products, including almost the exact label. It is really an inexcusable business practice. But it has frankly been very tough to deal with in a multilateral form.

Senator JEPSEN. Is it difficult mechanically to identify these products under some type of close supervision when they come into this country and then just set the——

Mr. BROCK. We can pretty well deal with it in this country. Frankly, they are very skillful. I saw an individual who had bought a watch—it was not a U.S.-made watch—it happened to be an exact duplicate of a Rolex watch which is Swiss, even down to the identification number on the back of the watch. This person bought it for $40, somewhat under the world price worldwide. You see this sort of thing constantly.

We can cope with it because we have an effective customs process here. Where we're running into a primary hazard is third country competition. If it's made in one country and sold in another country there's no mechanism for policing that without frankly the agreement of both of those countries, and that's been hard to get. But we are pursuing it. We intend to continue pursuing it until we have eliminated the problem.

Senator JEPSEN. I want to comment on a very broad general subject, and that is one of us being a reliable supplier. We lost that credibility as a result of the grain embargo and the Soviet pipeline sanctions recently, and that has had a very serious impact on our trade balance and specifically on the agricultural community in this country or agriculture-related business, especially in the areas of the farm implement business.

Are we on the road to developing an international trade policy, a domestic policy on trade, that would say we're not going to intermingle and mix our trade with implementing foreign policy, or if we do, here are the guidelines? What are we doing about getting something put together on it?

Mr. BROCK. I think we're making progress but we have a lot to make. Over the period of the last 12 or 15 years we've done ourselves a lot of damage and it's very difficult to quantify the policy side of an embargo.

The Congress has acted and the President has acted with the passage of the contract sanctity provisions that were adopted in the November session.

Senator, we do need a clear understanding, first among ourselves, as to what the guidelines are. It doesn't matter whether the President is a Democrat or a Republican, in the foreseeable future, this country will, in its national interest, constrain the sale of strategic national defense type processes or equipment that could be used to threaten us. I just don't believe you can expect the American people to ask otherwise. But we can make a very clear distinction between that narrow category of items and the broad category of products which is generally available on the open market from a variety of sources in which we do not have the unique capability or capacity.

Senator JEPSEN. Excuse me for interrupting. I don't think there would be any problem if we just define the rule of the ball game. Our trading partners are not much different from the 24 fellows or whatever it was on the football field the other day. They know what the rules are and then they go ahead and play the game. But we haven't set an established set of rules of what our trading policy is going to be, and nobody in the entire world, let alone within our own country, has known what the rules of the ball game are so they can plan or go accordingly, and that has been devastating.

I don't think there's any disagreement with this, but I'd like to put some things in the record by way of, hopefully, having people sit down weekly from our State Department, USDA, Commerce Department, the White House, the security agencies, to establish—with you presiding, hopefully—the rules of this ball game so that we again become a reliable supplier. And we need to explain to the American public why the necessity for being a reliable supplier is so important.

You know, we do things in this country and if something goes wrong, we appoint a committee and we take 18 months to resolve it—and what difference does it make? We've got so much of all kinds of things. We enter into a feed grain agreement with one of the emerging nations who doesn't have quite the same democratic process as we have here, and they enter into the contract and have a plan to feed their people, and if that plan indeed is interrupted and terminated or jerked out from under them, they don't have a committee meeting; the person who was involved, who may be leading their country, loses his head. And that's why they look at things a little differently and why becoming a reliable supplier is pretty important.

Mr. BROCK. I happen to agree with you, as you know. Let me point out that the problem does have additional dimension in those areas which are high technology in nature and do have strategic or defense application, but which are not produced solely in the United States.

I am one who believes that the pipeline action allowed us to do something that we should have been doing for the last 10 years; that is to begin to develop a consensus which we may have had in the 1960's but lost in the 1970's as to what items are subject to necessary control and what items are not. As I told the European Community when I was there the day after the decision was announced, during the 1970's, under several different administrations, we grew apart by inches in our understanding of the problem and our approach to it in East-West trade. We simply were not communicating. That fact was obvious in the aftermath of Versailles, when the President felt we had no agreement and we felt we had to take unilateral action. But that action dramatized the absence of context and understanding, and served to bring us together. We have had very constructive conversations with our allies since that time and we have moved toward a clearer understanding of what the rules are.

You will be considering the issue this year as you take up the Export Administration Act which expires in September. I hope that this process over the next 6 or 7 months will lead to the kind of clarification you and I both ardently desire.

Senator JEPSEN. Thank you. I went over my time a little bit. I thank you for your patience, Senator Sarbanes.

Senator SARBANES. Mr. Ambassador, I was interested in the response you gave to Congressman Lungren about applying the laws and agreements in terms of trade relationships. Would you say that the administration is of one mind on that or do you find yourself fighting a battle within the administration to make that point of view accepted and its vigorous application executed?

Mr. BROCK. We are of one mind in the effective enforcement of U.S. law. There are, obviously, disagreements as to methodology and there should be. I would hate to think that we had one person that would constitute the source of all wisdom on a subject as complicated as this one.

Senator SARBANES. Do you think we need any trade reorganization?

Mr. BROCK. I'm not sure that we do, but I'm willing to explore the subject.

Senator SARBANES. Is the administration contemplating any proposals with respect to trade reorganization?

Mr. BROCK. We are involved in internal discussions as to the role and responsibility of those of us who are involved in the trade area. We have some action-forcing events coming up. Senator Roth has introduced a very strong bill that we are carefully analyzing. Others have considered similar legislation. We will have to discuss these in the next 4 to 6 weeks.

Senator SARBANES. The French Foreign Trade Minister, in commenting about the GATT Conference, said, "The conference is ill-timed and ill-conceived and the subject should have really been the crisis in the world production and world monetary disequilibrium." What's your view of that comment?

Mr. BROCK. As I think was evident in Geneva, we disagreed on this, among other subjects. It was not in anyone's mind that we would have the state of economic disarray that existed in Geneva last November. When the conference was first discussed 1½ years before that it looked as if things were going to get better. Even a year before the Conference date was actually set, the attitude was reasonably positive as was the world financial situation. However, the world trading situation did deteriorate significantly and it made for a very difficult conference. But the fact that we met, that we moved the system ahead a bit, I think is testimony to the fact that the people walked up to the abyss of chaos and looked down and they didn't like what they saw, and they did so some constructive things.

I, frankly, do think that we need much more talk and analysis on the trade financial relationship not only in this country but internationally.

Senator SARBANES. How central a role do you expect to have in planning for the Williamsburg conference?

Mr. BROCK. Obviously, I will be involved, as will the other people who have economic and financial responsibilities in the administration.

Senator SARBANES. Well, this is maybe a difficult question for you to answer, but you have a sense that your office is not placed sufficiently at the center of formulating agendas and evolving a policy, that the centrality of your office in that process does not correspond to the centrality of the trade problem in our economic context?

Mr. BROCK. No; I don't have that sense. I'm very comfortable with the relationships we have with this administration. I cannot think of a Secretary of State in my lifetime that has a greater understanding of the economic mandates and economic reality than the present Secretary. That applies to Jack Block in Agriculture, and my colleagues in Commerce and Treasury, as well. We work well together and I think all of us have demonstrated a willingness to listen to each other and work together.

Senator JEPSEN. Congresswoman Snowe.

Representative SNOWE. Thank you, Mr. Chairman.

I have just a couple questions, Mr. Ambassador. I understand that the contracting parties of the GATT ministerial meeting that was held recently agreed to refrain from taking any measures inconsistent with GATT and will resist pressures in formulating any proposed legislation. Have you seen any early indications that these signatories are willing to live up to this agreement? And why I ask this question, of course, is that we have had a number of witnesses who have appeared before this committee suggesting that we should refrain from taking any protectionist action in the Congress, and obviously that's going to be a temptation difficult to resist.

So, do you see any hope or a ray of optimism in the coming months that we are going to see a willingness on the part of many countries to negotiate agreements in good faith to avoid protectionist measures in their governments?

Mr. BROCK. Yes; I do see some evidence of that. Frankly, I've felt better about the GATT ministrial meeting since leaving it than I did when I was there. Let me cite just two examples: First, in the European Community instance, we really did have good solid conversations when George Schultz, Jack Block, and I went there in December. The follow up results of that in these working level discussions on the agriculture dilemma we face are encouraging.

Second, in the Japanese instance, which is the other side of the trade coin, the Prime Minister's willingness to do something that has not been done until now in addressing a fundamental trade barrier in Japan. Up until now our concern has been that they might move on the baseball bat issue or modification of a quota a bit here and a little tariff there and that it would take 1,000 years to solve the whole trade problem. But the Prime Minister's action in his cabinet to deal with the broad testing and certification problems which affect 60 percent of all they produce was a very positive sign and if it is implemented into law, as we hope, that's the kind of thing that we need to give some evidence of tangible movement. I grant you there are some other examples on the other side, mostly as a consequence of the GATT situation—the limitation on imports, the increased subsidization of exports on the part of some of the heavy debtor countries is disturbing, but, on balance, I think we are still ahead of where we were.

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

PRESS AND INFORMATION SECTION
EMBASSY OF JAPAN
2520 MASSACHUSETTS AVENUE, N. W.
WASHINGTON, D. C. 20008
234-2266

Embargoed Until 7:30 PM EST
March 25, 1983

REVIEW OF STANDARDS AND CERTIFICATION SYSTEMS
March 25, 1983

1. The liaison and coordination headquarters on standards and certification systems, etc. has carried out its review for the last two months in pursuance of the decision by the Ministerial Conference for Economic Measures on • January 13 this year with the strong and concrete support of Prime Minister Nakasone. Chief Cabinet Secretary Gotoda has personally supervised the review in which a number of Government ministries and agencies have worked together. As can be seen from the fact that the number of laws examined were nearly 30. The review work has involved a highly complex and diverse range of matters and has entailed many difficulties. But the headquarters has arrived at a comprehensive set of policies and specific improvement measures designed to make Japan's standards and certification systems as a whole more open to her trading partners.

2. In the past, specific issues relating to import testing procedures and standards have been raised and dealt with in Japan-US. Japan-EC and other bilateral fora as well as through the OTO mechanism. The headquarters has conducted its review from the basic viewpoint of examining how best to tackle these issues systematically and comprehensively. rather than responding to them on an ad hoc basis as they arise.

3. Japan is a contracting party to the GATT standards code (agreement on technical barrier to trade) which came into effect on January 1, 1980. In conducting this review, we have placed our emphasis on further realizing the objective of the standard code which is to ensure that certification systems be applied in accordance with the principle of non-discrimination between domestic and foreign products/supppliers and to eliminate unnecessary barriers to trade. Thus our first goal has been to ensure in terms of legal systems that there be no discrimination between nationals and non-nationals in our certification procedures. In addition to this goal in terms of principle or form, our second goal has been to work out specific policies and

measures to ensure transparency, bring about greater conformity of Japanese standards with international standards, promote the acceptance of foreign test data and to otherwise simplify and speed up certification procedures, so that our systems can be made more open in substantive terms.

4. The salient points of the decision reached as a result of the review by the liaison and coordination headquarters are as follows:

(1) Legal non-discrimination

(A) In order to ensure in terms of legal systems that there be no discrimination between nationals and non-nationals in our certification procedures, we will seek to amend nearly 20 laws including the Pharmaceutical Affairs Law, Agricultural Chemicals Regulation Law, Law Concerning Standardization and Proper Labelling of Agricultural and Forestry Products (JAS law), Consumer Product Safety Law, Electric Appliance and Material Control Law, etc. Amendments will be proposed to the current session of the Diet

(a) to enable foreign suppliers to apply for and obtain certification directly, and

(b) to treat foreign products and suppliers equally with domestic products and suppliers with respect to testing methods.

These amendments will enable foreign manufacturers who wish to enter the Japanese market to have the choice between applying directly to Japanese certification systems and applying, as before, through importers in Japan. It means that these foreign manufacturers will be provided with the same opportunities as Japanese manufacturers.

It is noted that only a small portion of the contracting parties to the standards such as the United States grant foreign manufacturers direct access across-the-board to their certification systems. The above mentioned amendments will make Japan's certification system one of the most open in terms of legal systems.

(2) Transparency

The point has often been made by interested foreign parties that it is difficult to know precisely when and under what procedures various Japanese standards are drafted and to have their views reflected fully in the standard-drafting processes. To meet this, we will compile and publish a directory of standard-drafting and standard-revising processes in the Japanese Government and will provide opportunities to hear the opinions of parties concerned including foreign nationals from the outset of the standard-drafting processes. Further, we will extend the comment period under the standards code from the present 45 days to not less than 9 weeks.

(3) Conformity with International Standards

We will proceed promptly with the work of bringing our standards into conformity with international standards where such international standards already exist. Such work will be completed regarding standards on household electrical appliances with IEC (International Electical-Technical Commission) Standards and standards on driver's head gear with ISO (International Organization for Standardization) draft-standards within FY 1983. At the same time, we will participate actively in the work to newly formulate international standards on motor vehicles in the ECE (United Nations Economic Commission for Europe) and measuring devices in the OILM (International Organization of Legal Metrology), etc. With respect to approval of new food additives, we will take steps on the basis of specific scientific examinations on utility and safety, bearing in mind the evaluation by the joint FAO/WHO expert committee on food additives. Further steps will be taken to relax the safety standards on motor vehicles (rear spoilers, head-restraints, lights, speedometers, etc.) as from October 1983 and to add a new standard on plywood with white pockets to the Japan agricultural standards in the light of comparison with corresponding standards in other countries.

(4) Acceptance of foreign test data is of great significance in simplifying the regulatory testing process and in facilitating the flow of goods. We will accept the results of tests conducted by foreign testing organizations or foreign firms upon confirmation of the reliability of the data except where there exists compelling reasons not to do so. Steps are already being taken in this regard with respect to motor vehicles, imported foods, electrical appliances, etc. Further, we will, as from October 1983, accept those pre-clinical test data which have not been accepted before such as stability test data and data on specifications and test methods with resect to pharmaceuticals and

also actual performance data by foreign firms on medical devices. With respect to clinical test data on pharmaceuticals, we will seek to move forward by carrying out expert, scientific studies inm consultation with our trading partners on matters such as ethnic differences. On agricultural chemicals, we will work towards an early introduction of the GLP (Good Laboratory Practice) taking into account the state of consideration by our trading partners so as to facilitate the acceptance of toxic test data by foreign firms. As regards to chemical substances, we will introduce the GLP within FY 1983 to enable the acceptance of test data prepared by foreign firms.

(5) Simplification and Speeding-up Certification Procedures

The following steps will be taken. Inter ALIA, to simplify and speed up the certification procedures. Further, we will study the possibility of application in English and other foreign languages:

(A) Motor Vehicles

To enable the greater part of foreign car manufacturers to take advantage of the type designation system which does not require the inspection of each imported vehicle at the land transport office, we will greatly simplify the procedures and requirements for type designation. Specifically, (I) when durability test data are presented at the time of application, the submission of vehicles that have madea long distance running (30,000 KM, etc.) can be dispensed with (II). Data of tests conducted by foreign manufacturers through foreign testing methods which are roughly equivalent to Japanese testing methods can be accepted, and (III) documents to be attached to the application form will be greatly simplified (simplification of items in the specification table. Dispensing with the document on strength calculations, etc.). As a result, submission of one new sample vehicle and documents will suffice to meet the type designation requirements, and type designation will become roughly as easy to use as the present type notification system. (The time required will be reduced from about 7 months at present about 2.5 months.) The United States has been requesting that the Japanese government allow U.S. manufacturers to self-certify compliance with Japanese standards on safety, etc. This suggests that we should adopt the approach of dealing with accidents, etc., after the fact, i.e., through recall of the cars from the market, civil judicial procedures, etc. However, Japan's system on automobile accidents, pollution, etc., has long been predicted on the drafting and certification activities of non-governmental bodies (including quasi-governmental bodies) and take steps to see that the above-mentioned policies such as non-discrimination, transparency, conformity with international standards, etc., be reflected in the activities of these bodies.

(B) Pre-import Procedures

We will expend and strengthen the system for seeking improvements including information-giving with respect to pre-import procedures which involve various ministries and agencies.

5. In carrying out this review, we have solicited the views of the United States,the EC Commission, and other countries concerned and have also looked into the systems of our trading partners. We are convinced that the policies and measures included in this decision respond to the major part of the concerns of our trading partners. We will be handling further specific requests from our trading partners in the light of the policies contained in this decision.

6. Japan is the only country among the contracting parties to the GATT Standard Code which has, on its own initiative, taken steps to improve its standards and certification systems as a whole. We hope that similar efforts will be made in other countries as well.

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

83/11

EMBARGOED FOR RELEASE
7:30 P.M., EST
Friday, March 25, 1983

Contact: Barbara Bain
(395-4647)
David Demarest
(395-4647)

USTR BROCK HOPEFUL FOLLOWING JAPANESE STANDARDS REVIEW

U.S. Trade Representative Bill Brock today said he was optimistic that the Japanese Government's announced intention to seek parliamentary action to amend a number of its import testing procedures would result in greater access for U.S. suppliers to the Japanese market.

"I am hopeful that as a result of the review by the interministerial committee, 17 major Japanese standards and certification laws will be amended during this session of the Diet," Ambassador Brock said in response to the announcement by the Government of Japan.

The GOJ announced earlier today that it had arrived at a set of policies and specific improvement measures designed to make Japan's system as a whole more open to her trading partners. This followed a comprehensive, two-month review of standards and certification practices, supervised by Chief Cabinet Secretary Gotoda.

The review addressed all of the United States' concerns -- introduction of non-discriminatory treatment ('direct access') for foreign suppliers, increased transparency during the development of Japanese regulations, greater use of international standards, further reliance on foreign test data, and continued simplification of import procedures.

Ambassador Brock, the President's principal adviser on trade matters, said, "I am especially appreciative of the strong support and personal leadership of Prime Minister Nakasone in dealing with these difficult and controversial issues."

The proposed statutory changes to Japan's import testing procedures and standards are consistent with the commitment made by Prime Minister Nakasone in January during his visit to Washington and with that given to Ambassador Brock during his trip to Tokyo last February.

"It is critical that where Diet approval is necessary to implement the new certification policies of providing nondiscriminatory treatment to foreign suppliers, such approval is secured as soon as possible," Ambassador Brock stressed.

He added, "It is significant that the Government of Japan has publicly committed itself to securing legislative approval and the U.S. Government wholeheartedly supports this effort."

For the past three years, since the Agreement on Technical Barriers to Trade (Standards Code) went into effect and the U.S.-Japan joint statement on standards was initialled, Ambassador Brock said, our two governments have engaged in numerous bilateral technical discussions.

"These discussions have provided a foundation upon which we have proceeded to build a strong understanding of each other's standards and certification procedures, which has resulted in the resolution of many standards-related problems.

"The U.S. Government reaffirms its belief in this foundation and we look forward to a continuation of our close cooperation as the Government of Japan implements the commitments it has made in the context of its review of Japanese standards and certification laws and practices," Ambassador Brock concluded.

###

Representative SNOWE. You indicated earlier, I think, to Congresswoman Holt with regard to the poultry situation that it was unpredictable as to when you would meet to get a negotiating agreement.

Mr. BROCK. No; we're meeting now and we will continue that process over the next several weeks and we will reach a decision.

What I could not predict was when the GATT might reach a decision, if, in fact, it goes to the dispute settlement phase.

Representative SNOWE. Do you think the move that was taken with respect to the wheat flour sale will help in strengthening our position in our bargaining position?

Mr. BROCK. Yes.

Representative SNOWE. Good. Thank you.

Senator JEPSEN. Congressman Lungren.

Representative LUNGREN. Thank you, Mr. Chairman.

Mr. Ambassador, a moment ago the chairman asked you about the problem of counterfeit products. I'd like to talk about quasi-counterfeit products where they don't have the precise label of the American manufacturer but it's so close that unless you have a magnifying glass or you're really careful you don't know that.

An industry that I'm familiar with, Norris Industries and one of its subsidiaries, Price-Fisher, and they make hardware for bathroom fixtures. They have exact replicas to the—you just look at it—it's the exact design down to what the wringer looks like and so forth. And the requirement that they say where it's manufactured is such that they can put it way up and under and unless you've got an articulated neck there's no way you could find it.

I guess my question is, with respect to domestic sales, is there any implications that would not be obvious to me with respect to tougher requirements for identification of the country of origin? I mean when they bring it into me, it seems to me it's a simple answer. You require the country of origin to be absolutely identifiable very easily to anybody who looks at it, but I don't know. Is that something that's viewed as protectionist or "Buy American," or that sort of thing?

Mr. BROCK. No; that's legitimate. That simply goes with any of our normal labeling standards, our product standards, and if, in fact, the present description is inadequate, it can be tightened up. That is not a protectionist action. That's the kind of distinction I would like to make.

Representative LUNGREN. It sounded so simple, I wondered if there wasn't something wrong with it. Sometimes the simplest things are rejected here in Washington as not being responsible.

Mr. BROCK. Sometimes the simple things are best.

Representative LUNGREN. On another subject against dealing with our trading ally, Japan, we have to be honest; we are not entirely honest in relating to them. One of the things that's a very touchy political issue up here is the idea of possibly allowing the sale of Alaskan crude in Japan that some analyze as being more beneficial to them in terms of reduced transportation costs and that we could cover that by purchases from Mexico or elsewhere and actually the net transportation costs would be less across the United States. I know how tough it is politically. I have not at this point voted to allow that to happen.

My question is this, in your discussions with the Japanese, has this subject ever come up in view of the fact that their major difficulty with respect to international trade, their deficit side of trade, is largely the product of their reliance on foreign oil for running their industries?

Mr. BROCK. It has come up. I don't believe the Japanese are as concerned about price as they are about alternative sources of supply. I think they would be delighted to explore it.

We've had two problems with analyzing the issue. As you well know: One is the security issue which I think may not be a good issue. I think that can be managed. The international energy agreement does not address that kind of problem.

But the other problem is a bit more difficult and that is the problem that our maritimes have an assured employment agreement in this situation. It would be difficult to get anything through the Congress that does not address that situation.

Representative LUNGREN. Third, I'd like to ask you about the Caribbean Basin Initiative. As one that serves on the Immigration Subcommittee of the House Judiciary Committee, one of my compelling reasons for supporting the Caribbean Basin Initiative is the alternative, which is, if we don't shore up the economies in Central and South America, we won't have to worry about those economies because all those people will be in the southwest portion of the United States, and I don't think that's really an exaggeration. Usually on the southwestern border of the United States over 50 percent of the illegal aliens apprehended are from Mexico. Last year in California there were a lot from El Salvador.

So, I try to articulate that concern to my constituents and to others. But from your perspective, what are the short- and long-term trade implications of the Caribbean Basin Initiative?

Mr. BROCK. I will try to resist getting up on my pulpit and preaching on this subject, but I do feel strongly about it and I'm distressed by the quality of the debate. Early on, the debate took on some unfortunate dimensions.

Let me just put it flatly and plainly. In trade terms, the CBI is a net benefit to the United States. We gain, we do not lose. It is not the expenditure of $1 million in foreign aid that we never see again. It is an expansion of the trading process and we have a net benefit. The first thing that will happen when that bill passes, as the Caribbean begins to develop new small companies, is that they will buy American machines, American products, with which to produce whatever goods they want to sell. If you go into any of those island countries or even in the Central America area and you look on any shelf in any store, you will find as much as 90 percent of the products are of U.S. origin. We are a product producer of all that they buy and their income improvement, their jobs improvement, their economic growth will immediately and over an extended period of time result in the creation of jobs in the United States.

We will net gain. It has no negatives. It helps to deal with the immigration problem. It helps to deal with the security problem. It helps to keep friends of ours free when they are desperately trying to maintain their freedom in the face of terrorism and revolution, and it will give us economic growth and job creation here next year, the year after, and for the foreseeable future.

20-982 0 - 83 - 5

Representative LUNGREN. I appreciate that. I just don't think we have done a good enough selling job about the initiative's impact for jobs to Americans.

Mr. BROCK. Absolutely.

Representative LUNGREN. I very much appreciate your testimony today, I guess you have learned from your experiences that free trade is an important subject which a lot of people like to talk about, but I'm sure you take a lot of criticism from all sorts of different sources as you attempt to do your work. In reality, it's really no different than it always has been. It was McCullough who said, "Free trade, one of the greatest blessings government can confer on people, is in almost every country unpopular." His statement remains as timeless today as when it was made in the 19th century. Thank you, Mr. Ambassador.

Senator JEPSEN. Ambassador Brock, on behalf of the Joint Economic Committee, I thank you for your testimony today. It's been refreshing and candid and informative. Your distinguished career of service to this country is reflected in your knowledgeable and receptive role that trade plays as a necessary ingredient for the very economic survival of this country and subsequently the hope of all freedom-loving people around the world. I commend you for your commitment to resolve and improve and increase our trade activity, and any time this committee can assist in any way, please do not hesitate to call on us.

Mr. BROCK. Thank you, Senator.

Senator JEPSEN. Thank you. The committee will now stand in recess.

[Whereupon, at 11:55 a.m., the committee recessed, to reconvene at 10 a.m., Monday, February 14, 1983.]

THE 1983 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 14, 1983

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

The committee met, pursuant to recess, at 10 a.m., in room 5110, Dirksen Senate Office Building, Hon. William Proxmire (member of the committee) presiding.

Present: Senator Proxmire and Representative Holt.

Also present: James K. Galbraith, deputy director; Richard F. Kaufman, assistant director-general counsel; and William R. Buechner and Robert Premus, professional staff members.

OPENING STATEMENT OF SENATOR PROXMIRE, PRESIDING

Senator PROXMIRE. The committee will come to order.

It's good to have you gentlemen before us this morning. As you know, the weather is so bad that a number of members of the committee undoubtedly couldn't make it in this morning and are having difficulty getting over here, but I have great respect for the two distinguished experts who will testify this morning. I'm sure they can help the committee greatly, Rudy Oswald, director, Department of Economic Research, AFL-CIO; and Lester Thurow, professor of economics, MIT.

During the past few weeks we have heard from the top economic policymakers in the administration and their testimony has left many questions unanswered.

First, the administration predicts a 1.4-percent growth in real GNP during 1983. How realistic is the administration's forecast? Since the budget figures, and recommendations for spending and tax changes, are based on this lower than consensus growth projection, it is important to have an outside evaluation. Furthermore, if this is an accurate forecast under current policies, what changes should Congress make in the President's recommendations in order to improve the outlook?

Second, the administration has been giving the Federal Reserve mixed signals on monetary policy. In a speech during the middle of January, Secretary of Treasury Regan recommended that monetary policy accommodate the need for an economic recovery. The Economic Report of the President recommends, to the contrary, that monetary policy should continue to fight inflation. Wednesday, Chairman Volcker will testify before the Senate Banking Committee on the 1983 monetary growth targets, so it would be interesting to have the recommendations of you gentlemen as to what the Fed's monetary growth targets should be for 1983.

Third, Members of Congress on both sides of the aisle are talking about proposing a major jobs program and as we know the administration has indicated that they will support a jobs program of sorts. If so, how can we structure the spending so as to reduce the fear that a jobs program will contribute to inflation in the future and require government borrowing from credit that might otherwise go to finance home buying, auto buying and other buying in the private sector with little net increase in employment, given a fixed monetary policy on the part of the Federal Reserve Board?

Fourth, the administration has proposed to reduce the massive deficits projected through 1988. Are these deficits a danger and, if so, what tax measures would reduce them with the least damage to the economy?

And fifth, should we consider a shortening of the work day or work week, with double pay instead of time and a half for overtime? It would be a change for the first time in nearly 50 years to share the available jobs.

I hope we will have an opportunity to address these issues during today's hearing and we will proceed alphabetically, which means that, Mr. Oswald, you're on.

STATEMENT OF RUDY OSWALD, DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH, AFL-CIO

Mr. OSWALD. Thank you, Senator. I'm happy to be here and make these comments on the policy recommendations that are contained in the Economic Report of the President and to present the recommendations of the AFL-CIO to reverse the current recession, to create jobs, and stimulate economic growth, and get this Nation back on track toward full employment.

I'd like to summarize my prepared statement and ask that my full statement be made part of the record.

Senator PROXMIRE. Without objection, the full statement of both Mr. Oswald and Mr. Thurow will be made part of the record.

Mr. OSWALD. America needs jobs—millions of jobs—to meet the needs of almost 12 million workers now officially jobless and the 1.5 million workers who will be entering the labor force each year over the next 5 years. Unfortunately, the projections of the Reagan administration itself show that even after 5 years unemployment will be higher than it was in 1979. On through 1988, unemployment will remain above that 5.8 percent level that existed then.

Over the next 4 years through 1986, unemployment will continue to average over 8 percent, a level reached in only one recession year in the previous 40 years prior to 1982. It will take until 1987 for unemployment to return to the level of 1981, and the 1979 level of 5.8 percent is not foreseen in this decade.

Unemployment has risen rapidly during the past 2 years. Eleven and a half million American workers are officially unemployed. But that official rate assumes that 600,000 workers dropped out of the labor force between December and January—and nearly all of these were adult males.

Unemployment, including these 600,000 not counted, plus the 1.8 million officially discouraged workers, indicates that jobs are needed for 13.8 million workers. Another 6.8 million workers are on part-time work schedules, although they are looking for full-time job opportunities. To provide these part-time workers with the full-time job opportunities they are seeking would require the equivalent of another 3.4 million jobs—for a total of 17.2 million. Almost half the labor force is suffering through this recession–depression with lost jobs, layoffs, reduced worktime, and reduced earnings and lost opportunities.

Job creation is a moral, social, political, and economic imperative. For every one million jobless workers, America loses the production of nearly $100 billion in goods and services and the Federal Treasury losses $30 billion. Unemployment generates tremendous social losses which include physical and mental illness, family disorganization, social alienation, and crime.

The AFL–CIO calls on Congress to act promptly on direct, large-scale job creation programs.

When the private sector cannot provide enough jobs, the Federal Government must step in. This is the mandate of the Employment Act of 1946, reaffirmed in 1978 by the Humphrey-Hawkins Full Employment and Balanced Growth Act.

America clearly needs jobs, yet the President continues to hem and haw over job programs. In his economic report last week President Reagan claimed that such programs would simply raise the Federal budget deficit.

This is a simple, short-sighted, and wrong position the President is taking. Last year the President projected a Federal budget deficit of $91 billion for fiscal 1983 and he told the Nation that a jobs program would be too costly. Now the Reagan administration is telling us the 1983 deficit will be $208 billion and the argument given is that the recession and unemployment are responsible for this big deficit.

A large-scale, adequately funded, antirecession job creation program put into action last year would have very significantly reduced unemployment and reduced the severity of the recession and also significantly reduced the long-term Federal budget deficit. As noted earlier, each 1 percent of unemployment costs the Federal Treasury $30 billion.

The analysis and the prescriptions contained in the President's Economic Report and in the Report of the Council of Economic Advisers fail to reflect the urgent and serious nature of the current recession-depression. They are more concerned with limits and constraints than with opportunities and responsibilities.

For example, in a section of the Council report entitled "The limits of macroeconomic policy," there is a warning about "the inflation threshold unemployment rate," or the "lower limit on unemployment below which inflation will tend to increase," and a statement that this theoretical lower limit "probably lies between 6 and 7 percent," a level not obtained until 1988 in their own projections of unemployment.

This prompts a number of comments. First, it represents an acceptance of the so-called Phillips curve inflation-unemployment tradeoff theory, a theory which has been largely discredited by the experience of the last 10 years during which this country has experienced simultaneous high unemployment and high inflation. This discredited theory is reflected in President Reagan's abdication of responsibility for the Nation's economic welfare and his heartless comment that

"The unemployment that many of our citizens are experiencing is a consequence of the disinflation that must necessarily follow the accelerating inflation of the last decade."

Second, the theory of the so-called "inflation threshold unemployment rate" ignores the true causes of inflation over the past 10 or 15 years, the supply shocks which have come from external causes, raising energy and food costs, the high costs of advancing technology and structural defects in our health-delivery system, and particularly the extraordinarily huge inflation-accelerating effects of U.S. monetary policy with sky-high-interest rates adding tremendous costs throughout the economy and contributing to both inflation and depression in housing, in consumer durable buying, in small business, in agriculture, and in State and local public investment, not to mention high-interest costs in servicing the national debt.

A third comment on the theory of the so-called "inflation threshold unemployment rate" is that even if it were true, which it is not, the U.S. economy is a long, long way from approaching this rate. With official unemployment at 10.4 percent, 12 million people out of work, and with the Nation's industry operating at only two-thirds of capacity, it is ridiculous to be concerned at this time about an over-heated economy arriving at inflationary bottlenecks. If there are skill shortages, now is the time for aggressive expansion of job training programs far above the levels proposed by the Reagan administration.

The AFL-CIO has set forth a proposal in my prepared statement that involves how these jobs programs would work.

First of all, we emphasize the new community development supplemental jobs program that would be essentially a large-scale development program with 100 percent Federal funding for jobs on direct local government payrolls.

In every community there is work to be done that is vital to that community's economic health and public well-being but which has been neglected. Because of declining tax revenues, Federal budget cuts and local government fiscal crises, many of these communities need help to repair, maintain, and rehabilitate essential public facilities and public services.

Investment in accelerated public works can provide jobs and essential infrastructure underpinning for private sector investment and economic growth. The Surface Transportation Act of 1982 is only a start in the right direction. We have shortchanged investments in public facilities related to health, education, energy, safety, solid waste removal, water supply, parks, highways, bridges, ports, railroads, and urban mass transit. There is a huge backlog of such public works.

Similarly, housing construction and rehabilitation needs to be undertaken on a vast scale to bring about the housing needs of low and modest income Americans and, in addition, Congress should enact legislation to provide home mortgage relief and rental assistance for jobless workers.

Similarly, youth programs need to be expanded to provide for change for the large group of unemployed youth in our society today.

Supplemental funds need to be allocated for dislocated workers who are suffering large layoffs in traditional industries where particular help is needed to help them over the problems of plant closings and major layoffs.

In terms of unemployment insurance benefits, currently the extended program expires on March 31 of this year. We ask Congress to enact a permanent program of supplemental unemployment insurance funded by general revenues with a maximum duration not less than 65 weeks. Such a program existed in 1975 and was a major element in trying to help those workers in that recession, which was much less severe than the current one, meet the problems of lost income during unemployment.

Health care for the unemployed is one other major problem area. Currently, health insurance is related normally to work and when people are laid off they lose their health-care system. A special program should be implemented to provide health care for those workers who become unemployed.

We have set out specific sums for those programs. They are summarized in my prepared statement. It indicates that we call for spending as a supplement to the fiscal year 1983 budget of some $22.5 billion and in fiscal year 1984 some $46 billion. We believe the results would be that 880,000 people would be put to work still in this year and in fiscal year 1984, 1,785,000 new jobs would be provided. But we also think that there would be a second-round ripple effect from those job opportunities which would go on to provide additional jobs for other people.

But we think that one also needs to be concerned with revenues and we have set forth a number of revenue-raising elements that we think will provide an element of fairness and will help raise the sort of funding in the long run to provide for the stimulus that we need for the economy today.

We think the first essential element is to provide a $700 cap to the tax cut that is due this July and to thus provide some fairness in terms of the sacrifices that are needed in our society today. The result of the $700 cap would mean that everyone would get their full tax cut up to an income level of about $45,000 and above that would only get $700. The revenue gained would be about $6 billion in fiscal year 1984 and a total of $21 billion over the fiscal years 1984 to 1986.

Similarly, we feel that indexation should be repealed and, again, that will provide some $9 billion in fiscal 1985 and $23 billion in fiscal 1986.

We spell out a number of other loophole-closing proposals that would in essence deal with such items as the foreign tax credit, deferral on unrepatriated profits, and the Domestic International Sales Corp. A variety of programs in this area could raise nearly $50 billion in the 3-year budget of 1984 through 1986. Depletion allowances and special drilling writeoffs for energy companies reduce Federal revenues by more than $7 billion per year.

Similarly, the investment tax credit could be curtailed in future years back to the 7-percent level that it had been and that would save about $6 billion a year.

We believe that capital gains needs to be looked at again and that we need to really deal with that.

For the long run we believe that there is a need for a national reindustrialization effort to channel funds to those industries that need it the most and we believe that U.S. trade policies need to be looked at so that the full impact of the high dollar valuation and the unfair trade practices abroad don't displace American workers and that there be action to assure that those impacts are properly dealt with.

First, monetary policy and interest rates need to be a central part of any effort to try to bring us back out of the recession. Clearly, a monetary policy that targeted lower interest rates would be a major stimulus for a number of industries and we believe that the Credit Control Act of 1969 that expired last year should be extended so that credit allocation can be made to those industries that need it the most and restrict credit for corporate mergers and similar types of non-productive capital flows.

We think that the basic tragedy that the country faces is the tragedy of unemployment. That tragedy needs to be corrected as rapidly and quickly as possible. It won't happen by just wishing and the Federal Government has a central responsibility to offer hope for the millions of jobless so that they can meet the public needs that are not being met and be put back to work until the private sector again is in a position to offer jobs for the millions of jobless.

Thank you, Senator.

[The prepared statement of Mr. Oswald, together with attachments, follows:]

Prepared Statement of Rudy Oswald

We appreciate this opportunity to comment on the policy recommendations in the 1983 Economic Report of the President and to present the recommendations of the AFL-CIO for action to reverse the current recession-depression, create jobs, stimulate economic growth, and get this nation back on track toward full employment.

America needs jobs -- millions of jobs -- to meet the needs of almost 12 million workers now officially jobless and the 1.5 million workers who will be entering the labor force each year over in the next five years. Unfortunately, by the projections of the Reagan Administration itself, even after five years unemployment will be higher than it was in 1979.

America cannot tolerate the cruelly high unemployment rates projected by the Reagan Administration. Each one percent of unemployment represents more than 1.1 million people:

	1979	1980	1981	1982	...	1983	1984	1985	1986	1987	1988
Admin.	5.8	7.2	7.6	9.7	...	10.7	9.9	8.9	8.1	7.3	6.5
CBO	5.8	7.2	7.6	9.7	...	10.6	9.8	9.0	8.4	8.0	7.5

(1979-1982 actual as percent of civilian labor force; 1983-1988 projected by Administration as percent of total labor force including armed forces stationed in the U.S.A., by CBO as percent of civilian labor force.)

For the next four years, unemployment will continue to average over 8 percent -- a level reached in only one recession year in the previous forty years prior to 1982. It will take until 1987 for unemployment to return to the level of 1981 and the 1979 level of 5.8 percent is not foreseen in this decade.

Unemployment has risen rapidly during the past two years. Eleven and a half million American workers are officially unemployed. But that official rate assumes that 600,000 workers dropped out of the labor force between December and January -- and nearly all of these were adult males.

Unemployment,including these 600,000 not counted, plus the 1.8 million officially discouraged workers,indicates that jobs are needed for 13.8 million workers. Another 6.8 million workers are on part-time work schedules, although they are looking for full-time job opportunities. To provide these part-time workers with the full-time job opportunities they are seeking would require the equivalent of another 3.4 million jobs -- for a total of 17.2 million. Almost half the labor force is suffering through this recession-depression with lost jobs, layoffs, reduced worktime, and reduced earnings and lost opportunities.

Job creation is a moral, social, political, and economic imperative. For every one million jobless workers, America loses the production of nearly $100 billion in goods and services and the federal treasury loses $30 billion. And unemployment generates tremendous social losses which include physical and mental illness, family disorganization, social alienation, and crime.

The AFL-CIO calls on Congress to act promptly on direct, large-scale, job creation programs.

When the private sector cannot provide enough jobs, the federal government must step in. This is the mandate of the Employment Act of 1946, re-affirmed in 1978 by the Humphrey-Hawkins Full Employment and Balanced Economic Growth Act.

It is clearly in the economic and social interest of the nation to put Americans who are able and willing to work into productive jobs which generate taxes, produce useful community services and community facilities, and stimulate the economy in communities with high unemployment.

Unfortunately, the Reagan Administration's response to joblessness has essentially been a hands-off approach -- let the market take care of the problem. In his State-Of-The-Union message, in his Budget message, and in his Economic Report to Congress, President Reagan has failed to propose any realistic program to create jobs or to reduce unemployment over the next few years.

America clearly needs jobs, yet the President continues to reject all jobs programs. In his economic report last week President Reagan claimed that such programs would simply raise the federal budget deficit.

This is a simple, short-sighted, and wrong position the President is taking. Last year the President projected a federal budget deficit of $91 billion for fiscal 1983 and he told the nation that a jobs program would be too costly. Now the Reagan Administration is telling us the 1983 deficit will be $208 billion and the argument given is that the recession and unemployment are responsible for this big deficit.

A large-scale, adequately funded, anti-recession job creation program put into action last year would have very significantly reduced unemployment and reduced the severity of the recession and also significantly reduced the long-term federal budget deficit. As noted earlier, each one percent of unemployment costs the federal treasury $30 billion.

Unfortunately, the Reagan Administration has not learned the bitter lesson that the rest of us have learned about the disastrous, job-destroying effects of Reaganomics and its contribution to bringing on the worst recession-depression since the 1930s.

Unfortunately, as the President tells us in his Economic Report, in 1983 he wants to give us more of the same that he gave us in 1981 and 1982 -- more job-destroying cuts in federal spending, continuation of the irresponsible and unfair tax cuts, more of the tight monetary policy which was the biggest single factor in bringing on the Reagan recession-depression, and more weakening of protections for people at the workplace and protections for the environment.

This is a prescription for continuing and worsening the present recession-depression disaster.

If the priorities of the Reagan Administration prevail, in 1983 America will have still more lost output, more lost jobs, more lost income, and more losss of the sense of fairness and social justice that holds our nation together.

The analysis and the prescriptions contained in the President's Economic Report and in the Report of the Council of Economic Advisers fail to reflect the urgent and serious nature of the current recession-depression. They are more concerned with limits and constraints than with opportunities and responsibilities.

For example, in a section of the Council report entitled "The limits of macroeconomic policy." there is a warning about "the inflation threshold unemployment rate," or "the lower limit on unemployment below which inflation will tend to increase," and a statement that this theoretical lower limit "probably lies between 6 and 7 percent."

This prompts a number of comments. First, it represents an acceptance of the so-called Phillips curve inflation-unemployment trade-off theory, a theory which has been largely discredited by the experience of the last 10 years during which this country has experienced simultaneous high unemployment and high inflation. This discredited theory is reflected in President Reagan's abdication of responsibility for the nation's economic welfare and his heartless comment that "The unemployment that many of our citizens are experiencing is a consequence of the disinflation that must necessarily follow the accelerating inflation of the last decade."

Second, the theory of the so-called "inflation threshold unemployment rate" ignores the true causes of inflation over the past 10 or 15 years, the supply shocks which have come from external causes raising energy and food costs, the high costs of advancing technology and structural defects in our health delivery system, and particularly the extraordinarily huge inflation-accelerating effects of U.S. monetary policy with sky-high interest rates adding tremendous costs throughout the economy and contributing to both inflation and depression in housing, in consumer durable buying, in small business, in agriculture, and in state and local public investment, not to mention high interest costs in servicing the national debt.

A third comment on the theory of the so-called "inflation threshold unemployment rate" is that even if it were true, which it is not, the U.S. economy is a long, long way from approaching this rate. With official unemployment at 10.4 percent, 12 million people out of work, and with the nation's industry operating at only two-thirds (67.8 percent) of capacity, it is ridiculous to be concerned at this time about an over-heated economy arriving at inflationary bottlenecks.

If there are skill shortages, now is the time for aggressive expansion of job training programs far above the levels proposed by the Reagan Administration.

Another example of the Reagan Administration's failure to come up with realistic, workable, effective anti-recession job creation is its condemnation of public service and public works job creation programs. The goal of full employment is abandoned by this Administration. In fact, job creation programs in the past recessions have been put into effect with appropriate speed and have made significant contributions to bringing the nation out of recession in addition to providing useful services and facilities to local communities and to the nation.

We believe a number of new job programs should be undertaken at once. The AFL-CIO is offering a program to mend the nation. It is urgent for Congress to move to immediate job creation. Given the mass suffering in America today, none of us knows how long trust and confidence can be maintained in a democracy if the principal forum of that democracy, the federal government, can't or won't respond to severe hardship.

Even after the large tax increases in 1982, the 1981 tax program accounted for nearly half the 1984 deficit and two-thirds of the projected 1984-1986 deficits. These deficits were not a result of government overspending or consciously stepping in to strengthen the economy. They are the direct result of trying to boost the economy through tax cuts while sapping the economy's lifeblood through a monetary policy of sky-high interest rates.

In early 1981, the Reagan Administration was forecasting economic growth of 4.2 percent in 1982 -- but the actual figure was a minus 1.8 percent. Unemployment was to average 7.2 percent for 1982 -- but the actual rate was

9.5 percent. Interest rates on short-term (91-day) Treasury bills were expected to average 8.9 percent for the year; they averaged 13 percent. Similarly, for 1983, the GNP was projected to rise 5 percent year-over-year; now the prediction is only a 1.4 percent rise. Unemployment was to average 6.6 percent, while the current projection is 10.7 percent for 1983.

Subsequent economic developments have more than vindicated the corrective actions taken last year by the Congress. Continued unemployment and recession make it clear that even more decisive and more drastic modifications of the Administration's proposals are necessary today -- and they must be made on an urgent, immediate basis.

Each year, we have put forth an alternative budget with jobs as the cornerstone. We will do it again this year and will spell out our program in detail at the AFL-CIO Executive Council meeting starting February 21.

Our Council's agenda will also include: measures to protect the victims of the recession; to deal with the job-destroying effects of international trade and investment policies; measures to lower interest rates and channel available capital to areas and industries to rebuild and revitalize the nation's industrial base and public infrastructure. Attached to this testimony is a copy of "Jobs: The Agenda for Recovery," the overall AFL-CIO program.

For now, however, I would like to focus on the immediate need for a federal program to create jobs and protect the unemployed, funded at a level in line with the enormity of the task of putting millions of people back to work at a speed worthy of a humane society.

The fairest and most sensible way to start is to finish the job of patching up the damage from the 1981 tax giveaway -- a job on which Congress got started haltingly last year. We should also embark on a long-overdue campaign to close loopholes and put federal revenue raising back on an equitable basis.

Our program for job creation includes community development supplemental jobs, accelerated public works, and a recovery for the housing industry. In addition, special action is needed for dislocated, minority and young workers, and all workers in all categories who require added protections during this time of disaster for the job market in America. For example, millions of jobless workers need extended unemployment compensation and emergency action to protect lost health care protection for themselves and their families.

JOB PROGRAMS

Community Development Supplemental Jobs -- We propose a large-scale community development jobs program with 100 percent federal funding for jobs directly on the regular, local government payrolls. Unlike previous public sector jobs programs, specifically tne CETA program, these jobs would not be in a separate category. Measures would be included to prevent substitution.

In every community, there is work to be done that is vital to that community's economic health and public well-being but which has been neglected. Because of declining tax revenues, federal budget cuts and local government fiscal crises, many of these communities need help to repair, maintain, and rehabilitate essential public facilities and public services.

For this purpose, we urge a supplemental appropriation of $5 billion for fiscal year 1983 and an appropriation of $10 billion for fiscal year 1984.

<u>Accelerated Public Works</u> -- Investment in accelerated public works can provide jobs and essential infrastructure underpinning for private sector investment and economic growth. The Surface Transportation Assistance Act of 1982 is only a start in the right direction. For years this nation has lived off its public capital instead of replenishing it. We have shortchanged investments in public facilities related to health, education, energy, safety, solid waste removal, water supply, parks, highways, bridges, ports, railroads and urban mass transit. The result is a huge backlog of unmet public capital needs and a major impediment to growth and a return to the nation's full productive potential. The crucial role of public capital formation is too often ignored. Such public investment plays a key role in raising the nation's productivity and output. Experience in the 1960s and 1970s -- particularly in the 1975 recession -- demonstrates that accelerated public works can provide jobs quickly and economically while restoring economic growth.

For such a program, we urge a supplemental appropriation of $5 billion in fiscal year 1983 and an appropriation of $10 billion in fiscal year 1984.

<u>Housing Construction and Rehabiliation</u> -- In past recessions, housing was revitalized through such programs as

below-market interest rate subsidies and rental assistance for low-income households. But the depth and length of this recession has seriously worsened the underlying problems of housing inadequacy and affordability. A program which provided support for the construction of 250,000 new housing units a year -- about the level of assisted housing starts in the 1970s -- could make a significant contribution to closing the housing gap. In addition, Congress should enact legislation to provide home mortgage relief and rental assistance for jobless workers.

For these purposes, we urge a supplemental appropriation of $5 billion in fiscal year 1983 and an appropriation of $10 billion in fiscal year 1984.

Youth Programs -- Two million American teenagers are unemployed -- including half of all black teenagers in the workforce, and one of every four teenagers overall. Youth employment and training needs are too often shortchanged in programs aimed at older workers. Expansion of the successful Job Corps, establishment of a new youth conservation corps, and other employment and training projects are needed to alleviate the special problems of jobless youth.

The AFL-CIO remains adamantly opposed to subminimum wages for workers of any race, sex or age. A long history of studies and pilot programs have reached the same conclusion as then Secretary of Labor George Shultz did in 1970: there is no evidence of any appreciable increase in jobs because of a subminimum wage.

For the youth program, we urge a supplemental appropriation of $1.5 billion in fiscal year 1983 and an appropriation of $3 billion in fiscal year 1984.

<u>Dislocated Workers</u> -- Supplemental funds should be allocated to the new Job Training Partnership Act's program to help workers hit by plant closings and major layoffs. These workers need a variety of pre-layoff assistance and services, as well as training, to help them move back into regular jobs.

For this purpose, we urge a supplemental appropriation of $1 billion in fiscal year 1983 and an appropriation of $2 billion in fiscal year 1984.

<u>Unemployment Insurance</u> -- To replace the present supplemental benefits program expiring March 31, 1983, Congress should enact a permanent program of supplemental unemployment insurance, funded by general revenues, with a maximum duration of not less than 65 weeks. The 6.27 million jobless workers now on unemployment compensation are the most in the history of a system dating to 1935. Still, only half of the 12 million officially unemployed are getting any unemployment benefits.

Since July 1981, more than five million workers have exhausted their regular UI benefits and another one million long-term jobless workers have lost their extended benefits. Of the 900,000 unemployed workers getting federal supplemental benefits, 135,000 have already exhausted or will soon exhaust these benefits. The remaining 765,000 will run out of benefits in the coming weeks. The drastic cutbacks in the extended UI benefit program means that these extended UI benefits are available only in about half of these states despite catastrophic unemployment levels.

To meet the urgent needs of long-term jobless workers, we urge a supplemental appropriation of $3 billion in fiscal year 1983 and an appropriation of $6 billion in fiscal year 1984.

Health Care for the Unemployed -- Since health insurance coverage is usually tied to the workplace, Labor Department statistics indicate 50 percent of laid-off workers lose health care protection immediately or one month after layoff. Only 20 percent get coverage for three months or more. Since the average duration of unemployment is a little over four months, most jobless workers can expect to be completely without health insurance protection. At the same time, most unemployed workers are denied Medicaid coverage because they have not been poor long enough to meet the state eligibility criteria.

We urge the necessary authorizing legislation and a supplemental appropriation of $3 billion in fiscal year 1983 and an appropriation of $5 billion in fiscal year 1984 to assure health insurance coverage and health services for unemployed workers and their families.

In summary, we are calling for supplemental appropriations of $22.5 billion in fiscal year 1983 and an appropriation of $46 billion in fiscal year 1984 to create jobs, to stimulate the economy and to ease human suffering and hardship.

The AFL-CIO Jobs and Stimulus Program

	Supplement to Fiscal Year 1983 (Billions $)	Fiscal Year 1984 (Billions $)	Direct Jobs (thousands) 1983	1984
Community Development Supplemental Jobs	$ 5	$10	420	835
Youth Programs	1.5	3	215	430
Displaced Worker Program	1	2	---	---
Housing	5	10	75	180
Accelerated Public Works	5	10	170	340
Extended Unemployment Insurance	2	6	---	---
Health Care for the Unemployed	3	5	---	---
Total	**$22.5**	**$46**	**880**	**1,785**

TAX PROPOSALS

We believe there is much revenue that can be raised through the tax structure in a manner which will help the economy and at the same time add an element of fairness to national economic policy-making.

A $700 Cap -- If Congress does not act, on July 1, the third installment of the 5-10-10 percent tax cut will go into effect. Its cost will be about $30 billion, of which $10 billion will go to the wealthiest 5 percent of our society.

That $10 billion is just about equal to the amount of proposed reductions in food stamps, Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), and child nutrition programs over the next five years.

A family of four with income of $100,000 a year would receive $2,400 per year in tax reductions -- on top of the $4,500 per year from the first two installments. In sharp contrast, a $30,000 working family would receive a cut of $340, and at $20,000 the July cut amounts to $175.

We believe the third installment of the tax cut should be limited. We propose that no taxpayer get more than $700. Capping the total tax reduction in such a fashion will have little or no effect on incomes under $45,000, so it does not risk reducing consumer demand or otherwise weakening the economy. The revenue gain would be $6 billion in fiscal year 1984, and a total of $21 billion for the three years 1984 through 1986. At the same time, the income tax would become a little more fair.

We therefore urge House support for H.R. 1183, which was introduced, February 2, by Rep. Frank Guarini of New Jersey with co-sponsors including Representatives Wright of Texas, Foley of Washington, Alexander of Arkansas and Gephardt of Missouri.

Repeal Indexation -- Another route to revenue and economic strength is repeal of the indexation provisions that will take effect in 1985. An indexed tax code means a sharp limitation on the ability of the federal government to manage the economy; it amounts to a permanent and continuing erosion of the tax base regardless of economic need or circumstance. Repealing that provision would save $9 billion in fiscal year 1985, $23 billion in fiscal year 1986 when its full impact would be felt, and increasing amounts in out years.

The Congressional Budget Office found that tax expenditures totaled $300 billion in fiscal year 1984. Like any other expenditures, they affect the deficit, the level of funds available for other programs, lending activities, debt reduction or even the tax cuts, and they serve to redirect resources to particular sectors, groups or activities.

Tax expenditures, however, are subjected to few of the standards of performance, accountability and oversight that apply to spending programs; rarely are they enacted as a result of reliable evidence of need or likelihood of fulfilling expectations, and in the main they represent open-ended "entitlements" over which Congress has little control.

Although tax expenditures are not necessarily synonymous with loopholes, most of the costly and inequitable provisions in the tax code are included in the tax expenditure budget. Significantly, the 1981 tax bill added $42.4 billion to the list.

Last year the AFL-CIO Executive Council highlighted a number of loophole closing measures which would provide substantial amounts of revenue and provide equity, balance and confidence to government policy.

For example, ending the tax gimmicks subsidizing the overseas activities of U.S. corporations -- the dollar-for-dollar foreign tax credit, deferral on unrepatriated profits, and the Domestic International Sales Corporation (DISC) -- could raise nearly $50 billion in the 3-year budgets of 1984 through 1986.

Depletion allowances and special drilling write-offs for energy companies reduce federal revenues by more than $7 billion per year.

The investment tax credit will cost more than $20 billion in fiscal year 1984. Despite the level of corporate investment anticipated, it should be phased out as soon as possible. Cutting the 10 percent rate down to the prior 7 percent would save about $6 billion per year.

And if the so-called small business provision which reduces the corporate tax rate on the first $100,000 of all corporations, big and small, were, in fact, limited to small business, $6 billion could be saved on fiscal year totals of $1.9 billion in 1984, $2 billion in 1985, and another $2 billion in 1986.

We also remain firm in our conviction that the key impediments to tax justice include the 60 percent exclusion for capital gains income and the total tax exemptions for such gains passed on at death. Changes should also be made in the estate and gift taxes, which were virtually repealed in 1981.

The 60 percent capital gains exclusion is an $18 billion a year revenue loser, and the top 5 percent of the nation's taxpayers get 60 percent of the benefit. Just cutting the exclusion back to the pre-1979 level of 50 percent would raise $2.5 billion this coming fiscal year and $7.6 billion in the 1984-1986 period.

Restoring the estate and gift taxes to its pre-1981 level and allowing generous exemptions for survivor's spouse ($250,000 or half, whichever is larger) could generate $3 billion in fiscal year 1984, $4.2 billion in 1985, and $5.6 billion in 1986.

What I have outlined here would save the U.S. Treasury about $40 billion in fiscal year 1984 and about $175 billion in the 1984-1986 period. And that does not, by any means, exhaust the list.

National Reindustrialization Board -- To start revitalizing and rebuilding the nation's industrial base and economically distressed areas, we urge establishment of a National Reindustrialization Board with the tripartite -- business, labor and government -- involvement spelled out in H.R. 134.

Its funding body would be a Reconstruction Finance Corporation which would channel public and private funds into reindustrialization projects primarily in areas with greatest need. It would have initial authority to allocate $5 billion in loans, loan guarantees and interest subsidies.

U.S. TRADE POLICIES

Unfair trade practices and an overvalued U.S. dollar have added to the recession's severity and sharply clouded the outlook for recovery.

In 1982, imports will exceed exports by over $40 billion and for 1983 a deficit almost double that amount is expected.

A clear relationship between growth of imports and job displacement is evident in a number of industries. For example, imports of automobiles rose 42 percent between 1979 and 1982, while employment dropped 47 percent. Imports of apparel rose 26 percent, while employment dropped 23 percent. Footwear imports rose 13 percent and employment went down 24 percent.

A loss of almost 3 million jobs in manufacturing from July 1979 to November 1982 included hundreds of thousands of jobs related to these trade facts of life. They cannot be ignored.

In rich countries and poor, the U.S. ability to export is retarded and imports to the U.S. encouraged as the combination of other nations' trade barriers and this nation's open markets squeezes the U.S. economy.

Industrialized nations have cut back on imports as a result of the recession and developing countries have cut back on their imports to meet their financial problems. The result is fewer American exports and fewer export-related jobs.

Fair trade must become a reality. A first step toward achieving that reality requires a recognition that misguided U.S. international trade, monetary and investment policies have been key factors contributing to the destruction of basic U.S. industries.

Unfortunately, the President's Economic Report and the Report of the Council of Economic Advisers show a surprising disregard for the serious trade, finance, and investment issues that face the U.S.A. on the international scene. They offer a dream-world theology of free trade that is contradicted by the widespread, almost universal existence among our trading partners of export subsidies and barriers to imports. They offer no solution for imports-injured U.S. industries. They offer no solution for the export of U.S. capital and technology.

The Administration must recognize that trade-related job losses are rapidly spreading beyond manufacturing and into service industries. Exports of jobs in services have already begun through the runaway shop, the runaway ship, and the runaway film and computer service. Imports of services have cost construction jobs and theatrical jobs, while other types of service jobs also have eroded. But as important, this nation's economy and industries are interrelated, and for every manufacturing plant there is a set of service jobs, and each affects the other.

The AFL-CIO is calling for a realistic and effective program to deal with these problems, to achieve fair trade, to control the outflow of technology and capital. Such a program should include:

* Placement of temporary restrictions on harmful imports during periods of recession and high unemployment to prevent increased joblessness, added penetration of U.S. markets by foreign producers and a further weakening of the U.S. industrial base.

* Enactment of an auto domestic content law to protect the continued U.S. capability to produce autos.

A domestic content bill for automobiles is a major goal because it is fair and because it tries to assure that Americans will have a chance to benefit from the U.S. auto industry -- as workers, as consumers, and as business suppliers. For every one job in autos, for example, there are over two jobs in supplier industries.

* Action to assure that a portion of U.S. raw material exports is processed in this country.

* Establishment of bilateral shipping agreements and adherence to cargo preference laws.

* Commitment that foreign grant, insurance and loan programs, such as the Export-Import Bank, are carefully managed to safeguard U.S. interests at home and abroad.

* Vigorous enforcement of reciprocity provisions of the Trade Act.

MONETARY POLICY AND INTEREST RATES

Right from the start of the Reagan Administration in January 1981, it has been clear and explicit that the Administration supported a tight-money, high-interest-rate monetary policy and encouraged the Federal Reserve Board to maintain such a policy as part of the Administration's fight against inflation.

The harmful effects of persistent, prolonged tight money and high interest rates have been amply demonstrated during the past two years.

The Administration's Economic Report suggests that the 1981-1982-1983 recession-depression is primarily the result of a sharp decline in the velocity of money, the ratio of Gross National Product in current dollars to the money supply, as if the responsibility for perverse monetary policy rested on the shoulders of some anonymous individuals who failed to spend their money fast enough.

But it is the tight money policies pursued by the Federal Reserve Board with the support of the Reagan Administration that pushed interest rates to record 20th Century levels in the 1980s. The result was the major curtailment in economic activity, pushing the economy into the recession.

The impact was felt, first and most severely, in residential and local public construction. The automobile and farming sectors were also depressed. The high unemployment and reduced income generated in these sectors spread their effects upon sales, incomes and output in other parts of the economy. As high interest rates took their toll, men and machines were idled in manufacturing, in construction, in extractive industries, and in farming. The effects have spread to other economic activities.

In March 1980, under authority of the Credit Control Act of 1969, there was a departure from the overall tight-money policy by way of a brief implementation of credit controls. This was helpful in bringing down interest rates and pulling the economy out of the short recession which began in January 1980.

Authority for credit control implementation, which expired this past June 30, is essential to have as an alternative or supplement to monetary policy. It is needed, so that it can be used to help restore economic recovery with stability and help the country become more productive and internationally competitive. The President should have the authority, and legislation to reestablish it should be enacted.

In addition, there is a need to reconstitute the Board of Governors of the Federal Reserve System, so that there will be a broader representation of economic interests. Four of the present seven governors were employees or officials in the Federal Reserve system during their careers; one had been in private finance and also Chairman of the Federal Home Loan Bank Board, and one has been an economics professor. These members cannot adequately share the perspective or represent the interests of labor, agriculture and small business which are subject to the risks and hardships brought on by problonged periods of high interest rates. Legislation should be enacted to reconstitute the Board of Governors, so that a wider spectrum of interests and concerns will be represented.

CONCLUSION

The tragedy of unemployment and the prospect of further economic downturn -- or, at best, slow and inadequate economic growth -- must be reversed. But the Reagan Administration response promises only more cuts in federal spending that will further weaken demand, reduce output, and destroy more jobs.

The resulting weakened economy would be costly and damaging to the nation in terms of lost production, lost jobs, lost skills, and lost income to producers and workers -- much more costly than job creation programs and temporary job-creating deficits in the federal budget.

The AFL-CIO again calls on the Congress to enact a job creation program along the lines I have outlined. Thank you.

[From the AFL-CIO Federationist, Jan. 8, 1983]

JOBS: THE AGENDA FOR RECOVERY

INTRODUCTION

Since July 1981, the American economy has been in a nosedive: Unemployment has reached post-depression depths, human suffering has spread across the land and growing numbers of plants and factories have been idled.

Twelve million American workers are now officially jobless. Almost half the labor force is feeling the impact of the Reagan recession-depression with lost jobs, reduced worktime and earnings, and lost opportunities. And the Administration's programs offer no hope for the jobless in 1983.

Early last year, the AFL-CIO pointed out the need for large-scale anti-recession job-creation measures to put America back to work. This February the AFL-CIO Executive Council will carefully review the economic situation and present a detailed program to end the recession, protect its victims, and deal with fundamental problems that are adversely affecting living standards and the basic strength of the Nation. An effective and permanent end to the tragedy, waste and hardship of unemployment is our goal. This issue of the Federationist contains an outline of the AFL-CIO agenda as prepared by the Department of Economic Research.

Today's recession-depression is further complicated by a major turndown in the world economy. Further aggravating the economic downturn are unfair trade practices and an overvalued dollar.

Technology is also changing the structure of the U.S. economy, the mix of industries, the location of industries and jobs, occupations and education and skill requirements, often displacing workers with a long history of regular employment. Robots in the factory, word processors in the office, scanners at the checkout counter, pushbutton banking, gene-splicing in the laboratory, and computers in the home—all of these are hitting white-collar and blue-collar workers, workers in goods-producing industries and workers in service-producing industries.

Many minority and disadvantaged workers still suffer from discrimination and inadequate education, little work experience, and few job skills.

Public investments have fallen far behind in providing basic support facilities critical to private-sector jobs, investment and productivity like roads, bridges, water and sewer systems, transportation and port facilities. America's infrastructure is rapidly deteriorating and seriously holding back economic progress.

The misallocation of money and capital is exemplified by the merger mania of big corporations, big banks, and other financial institutions and the speculative fever of the stock and commodity markets. Without any effective control big business mergers soak up credit and along with the tight money policy of the Federal Reserve bid up interest rates. The result is a loss of capital for productive private and public enterprise, and housing. Conglomerate mergers increase the concentration of wealth while the power of workers and other taxpayers to maintain a healthy, pluralistic, democratic society is weakened.

The gaps and disparities in income between families have widened considerably and poverty is on the rise. A two-tier economy at home and an energy cartel abroad have inflated prices for limited supplies of scarce resources, including necessities, such as fuel and food. Traditional weapons of monetary policy to fight inflation, with high interest rates as the cutting edge, have been counterproductive. Short-term gains on the price front have been bought at a huge cost of unemployment and loss of national product and income.

New economic policies are needed to cope with the recession-depression.

AN ANTIRECESSION PROGRAM

First of all, America must have a dramatic expansion of job opportunities. The job situation is a catastrophe and large-scale direct job generating programs must be the first priority of governmental economic policy.

Job creation is a moral, social, political, and economic imperative. Unemployment generates tremendous social losses which include physical and mental illness, family disorganization, social alienation and crime.

For every one million jobless workers, America foregoes the production of $100 billion in goods and services and the federal treasury loses $30 billion.

Job opportunities must be made available to unemployed men and women who cannot find jobs in the private sector. This means there must be direct, targeted and adequately funded large-scale public employment programs. It also means quick action to get essential public works under way immediately.

When the private sector cannot provide enough jobs, the federal government must step in. That is the mandate of the Employment Act of 1946, reaffirmed in 1978 by the Humphrey-Hawkins Full Employment and Balanced Growth Act.

The Reagan Administration's response to joblessness is essentially a hands-off approach—let the market take care of the problem. Supposedly, people will find jobs by relocating or by looking harder. Mismatches in skills and location are indeed problems. However, it must be recognized that the number of unemployed persons far exceeds job opportunities now available or likely to become available under the policies of this Administration.

Public works jobs can be generated through renewing the urban infrastructure of sewers, water systems, streets and bridges and upgrading the nation's transportation network so people and goods can move efficiently. Railroads, highways, port facilities, and airports are in desperate need of rehabilitation. Urban mass transit systems need support and modernization.

Community service and public investment projects can provide opportunities for unemployed workers that expand services and facilities needed for a healthy economy and a healthy society. Workers should also receive training in skills that are in short supply.

Housing is essential to the anti-recession job-creation effort. More government support will increase the supply of housing for low and middle-income families. Expansion of existing housing programs will create jobs in the construction industry where one in five workers are unemployed and help reduce inflation in housing by expanding the supply of affordable homes.

Inflation must be fought through attacking directly the key sectors of inflationary pressures, and this includes specifically an attack on high interest rates.

Lower interest rates are essential. Congress must press the Federal Reserve to ease the money supply and lower interest rates. Legislation should be enacted to assure availability of existing credit and to selectively allocate credit. Lower borrowing costs are necessary to stimulate the housing, automobile and other hard-hit industries, investment in productive plant and equipment, state and local public investment.

Unfair international trade policies must be dealt with effectively as well as the adverse effects of the overvalued dollar, international technology transfer and financial transactions on American workers, American industries, and national security.

Unemployment insurance and trade adjustment assistance are essential to alleviate the suffering of the unemployed and other victims of the Reagan recession-depression, Congress should improve and extend unemployment insurance benefits and restore trade adjustment assistance for workers who lose jobs because of imports.

Health insurance protection for the unemployed must be secured through congressional action. And Congress should reverse the Reagan Administration's attack on the nation's system of Medicaid and welfare, food stamps, and human services.

These basic programs help people who are unemployed, weak, or helpless. They maintain income and the consumer buying power which gives stability and resilience to the economy.

The stimulus and support of those programs for the economy would be timely. Record overall unemployment and record construction industry joblessness now prevail. High unemployment and slow real growth in GNP are expected to remain for many years even under the most optimistic assumptions and economic projection. Overall unemployment and construction unemployment will decline very slowly as new entrants into the job market seek jobs while record numbers are presently jobless. Any recovery in the economy is expected to be slow and weak. The recent declines in interest rates though welcome will not translate into a boom nor generate high levels of employment.

To meet longer-term fundamental issues, a comprehensive reindustrialization program should be undertaken to bolster the nation's growth and productivity.

Business, labor, and government, working together, can strengthen America by helping to generate and channel private and public investment to modernize basic and essential industries, public infrastructure, and lagging geographic areas. This long-run reindustrialization program would include effective employment and training programs.

All these programs—those for quick anti-recession job-creation and alleviation of human suffering and those to deal with long-term fundamental problems—are aimed at social justice and economic progress.

PUBLIC WORKS

Investments in public works provide jobs and an essential underpinning for economic growth and a critical complement to private sector investment, and productivity. For years this nation short-changed investments in public facilities related to health, education, energy, safety, solid waste removal, water supply, parks, highways, bridges, ports, railroads, and urban transit. The result is a huge backlog of public capital needs and a major impediment to growth and the attainment of the nation's productive potential.

An efficient public transportation system significantly enhances private sector productivity. Conversely, the current state of disrepair in our highways, bridges and transit system causes delays which in turn limit growth and raise costs. The job of rebuilding the nation's transportation network has begun with the highway and mass transit program enacted last year. It is expected to provide about $5.5 billion dollars in 1983 and over five years some $33 billion dollars for repair and improvement of highways, bridges and mass transit facilities.

While a step in the right direction, it falls far short of needs. Over the next ten years, one trillion dollars are needed to rehabilitate highways and bridges, and another forty billion dollars are required for urban transit systems. Obviously, the transportation program could be expanded to fill a basic public need as well as provide needed jobs.

The crucial role of public capital formation and public investment is all too frequently forgotten. The Reagan Administration's 1981 tax cut is, of course, a prime example of a one-sided attempt to promote private capital investment and ignore needed public improvements. The effect was a diversion of huge amounts of money that could have been channeled and directed to public investments essential to jobs and revitalizing and rebuilding the nation's cities, industries and distressed areas. The huge revenue drain also drove up interest rates to a level that sharply restrained private investment and public sector improvements.

Well-known analysts of the sources of productivity growth have tried to highlight the often overlooked but crucial role that public capital formation plays in increasing the nation's output. They have pointed out that the role of private capital formation is far less important in fostering growth than is popularly believed. In his major study of the sources of economic growth, Edward F. Denison found that private investment accounted for only 15 percent of the nation's long-term growth. At 40 percent, the largest single source of growth was the general advance of knowledge, much of which is a product of public investment in research and education. More recently Denison has observed that the revised GNP data should help policymakers recognize the ineffectiveness of tax cuts designed to stimulate productivity growth. He adds "that government support for investment in human capital, infrastructure, and research and development, are currently receiving short shrift" (*Business Week*, September 13, 1982, p. 22).

The deterioration in highways, bridges, and transit systems is not unique. Serious inadequacies exist in every other type of public capital stock.

Waste-water treatment facilities are so overburdened that a large number of communities cannot allow firms to build new plants or expand existing plants. A recent Joint Economic Committee study points out that cities like Newark are on a sewer replacement cycle that would result in new facilities in 300 to 500 years.

Water supply systems are slowly decaying. In many older cities like Philadelphia, Boston and Chicago, more than 15 percent of the water supply simply leaks out of the system due to corroded pipes. This worsens water shortages, raises water bills, and can even cause street cave-ins.

A study conducted a few years ago by the Interior Department found that extensive rehabilitation of recreational facilities is needed in older cities and suburbs. In eight of 21 core cities surveyed, the cities' rehabilitation costs were greater than their annual park and recreation expenditures.

Over one-half of the nation's 3,500 jails are more than 30 years old, and it is estimated that between 1,300 and 3,000 of these must be either totally rebuilt or substantially rehabilitated during the 1980s. In addition, resources will be needed to expand these facilities.

20-982 O - 83 - 7

Not only has this neglect of public construction reduced the services that flow directly from public facilities, as well as the private output these facilities support, but it has contributed to the underutilization of human resources, particularly in construction. The 1982 trough in public construction expenditures coincided with a peak for total construction unemployment at 23 percent. The construction unemployment rate is normally higher than the rate for all industries. The only years during the past two decades in which construction unemployment did not exceed eight percent were the four years from 1966 through 1969. Not coincidentally, those were the only years in which total public investment in structures and equipment exceeded $300 per person, measured in 1972 dollars. It is evident, therefore, that public investment creates jobs as well as an environment conducive to economic growth.

The experience in the 1960s and 1970s demonstrates that accelerated public works programs can be effective in providing jobs and restoring economic growth. An evaluation of the 1976 Public Works Act clearly illustrates the potential of these programs. The program was a large success in aiding the recovery from the deep 1974–1975 recession. The $6 billion spent as part of the Local Public Works Program generated 110,000 direct onsite jobs and 66,000 jobs in firms supplying building materials. The added income of these workers resulted in additional sales and production, and is estimated to have generated an additional 249,000 jobs throughout the economy. The total—425,000 job years—represents an average cost of $14,000 per person year of employment.

This experience also refutes the claim that such programs are "procyclical"—that is, by the time public works projects get started, the recession is over and they then cause inflation. In the 1976 programs, except for isolated incidents, decisions on applications were made within 60 days and construction started within 90 days. Projects can also be small and of short duration. The average project funded under Round II of the program was under $500,000 and the average project duration was only 10.4 months. Finally, funds were successfully targeted to the areas that were most in need. The average unemployment rate for areas receiving Round II funds was 9.4 percent, substantially higher than the national average.

Within the framework of an ongoing program of public capital formation, projects specifically designed to be brought on stream quickly to generate jobs and counteract recession, could be easily identified without in anyway detracting from the long-term continuing program to revitalize the nation's private capital.

The expense of these jobs would, of course, be offset to some degree by the resultant reduction in welfare benefits and unemployment insurance payments. In addition, the government would gain tax revenues both from the direct and indirect jobs and economic activity generated by the projects. Equally important is that these projects are investments—they produce the facilities that are of continuing value to society with payoffs far into the future.

COMMUNITY DEVELOPMENT JOBS

A large-scale, federally financed community development jobs program is needed to provide jobs and meet community development needs. Past experience has demonstrated the effectiveness of job expansion programs based on local community public service employment programs. Job expansion based on public employment was accomplished within a short time frame under prior law, and the current fiscal crises of local communities underscores the need for such programs.

It is clearly in the economic and social interest of the nation to put Americans who are able and willing to work into productive jobs which generate taxes, produce useful community services and community improvements, and stimulate the economy in communities with high unemployment.

In every community, there is work to be done that is vital to that community's economic health and public well-being, but which has been neglected. Because of declining tax revenues and federal budget cuts many of these communities need help to repair, maintain, and rehabilitate essential public facilities. There is also a recession-generated increase of people who need the help of services which the local government cannot provide because of a shortage of funds. Federal funds should be provided to communities with high unemployment to put local unemployed people to work immediately.

Examples of needed community repair and service activities include:

Helping working mothers with child care;

Police and traffic control to free regular police for full-time street duty;
Increased staff support for adult and juvenile correctional facilities;
Security guards for schools and housing projects;
Staff support for community health centers and preventive health screening and immunization programs;
Rat and mosquito control;
Surveys of potentially dangerous conditions in local communities;
Bridge painting;
Patching potholes and other minor road repair;
Traffic control signs and removal of road sign obstructions;
Park and streams clean-up;
School crossing and intersection markings;
Home security for elderly and low-income people;

At the urging of the Carter administration, Congress passed the Economic Stimulus Appropriations Act of 1977, providing $8 billion for public service employment. The legislation was signed in mid-May of 1977 and almost 600,000 workers entered public service jobs by September 30. Despite some examples of administrative misjudgment and abuse, 600,000 formerly jobless workers—many of them low-income, long-term unemployed persons—had jobs. And much useful and needed community public service work was done.

Ironically, many who argue that community service jobs are inefficient, cost too much and create "dead end" jobs are quick to advocate the proven wasteful and inequitable gimmick of tax credits to private employers for hiring workers. Despite the numerous failed experiments with this approach and the obvious built-in wage suppression bias of such devices, the idea still has its proponents.

The evidence indicates that job tax credits have failed in generating new jobs while paying employers tax money for what they were doing on their own. The CETA public service employment program was highly successful despite popular claims to the contrary. The rate of displacement of local funds that would have been spent anyway actually was very low. The counter-cyclical effects of the program were positive, with the money spent quickly by local sponsors. The quality of services performed by the program's workers was usually equal to that of regular employees in the same occupation. Finally, funds were used successfully to leverage access for minorities and women to higher job classifications.

In sum, previous experience with community development job programs shows that they can be a highly successful means of fighting unemployment, helping individuals and getting needed community work accomplished.

HOUSING

The nation is in the midst of a deep and prolonged slump in housing production. This has worsened the underlying problems of housing inadequacy and affordability. The immediate crisis is the direct result of the Reagan Administration's tight money policy, budget cuts, and recession. In 1982, housing production has fallen to half of the 1978 building rate.

Construction industry unemployment was 23 percent in November 1982, a record high level for these figures which have been collected since 1940s. Industries which depend on housing, such as forestry and mining, and manufacturers and suppliers have been adversely affected by the housing slump as well.

The housing shortfall, which has grown as housing production declined from a level of 2 million units in 1978, has created shortages in many areas and rising housing prices. Over the year ended October 1982, for example, residential rents rose faster than general price levels. The result has been unaffordable homes, a near-record low national rental vacancy rate, a bidding up of rents, families forced to double up and a rising number of homeless people. The recession has devastated many communities and whole states, leading to rising defaults and foreclosures as people who are laid off are unable to keep up the payments on their homes.

A combination of pent-up demand, and a decline of mortgage interest rates to a 12–13 percent range, caused the seasonally adjusted annual housing starts rate to rise to 1.4 million in November. However, this rate is still far below national housing requirements and reflects only the upper income layer of the home sales market and the tail end of the government-assisted program pipeline in the rental segment. More positive action will be needed to achieve a sustained higher level of housing construction.

In past recessions, housing was revitalized through such programs as below-market interest rate subsidies and rental assistance for low-income households.

The Reagan Administration is moving in the opposite direction, however, calling for cutbacks or elimination of such basic supports.

In early 1982, the Administration set a 1983 budget with sharply reduced government support for home building and has advocated replacing direct housing programs with a voucher system. This would add nothing to the supply of available housing, and at the same time add to the inflationary demand pressures in the many local communities where housing is in short supply.

The number of additional new and rehabilitated housing units built with government assistance was reduced to a trickle under the fiscal 1983 continuing resolution enacted into law in December 1982. Under the stopgap funding law, the Congress provided funds for 1983 mainly to support existing units, including units already assisted but shifted from one program to another. Meanwhile, no funds went for new construction under the low-rent public housing program, while there were only 14,000 units of new housing for the elderly and a couple thousand units for Indians.

Funds for public housing were left out with the understanding that there would be an agency speedup to bring already funded projects in the processing pipeline to construction and that added funds for public housing new construction would be considered for the next fiscal year.

A good start can be made on catching up with housing needs while at the same time contributing to a broader anti-recessionary economic program.

A program which provided 250,000 new assisted housing units annually, which was about the level of assisted housing starts prevailing in the 1970s, could make a significant contribution to closing the gap. The assistance for 250,000 units annually would be for rental and homeowner units for lower income families in urban and rural areas. It would include assistance under already authorized programs in addition to activity under a modified homeownership assistance program, a new rental housing production program, and a new initiative for the expansion of housing and related facilities for the elderly.

Type of assistance:	*Units*
Homeownership assistance	50,000
Rental housing assistance for elderly	20,000
Low rent public housing	55,000
Rental housing production program	40,000
Rural housing	65,000
Elderly housing initiative	20,000

Funds to begin a mortgage foreclosure relief program for conventional financed homes is a needed element of a housing stimulus program. This program is needed to protect people and to assure that home values and the market for housing does not collapse under an avalanche of foreclosures. Similiarly, rental emergency funds should be available to forestall evictions.

In addition, we oppose legislation that would completely "privatize" the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Each of the rental programs could have limited authorizations, so that the number of units could be allocated, in projects not to exceed 100 units each, among local housing authorities and other agencies with know-how for present programs and for the new rental housing production program. HUD might also give priority for rental housing projects to those sponsors who already have a locally approved site.

In addition, funds should be provided for a much needed, large public housing modernization effort, which could serve the purpose of preserving and upgrading low-rent public housing projects which need refurbishing to extend their economic life, and have an immediate jobs impact.

The new construction would provide thousands of man-years of work in construction and supplier industries. Public housing modernization would provide about 37,000 jobs per $1 billion in outlays. The multiplier effects, as wages and profits from construction and materials production are spent on other products and services, would almost double the number of jobs initially generated.

MONETARY POLICY AND INTEREST RATES

The tight money policies pursued by the Federal Reserve Board pushed interest rates to record 20th Century levels in the 1980s. The result was the major curtailment in economic activity, pushing the economy into the recession. The impact was felt, first and most severely, in residential and local public construction. The automobile and farming sectors were also depressed. The high unemployment and reduced income generated in these sectors spred their effects upon sales, incomes and output in other parts of the economy.

The harmful effects of persistent, prolonged tight money and high interest rates have been amply demonstrated during the past two years.

Business bankruptcies numbered 44 percent more in 1981 than in 1980, and in 1982 they are 49 percent above 1981. The unemployment rate rose from 7.4 to 10.8 percent, leaving 12 million unemployed. Manufacturing capacity utilization was reduced from about 80 percent to 68 percent. And, as the high interest rates took their toll, men and machines were idled in manufacturing, in construction, in extractive industries, and in farming. The effects have spread to other economic activities.

In March 1980, under authority of the Credit Control Act of 1969, there was a departure from the overall tight-money policy by way of a brief implementation of credit controls. This was helpful in bringing down interest rates and pulling the economy out of the short recession which began in January 1980.

The downturn in aggregate economic activity in 1980 had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. However, after credit controls were instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rose from the May low of 938,000 to about 1,550,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up.

Authority for credit control implementation, which expired this past June 30, is essentional to have as an alternative or supplement to monetary policy. It is needed, so that it can be used to help restore economic recovery with stability and help the country become more productive and internationally competitive. The President should have the authority, and legislation to reestablish it should be enacted.

In addition, there is a need to reconstitute the Board of Governors of the Federal Reserve System, so that there will be a broader representation of economic interests. Four of the present seven governors were employees or officials in the Federal Reserve Bank system during their careers; one had been a commerical bank officer; one had been in private finance and also Chairman of the Federal Home Loan Bank Board, and one had been an economics professor. These members cannot adequately share the perspective or represent the interests of labor, agriculture and small business which are subject to the risks and hardships brought on by prolonged periods of high interest rates. Legislation should be enacted to reconstitute the Board of Governors, so that a wider spectrum of interests and concerns will be represented.

TRADE

Unfair trade practices and an overvalued U.S. dollar have added to the recession's severity and sharply clouded the outlook for recovery.

In 1982, imports will exceed exports by over $40 billion and for 1983 a deficit almost double that amount is expected.

In manufactured products, the U.S. trade surplus in 1981's first 9 months shifted to a $7.7 billion deficit of more imports than exports during the first nine months of 1982. Exports have fallen off in the industries which were America's pride: Capital equipment—industrial machinery, computers, communication, autos and aerospace, showed a drop in the trade surplus of $10.4 billion—a 50 percent fall-off in a single year. Imports have been growing in all of these categories. There was for example, a doubling of semi-conductor imports in the first 8 months of 1982.

A high and rising dollar (up 30 percent against major trading partners' currencies) has spurred imports of manufactured products and made it even more difficult for the U.S. to sell abroad. The Japanese yen has declined by 21 percent and the German mark by 22 percent against the dollar between January 1981 and November 1982.

Fair trade must become a reality. A first step toward achieving that reality requires a recognition that misguided U.S. international trade, monetary and investment policies have been key factors contributing to the destruction of basic U.S. industries.

A clear relationship between growth of imports and job displacement is evident in a number of industries. For example, imports of automobiles rose 41.5 percent. Imports of apparel rose 25.9 percent, while employment dropped 23.3 percent. Footwear imports rose 12.8 percent and employment went down 23.9 percent.

A loss of almost 3 million jobs in manufacturing from July 1979 to November 1982 included hundreds of thousands of jobs related to these trade facts of life. They cannot be ignored.

In rich countries and poor, the U.S. ability to export is retarded and imports to the U.S. encouraged as the combination of other nations' trade barriers and this nation's open markets squeezes the U.S. economy.

Industrialized nations have cut back on imports as a result of the recession and developing countries save cut back on their imports to meet their financial problems. The result is fewer American exports and fewer export-related jobs.

Unless the government takes action, however, the chance to "Buy American" may fade entirely. A domestic content bill for automobiles is a major goal because it is fair and because it tries to assure that Americans will have a chance to benefit from the U.S. auto industry—as workers, as consumers, and as business suppliers. For every one job in autos, for example, there are over two jobs in supplier industries.

The Administration must also recognize that trade-related job losses are rapidly spreading beyond manufacturing and into service industries. Exports of jobs in services have already begun through the runaway film shop, the runaway ship, and the runaway film and computer service. Imports of services have cost construction jobs and theatrical jobs, while other types of service jobs also have been eroded. But as important, this nation's economy and industries are interrelated, and for every manufacturing plant there is a set of service jobs, and each affects the other.

These are not old problems, but new ones in a changing world. What is old is the simplistic dialogue of "free trade" vs. "protectionism." Governments of other nations often regulate imports as a matter of course. The U.S. needs clear limits on certain imports until the nation's future is assured.

Other issues arise from U.S. laws that are geared to encourage investment abroad and technology outflows. At a time when the nation must rebuild its industrial base and improve its "competitiveness" the newest processes are up for sale to the closed economies of the world. Brand new technological processes invented in the U.S. are sold or licensed for production and use abroad. Employment is often created for foreign workers who make productss such as steel and auto parts that compete in the U.S. markets with firms and industries that can no longer afford to invest in new production here.

Productivity of the U.S. economy is still the highest in the world, but other nations are rapidly catching up. Technology outflows and capital outflows are swift and in most economies subject to a variety of controls, monitoring and regulation. Closed economies abroad invite producers and investors who build the jobs of tomorrow. The U.S. market is now flooded with the result of today's jobs and those of the future are constantly being exported.

Because of these factors, fair trade accompanied by efforts to slow down the outflow of technology and capital are essential elements in an anti-recession program. Both tax and trade provisions are needed to accomplish this goal, including:

Placement of temporary restrictions on harmful imports during periods of recession and high unemployment to prevent increased joblessness, added penetration of U.S. markets by foreign producers and a further weakening of the U.S. industrial base.

Enactment of an auto domestic content law to protect the continued U.S. capability to produce autos. Buy American must be more than a slogan. It must be an achievable result.

Action to assure that a portion of U.S. raw material exports, including grain, logs and other commodities, is processed in this country.

Establishment of bilateral shipping agreements and adherence to cargo preference laws.

Commitment that foreign grant, insurance and loan programs, such as the Export-Import Bank, are carefully managed to safeguard U.S. interests at home and abroad. Despite defects of the Ex-Im Bank, funds must not be slashed until other countries cut or eliminate their subsidy programs. Ex-Im Bank funds and guarantees must not be extended to any communist countries.

Vigorous enforcement of reciprocity provisions of the Trade Act.

UNEMPLOYMENT INSURANCE BENEFITS

Millions of jobless workers are in disastrous circumstances because they are without the protection of the unemployment insurance system. Only 45 percent of the 12 million workers officially counted as unemployed are receiving unemployment compensation benefits. In contrast, during the 1974-1975 recession 75 percent of unemployed workers received benefits. Since July 1981 over 5 million workers have exhausted their regular benefits and another 1 million long-term jobless workers have lost their extended benefits. Of the 900,000 unemployed workers receiving federal supplemental benefits, 135,000 have already exhausted or will exhaust these benefits soon. The remaining 765,000 will run out of benefits in the coming weeks.

Since the program of federal supplemental benefits is temporary, hundreds of thousands of additional unemployed workers will receive either no benefits or benefits of reduced duration under the program.

The extended benefit program which provides up to 13 weeks of benefits to unemployed workers who have exhausted regular benefits has been drastically cut back. The elimination of the national trigger, the one percent increase in state triggers and the exclusion of extended benefit recipients from the trigger calculation demanded by the Reagan Administration means that extended benefits are available only in those states experiencing catastrophic unemployment levels.

Congress must restore immediately the protections of the extended benefit program that have been eliminated so that all unemployed workers have the benefits to which they are entitled. The extended benefits program provides income protection for long-term jobless workers and is an effective countercyclical mechanism in blunting some of the adverse effects of recession. The combined duration of regular and extended benefits is inadequate for long-term jobless workers who are unable to find jobs commensurate with their skills. The present program of federal supplemental benefits will expire on March 31, 1983.

A permanent program of supplemental unemployment insurance, funded by general revenues, with a maximum duration of not less than 65 weeks is needed.

HEALTH INSURANCE FOR THE UNEMPLOYED

One of the more tragic, yet often forgotten, consequences of unemployment is the loss of health insurances coverage for unemployed workers and their families.

Eligibility for health insurance coverage is usually tied to an individual's place of employment. When workers are laid off they also lose health care coverage. Department of Labor statistics indicate that 50 percent of laid-off workers covered by employer-employee benefit plans lose health care protection immediately or one month after layoff. Only 20 percent can expect coverage for three months or more. Since the average duration of unemployment is a little over four months, most jobless workers can expect to be completely without health insurance protection.

When jobless workers lose their health insurance protection, they delay seeking medical care for themselves or their families. Ironically, because of the social and economic malaise associated with joblessness, this is also a time when they have a special health care need. Dr. Harvey Brenner of Johns Hopkins University has determined, for example, that for each one percent rise in unemployment, suicides increase 4.1 percent and homicides 5.7 percent. Excessive smoking, high blood pressure, insomnia and heightened anxiety are symptoms frequently associated with joblessness. Thus, during unemployment minor health care problems grow larger and the chance of laid-off workers falling victim to chronic conditions increases dramatically. At the same time, most unemployed workers are denied Medicaid coverage because they have not been poor enough for a long enough time to meet the medical criteria of most states.

This situation would, of course, not have existed if the AFL-CIO's long-standing proposal for a universal, comprehensive national health insurance program were in effect. We continue to strongly support this goal. However, unemployed workers and their dependents should not be deprived of health insurance protection until it is achieved.

The only effective solution to this serious and far-reaching problem is legislation to assure that unemployed workers are not forced to go without needed health care treatment. Catastrophic protection and a basic benefit package of hospital care and physician services must be provided so that workers and their families are eligible for basic medical care services and do not postpone preventive care, put off obtaining needed diagnostic services or increase their risk of developing more serious illness.

INFLATION

Inflation-fighting policies should be directed toward the basic causal factors—particularly "supply shocks" in basic commodities, such as energy and food and sectoral problems in housing and health. Such specific actions would contribute to maintaining an orderly supply of goods and services needed for industries to grow and people to prosper.

The inflation deceleration of the past two years was partly fortuitous and mostly the result of the recession. Food price increases slowed dramatically as bumper crops in 1981 and 1982 replaced the shortfalls of 1979 and 1980 and energy price increases slowed to 11.7 percent in 1981 and to only a 1.9 percent increase rate in the 12 months ended October 1982. The crucial elements were the emergence of a world glut in petroleum supply early in 1981 followed by falling demand as a worldwide economic recession took hold.

Shelter price increases also slowed with a virtual halt of house price increases in 1981 as sales fell off. Under the burden of high interest costs, sales of new and existing housing slumped almost 20 percent from 1980 levels, and the number of new private housing starts dropped to the lowest figure in 35 years. In the year ended October 1982, the increase in shelter prices slowed to 5.2 percent.

Medical care prices, however, have not responded to recessionary influences. They were still runing at a 10.7 percent increase rate in October 1982.

Most of the drop in the consumer price inflation rate—nearly 93 percent—arises from the very factors that caused the original runup. About 22 percent of the decline results from abatement of food price increases and about 31 percent from the drop in energy prices. A very large portion—nearly 40 percent—comes from a sharp drop in shelter cost increases. These were occasioned by the falloff in price increases for houses which accompanied the deepening recession. Toward the end of the period, mortgage interest rates declined, from close to 16 percent at mid-1982 to about 12-13 percent in the last quarter.

Wages have had little to do with the runup in prices or in the subsequent abrupt price deceleration. In 1979 and 1980, average hourly earnings rose 8.0 percent and 8.8 percent respectively—far below the rate of inflation. Wage increases have trended downward in 1981 and 1982, again in response to recessionary developments. In the year ended December 1981, average hourly earnings rose 7.3 percent, and average weekly earnings 6.1 percent. In the year ended October 1982, average hourly earnings were up 4.9 percent while average weekly earnings—reflecting a recessionary contraction in weekly hours of work—were up only 3.7 percent, well below the diminished consumer price inflation rate of 5.0 percent. The downward movement of real wages does, however, feed into the general reduction in purchasing power which deepens the recession and prolongs economic stagnation.

The tight money, high interest rate solution of the Administration has been largely irrelevant to the nature of the inflation and has had disastrous consequences for the economy.

The AFL-CIO anti-inflation proposals are based upon the experience of recent years which conclusively demonstrates the need for programs that will avoid possible commodity supply shocks in the future.

Energy inflation must be dealt with through conservation and stockpiling as well the development of alternative type of energy. Natural gas prices should continue to be controlled. A standby energy program including provisions for allocation, rationing and energy price controls, if needed, should be enacted to deal with possible future emergencies.

Food inflation should be moderated by pursuing supply-and-demand policies that mitigate inflation and overcome the violent swings in farm commodity prices with their "boom and bust" results for American farmers. With so much of agricultural production destined for export, the nation should restrain agricultural exports in times of inflationary shortage and stockpile in times of abundance. The establishment of a National Grain Board is needed to protect the interest of the United States in foreign markets and to provide price and supply stability in U.S. markets.

Housing inflation should be fought by expanding the supply of housing and allocating more money specifically to finance mortgages. Government programs to promote increased housing construction, particularly for low- and moderate-income families, should be expanded rather than curtailed.

Medical care inflation would most effectively be dealt with by enactment of a universal and comprehensive national health insurance system. Pending such reform, health care cost containment legislation, properly structured, should be enacted as an important interim step. The expansion of preventive health care—thereby reducing pressures on hospital usage—should be encouraged through further development of "health maintenance organizations" (HMOs).

Looking toward the future, the matter of specific price pressures which may be generated by the national defense buildup must be accompanied by appropriate economic policies. The defense sector can drain capital away from civilian industries and away from other government programs. It can bid away key human resources, such as scientists, engineers and skilled trade workers, as well as scarce material away from the civilian economy. A materials allocation program, for example, would become a necessity if shortages and bottlenecks should develop.

A sector-by-sector anti-inflation policy should be undertaken that concentrates on dealing with the causes of inflation and rejects efforts to "cure" inflation by engineering recessions and unemployment.

REINDUSTRIALIZATION

The need for a national industrial policy in the United States is becoming more and more evident. The American economy is experiencing the highest and most extended period of unemployment since the Great Depression. The growth of the economy has stopped in the 1980s and the U.S. position in world trade has deteriorated dramatically. In both the private and public sectors, the modernization of physical capital has been inadequate. The industrial base of the American economy is eroding and, there is no coherent national policy to reverse the trend.

Current levels of unemployment and idle capacity are causing the loss of hundreds of billions of dollars in product and income that can never be recovered. To carry forward a rational national industrial policy, a tripartite National Reindustrialization Board should be created which would include representatives of labor, business, and the government. The Board would develop a balanced economic program to insure the revitalization of the nation's sick industries and decaying communities, while at the same time encouraging the development of new industries with promise for the future. The Board would encourage productivity growth, dissemination of research and development findings, and a balanced use of the nation's resources. It would target industrial sectors and regions that particularly need help. The National Reindustrialization Board would also be directed to consult with, and be consulted by, the Administration and the Federal Reserve Board. The composition of the Reindustrialization Board should automatically provide Congress with a liaison with labor and industry.

This Board would also provide policy and priority guidance for the activities of a financing agency, patterned after the Reconstruction Finance Corporation of the 1930s and 1940s. It would be authorized to make and guarantee loans to finance approved reindustrialization ventures. Private pension funds could be encouraged to make investments in such financing arrangements to support and expand industrial employment in the United States.

The Reindustrialization Board would bring together all of the elements in economic society. It would insure that the interests of workers, industry, consumers—all the people—are an integral part of the economic decision-making process.

The AFL-CIO has recognized for some time that both private and public capital facilities are deteriorating. The proposed new RFC would make, participate in, or guarantee loans to private business and local governments in the industrial sectors and geographic regions designated by the Reindustrialization Board. The actual lending and other financing functions carried on by the RFC would be under the Reindustrialization Board.

The RFC could handle loans to private business and to state and local governments. Each of the two lending "windows" would be operated under an executive officer appointed by the Board of Directors. The Board of Directors would also be required to see that there was coordination between the two lending units to maximize economic development in areas where new construction or improvement of public facilities is needed to enhance the efficiency of the private business activities being assisted. Public facility loans should also be available to other areas in need of such loans to renew or expand public facilities required in the local economy. The issuance of capital stock to be subscribed by the Secretary of the Treasury for the RFC would be authorized by legislation, with authority for the RFC to issue bonds.

Pension funds should be used for reindustrialization and expansion that provides employment, as long as there are adequate protections for the pension funds. The legislation should provide that all obligations of the Corporation which are purchased by employee pension benefits plans shall be guaranteed—backed by the full faith and credit of the U.S.

CONCLUSION

The policies that AFL-CIO is calling for are ambitious. They add up to a repudiation and a dramatic reversal of the policies of the Reagan Administration. We firmly believe, however, that such action is the key to progress. We also recognize that many of the job creating programs we call for will cost money and in the near term would enlarge the budget deficit even further. Deficit increases, however, could be blunted or avoided through tax policies that prevent some of the more inequitable and costly provisions of the Reagan Administration's tax cut from taking effect and by plugging some of the long-standing loopholes that hurt the economy and destroy jobs.

America needs jobs. There is no higher economic priority and no more urgent economic agenda.

THE REAGAN RECESSION

PREPARED BY AFL-CIO DEPARTMENT OF ECONOMIC RESEARCH
FEBRUARY 1983

LANE KIRKLAND, PRESIDENT

THOMAS R. DONAHUE, SECRETARY-TREASURER

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

AFL-CIO Department of Economic Research

Rudy Oswald, Director

Henry Schechter, Deputy Director

Arnold Cantor, Assistant Director

Staff:

Kathy Becker
Bill Cunningham
Anne Draper
Elizabeth Jager
Rick Krashevski
Frank Parente
James Parrott
Markley Roberts
John Zalusky

INDEX

I. THE REAGAN RECESSION

Starting July 1981, the American economy plunged into the longest and deepest recession since the Great Depression. The effect on working people has been particularly devastating. The unemployment rate that was 7.2 percent in July 1981, was 10.4 percent in January 1983. During Reagan's first year in office, his Treasury Secretary predicted the U.S. economy would come "roaring back" in the spring of 1982. But 1982 is over and it will only be remembered as a year of human suffering, lost jobs, reduced worktime and earnings, idled plants, and prohibitively high interest rates. The beginning of 1983, 18 months after the recession began, shows only weak signs of improvement. The number of workers counted as officially unemployed was over 11.4 million. An additional 1.8 million had given up entirely on the desperate and fruitless search for work, and 6.8 million were forced to work part time. Thus, Reaganism has resulted in 20 million Americans suffering job loss and income loss.

The future outlook is no brighter, with the Administration's own unemployment projections at devastatingly high levels. Not until 1987 is unemployment projected back to the level of 1980-1981 (7.1 to 7.6 percent) and the 5.8 percent unemployment of 1979 is not envisioned for this decade. The projections of the Congressional Budget Office are as dismal. Different economic policies and job programs could change these projections.

Unemployment, 1979 - 1988
(1979-1982 civilian labor force, 1983-1988 includes armed forces in U.S.)

Actual					Projected					
1979	1980	1981	1982		1983	1984	1985	1986	1987	1988
5.8%	7.1%	7.6%	9.7%	Reagan	10.7%	9.9%	8.9%	8.1%	7.3%	6.5%
				CBO	10.6	9.8	9.0	8.4	8.0	7.5

Source: Economic Report of the President, February 1983 and Congressional Budget Office

The unemployment rate for adult men now stands at 9.6 percent. Nearly two-thirds of the increased unemployment since July 1981 occurred among adult men. The increase in the number of adult males unemployed is without precedent since the Depression. The 5.6 million adult males now unemployed constitute nearly one-half of the total officially unemployed. This five million level is five times greater than the average number of unemployed adult males during the late 1960s. In addition, there are nearly 4 million unemployed adult women, for an unemployment rate of 9.0 percent.

Minorities have been devastated with joblessness, with black Americans experiencing an unemployment rate of 20.8 percent. For black teenagers, the situation is catastrophic with an official unemployment rate of nearly 46 percent.

The effects of the Reagan Recession are being felt throughout the economy. The auto, steel, and construction industries, which together directly and indirectly account for more than one out of every three jobs in the country, have been particularly hard hit. Manufacturing employment has declined by 2.2 million since July 1981. The rate of unemployment in the construction industry was 20 percent in January 1983. While the industrial areas of the Northeast and Midwest continue to suffer from the combination of cyclical unemployment and permanent job loss, the number of unemployed has increased the fastest in the states of the South and West. As of November of 1982, the latest month for which data are available, 19 states plus the District of Columbia had double-digit unemployment rates, compared with only one state two years earlier.

The Reagan-Federal Reserve devotion to a high interest rate policy continues to have shattering effects on the housing, construction, automobile, farming, state and local governments, and other sectors particularly sensitive to the cost of borrowed funds. Home mortgage delinquencies, foreclosures, and business failures are at record high levels.

According to the Reagan Administration, the huge tax giveaways to business and the wealthy were supposed to stimulate a job-creating investment boom. Yet, business investment has been declining since early 1981. The latest survey of capital spending plans reveals that business plans to <u>cut</u> real investment spending by 5.2 percent during 1983. The misallocation of money and capital is exemplified by the merger mania of big corporations, big banks, and other financial institutions and the speculative fever of the stock and commodity markets. Without any effective control big business mergers soak up credit and along with the tight money policy of the Federal Reserve bid up interest rates. The result is a loss of capital for productive private and public enterprise, and housing.

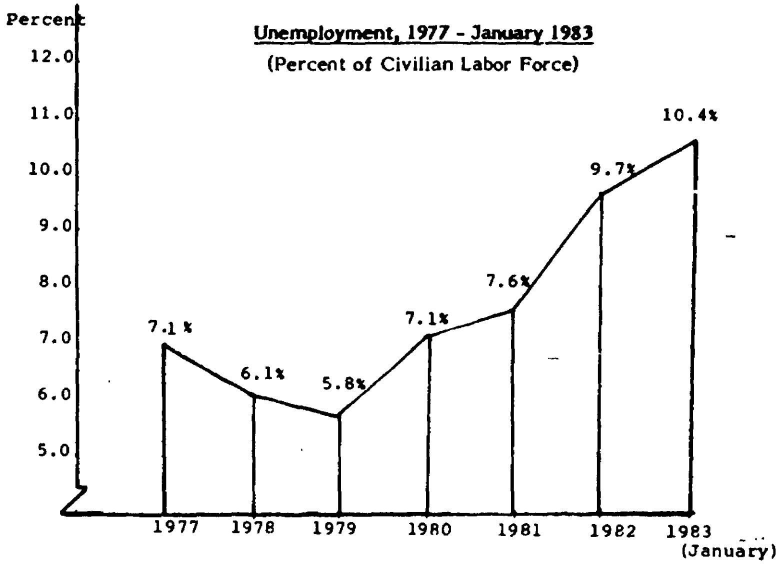
The gaps and disparities in income between families have widened considerably and poverty is on the rise. A two-tier economy at home and an energy cartel abroad have inflated prices for limited supplies of scarce resources, including necessities, such as fuel and food. Traditional weapons of monetary policy to fight inflation, with high interest rates as the cutting edge, have been counterproductive. Short-term gains on the price front have been bought at the huge cost of unemployment and loss of output and income.

Today's recession-depression is further complicated by a major downturn in the world economy. Further aggravating the economic downturn are unfair trade practices and an overvalued dollar.

This booklet describes the grim tales of the Reagan recession in terms of unemployment and various economic indications of the economic downturn. These figures indicate the severity of the recession, and show that it is far from being over.

II. UNEMPLOYMENT

Unemployment is a key indicator of the economy's performance and its impact on people. According to the National Bureau of Economic Research, the official "caller" of business cycle dates and turning points, the Reagan recession began in July 1981. Since then unemployment has increased sharply, with joblessness rising by 3.6 million workers as of January 1983. Since September of 1982, unemployment has remained at double-digit levels, the highest in more than forty years. The January 1983 rate of 10.4 percent or over 11.4 million people shows no sign of improvement.



monthly rate seasonally adjusted
Annual Averages
Source: BLS, Department of Labor

In spite of the fact that unemployment surpassed all postwar records, the Administration failed to support any of the traditional anti-recession policies used in other recessions to ease the calamity of unemployment. This represents a serious deterioration from the post-World War II experience of the U.S. and an unconscionable retreat from the commitment to full employment set forth in the Humphrey-Hawkins Full Employment and Balanced Growth Act of 1978.

Reagan forecasters, who have consistently been overly optimistic in their projections for the economy, are now more cautious. They predict an unemployment rate of 10.7 percent in 1983, and 9.9 percent in 1984. Not until 1987 does the rate drop back to 7.3 percent.

Unemployment, 1950 - 1983

(Percent of Civilian Labor Force)

Year	1950s Unemployment Rate (%)	Year	1960s Unemployment Rate (%)	Year	1970s Unemployment Rate (%)	Year	1980s Unemployment Rate (%)
1950	5.3	1960	5.5	1970	4.9	1980	7.1
1951	3.3	1961	6.7	1971	5.9	1981	7.6
1952	3.0	1962	5.5	1972	5.6	1982	9.7
1953	2.9	1963	5.7	1973	4.9	1983	
1954	5.5	1964	5.2	1974	5.6	Jan	10.4
1955	4.4	1965	4.5	1975	8.5		
1956	4.1	1966	3.8	1976	7.7		
1957	4.3	1967	3.8	1977	7.1		
1958	6.8	1968	3.6	1978	6.1		
1959	5.5	1969	3.5	1979	5.8		
high	**6.8**	**high**	**6.7**	**high**	**8.5**	**high**	**10.4**
low	**2.9**	**low**	**3.5**	**low**	**4.9**	**low**	**7.1**

Source: Bureau of Labor Statistics, U.S. Department of Labor.

Discouraged Workers and Involuntary Part-Time Workers

The reality of unemployment is much worse than the official monthly statistics imply. For the fourth quarter of 1982, the months of October, November and December, an average of 11.8 million people were officially counted as unemployed by the Bureau of Labor Statistics. An additional 1.8 million "discouraged" workers had given up entirely on the desperate and fruitless search for work. Their plight is not captured in the official unemployment rate. The number of discouraged workers has increased by 55 percent since the fourth quarter of 1981.

Of those employed, 6.4 million were forced into part-time schedules because of the slack economy. Thus, over 20 million Americans are suffering job loss and income loss.

Workers Suffering Job Loss and Income Loss

Fourth Quarter*, 1982

seasonally adjusted	(thousands)
Offically unemployed	11,839
Involuntary part-time workers	6,413
Discouraged workers	1,849
Total	20,101

*average on a monthly basis
Source: Bureau of Labor Statistics

Total Experiencing Some Unemployment During the Year Approaches One-Third

The unemployment figures are monthly averages. But the total number of people hit by unemployment in the course of a year is substantially higher. Since 1959, the total number of workers experiencing unemployment during a year has ranged from 2.7 to 4.2 times the number who are unemployed in any given month.

Thus, in 1982, average monthly unemployment was 10.7 million persons, but more than 28 million workers were probably jobless during the year -- about 25 percent of the workforce.

Unemployment Rates for All Population Groups at Post-World War II Record High Levels

The number of unemployed increased by nearly one-half (3.6 million) from July 1981 to January 1983. In January 1983, figures implie an improvement from the 10.8 percent unemployment level in December to a 10.4 percent level for the civilian labor force and 10.2 percent if the military in the U.S. is included, as reported for the first time in the January figures. However, the January report showed no increase in employment but rather that 395,000 adult males and 85,000 adult women dropped out of the labor force. Similar drops occurred a year ago, indicating severe problems with seasonally adjusting the change from December to January.

All age, sex, and racial groups have experienced significant deterioration in their employment prospects. The unemployment rates for all groups --adult men, adult women, teenagers, whites, blacks, and Hispanics -- are at post-World War II record high levels equalled or surpassed only in the immediately preceding month of December 1982. For the category, "women who maintain families," the January unemployment rate of 13.2 percent is at its highest level since this statistic was introduced in 1967.

Unemployment Increases Fastest Among Adult Males

The unemployment rate for adult men now stands at 9.6 percent. The percentage increase in the number of unemployed from July 1981 to January 1983 was greatest among adult males, with an increase of 67 percent since the recession began. Another way to consider it is that 63 percent of the increased unemployment occurred among adult men. The five and one-half million adult males now unemployed constitute 49 percent of the total officially unemployed. This is five times greater than the average number of unemployed adult men during the late 1960s. Of all working people, adult men have traditionally had the most stable attachment to the labor force and are proportionately more often the primary income earner supporting families.

There are nearly 4 million unemployed adult women, for an unemployment rate of 9.0 percent. Approximately one out of seven women who maintain families is unemployed.

Minorities Suffer Depression Level Unemployment Rates

Black unemployment increased by 46 percent from July 1981 to January 1983, climbing from 1.6 million to 2.4 million unemployed. This represents an official unemployment rate of a staggering 20.8 percent. Unemployment among workers of Hispanic origin climbed to 929,000 in January, 56 percent greater than in July 1981. The unemployment rate now stands at 15.5 percent for Hispanics.

Employment Prospects for Teenagers Rapidly Disappearing

In the face of mounting layoffs, young people just entering the labor market cannot find jobs. The official teenage, (ages 16-19), unemployment rate increased from 18.6 percent to 22.7 percent over the past 18 months of Reagan Recession. For black teenagers, the unemployment rate increased from 38.9 to 45.7 percent.

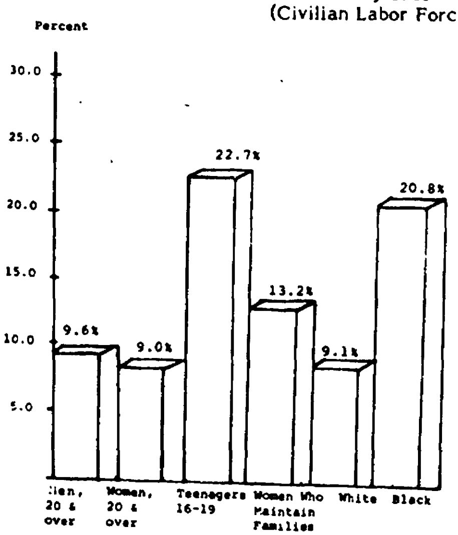
For white teenagers, employment declined by 10 percent since July 1981, and the number of black teenagers with jobs fell by 14 percent. While 46 percent of white teenagers have a job, only 19 percent of black teenagers do.

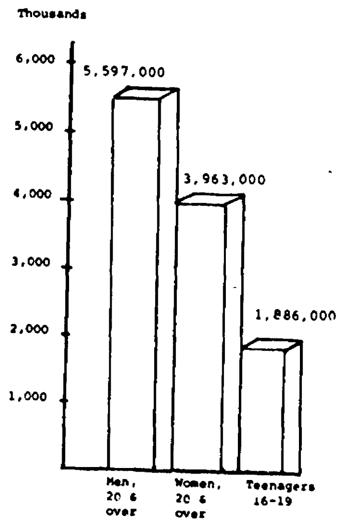
Changes In Unemployment
July 1981 - January 1983
(Civilian Labor Force)

	Number Unemployed (in thousands) July 1981	January 1983	Increase in Unemployed	Percent Unemployed
TOTAL	7,854	11,446	3,592	10.4%
Males, 20 years +	3,343	5,597	2,254	9.6
Females, 20 years +	2,867	3,963	1,096	9.0
Teenagers, 16-19 years	1,644	1,886	242	22.7
Black Teenagers	317	360	43	45.7
Women who maintain families	619	765	146	13.2
Whites	5,975	8,711	2,736	9.1
Blacks	1,640	2,400	760	20.8
Hispanic origin	595	929	334	15.5
Full-time workers	6,428	9,810	3,382	10.3
Part-time workers	1,441	1,649	208	10.6

Seasonally adjusted data
Source: Bureau of Labor Statistics, U.S. Department of Labor.

Who Are The Unemployed?
January 1983
(Civilian Labor Force)





Seasonally adjusted data
Source: Bureau of Labor Statistics, U.S. Department of Labor, "Employment Situation" January 1983

Unemployment by Occupation

Blue-collar workers have suffered most of the job losses during the recession with unemployment levels in January 1983 ranging from 9 percent for mechanics and repairers to 39 percent for construction laborers, according to new BLS occupation classifications. (These figures are not seasonally adjusted.)

White-collar unemployment ranged from 3 percent for professional workers to nearly 8 percent unemployed in sales occupations. Professional and technical workers and managers have been forced into the unemployment line but proportionally far less than blue collar workers.

Unemployment in service occupations was 11.8 percent with 1.8 million workers unemployed.

Unemployment By Industry

Manufacturing and construction continue to bear the brunt of the recession's impact. Unemployment in manufacturing has increased precipitously from 7.4 percent in July 1981 to 13 percent in January 1983. Unemployment in durables manufacturing, which includes autos, steel, and machinery, stands at 14.7 percent and in nondurables at 10.5 percent. Layoffs have even occurred among high technology electronics firms once thought to be immune to recession in the 1980s.

Even with recent housing start increases, construction unemployment is at a prohibitively high 20 percent rate in January 1983.

In the wholesale and retail trade sector unemployment is 10.8 percent; transportation and public utilities, 7.8 percent; and in finance and service industries, 7.6 percent.

For the private, non-agricultural sector in general, the January 1983 unemployment rate for wage and salary workers was 10.8 percent. Government workers, normally a stabilizing force in recessionary periods, are no longer assured that security with an unemployment rate of 5.7 percent in January 1983. The high unemployment rate among agricultural wage and salary workers, 16.0 percent, reflects the depressed condition of the farm sector.

Unemployment by Occupation
January 1983

(Civilian Labor Force)

Occupation	Unemployed January 1983 (000's)	Unemployment Rate (%)
Total, 16 years and over	12,517	11.4%
White-Collar Workers		
Managerial and professional specialty	941	3.9
Executive, administrative, and managerial	498	4.4
Professional specialty	443	3.4
Technical, sales and administration support	2,435	7.3
Technicians and related support	167	5.3
Sales occupations	978	7.9
Administrative support, including clerical	1,290	7.3
Blue-Collar Workers		
Precision production, craft and repair	1,833	13.6
Mechanics and repairers	418	9.2
Construction trades	952	19.8
Other precision production, craft and repair	464	11.2
Operators, fabricators, and laborers	3,934	20.6
Machine operators, assemblers and inspectors	1,783	19.4
Transportation and material moving occupations	903	18.4
Handlers, equipment cleaners, helpers and laborers	1,247	24.7
Construction laborers	275	38.6
Other handlers, equipment cleaners and laborers	972	22.4
Service Workers		
Service Occupations	1,774	11.8
Private household	81	8.1
Protective service	119	4.9
Service, except private household protective	1,574	12.8
Farm Workers		
Farming, forestry, and fishing	477	13.4

Data are not seasonally adjusted
Source: Bureau of Labor Statistics, U.S. Department of Labor, "The Employment Situation" January 1983.

Unemployment By Industry (Wage and Salary Workers)
January 1983

(Civilian Labor Force)

Industry	Unemployed January 1983 (000's)	Unemployment Rate Rate (%)
Nonagricultural private wage and salary workers	8,773	10.8%
Mining	182	17.1
Construction	1,043	20.0
Manufacturing	2,829	13.0
Durable Goods	1,893	14.7
Nondurable Goods	936	10.5
Transportation & public utilities	450	7.8
Wholesale & retail trade	2,253	10.8
Finance & service industries	2,015	7.6
Government Workers	834	5.7
Agricultural wage and salary workers	305	16.0

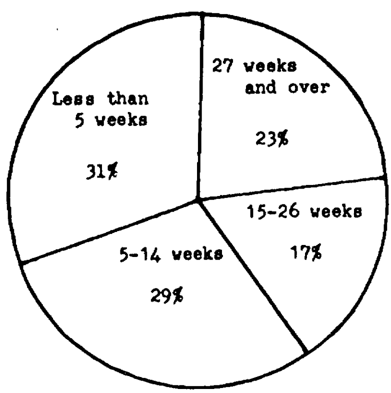
seasonally adjusted data
Source: Bureau of Labor Statistics, Department of Labor, The Employment Situation, January

Average Duration of Unemployment Increases

In January 1983, the average unemployed worker was out of work for 19.4 weeks. More than 40 percent of the unemployed have been jobless for 15 weeks or longer, with 24 percent unemployed for more than half a year. These figures fail to show any indication of a recovery in progress.

Duration of Unemployment

January 1983



19.4 WEEKS AVERAGE DURATION OF UNEMPLOYMENT

seasonally adjusted data

Source: Bureau of Labor Statistics, U.S. Department of Labor, "Employment Situation," January 1983.

Unemployment by State and Region

In November 1980, Michigan was the only state with a double-digit unemployment rate. By November 1982, the latest month for which data is available for all states, 18 other states and the District of Columbia had joined Michigan in the double-digit category.

Heavily dependent on depressed industries such as auto, steel, textile, or coal mining, the states topping the list in November include Michigan and West Virginia with an unemployment rate of 16.4 percent, Alabama with 15.3 percent, Ohio with 14.0 percent, Indiana with 13.0 percent and Illinois with 12.7 percent.

For November 1982, only South Dakota had an unemployment rate below 6 percent. For predominantly agricultural states like the Dakotas, Nebraska, and Kansas, low unemployment rates mask the precarious condition of their farm economies. The dramatic slowdown in investment in energy resource development in 1982 also bodes ill for Oklahoma and Wyoming. During the Reagan Recession the number of unemployed increased by 50 percent from November 1980 to November 1982 for all states combined.

While the industrial areas of the Northeast and North Central continue to suffer from both recession related and longer term job loss, the number of unemployed has increased the fastest in the West and South by 58 percent and 54 percent respectively. The North Central region increased by 47 percent; and the Northeast by 39 percent. In November 1982, North Central suffered the highest rate of unemployment at 12%; the West was next at 10.7%; the South at 9.5%; and the Northeast at 9.3%.

Increase In Number Unemployed by Region
November 1980 - November 1982p

Region	November 1980 (000's)	November 1982p (000's)	Percent Change
NORTHEAST	1,565	2,183	+39%
NORTH CENTRAL	2,318	3,413	+47%
SOUTH	2,266	3,483	+54%
WEST	1,483	2,349	+58%
ALL STATES	**7,632**	**11,428**	**+50%**

Data not seasonally adjusted and based on state distributions.
p = preliminary
Source: Bureau of Labor Statistics, U.S. Department of Labor

Unemployment By State and Region
November 1982p

	Number Unemployed (000's)	Unemployment Rate		Number Unemployed (000's)	Unemployment Rate
NORTHEAST	**2,183**	**9.3%**	**NORTH CENTRAL**	**3,413**	**12.0%**
Maine	35	7.0	Ohio	709	14.0
New Hampshire	34	7.0	Indiana	341	13.0
Vermont	18	6.7	Illinois	704	12.7
Massachusetts	196	6.5	Michigan	699	16.4
Rhode Island	46	9.5	Wisconsin	272	11.0
Connecticut	110	6.9	Minnesota	185	8.6
New York	753	9.5	Iowa	118	8.5
New Jersey	345	9.4	Missouri	214	9.4
Pennsylvania	646	11.6	North Dakota	21	6.9
			South Dakota	18	5.6
SOUTH	**3,483**	**9.5%**			
			Nebraska	48	6.2
Delaware	27	9.2	Kansas	84	7.1
Maryland	167	7.7			
District of Col.	35	10.8	**WEST**	**2,349**	**10.7%**
Virginia	216	8.1			
West Virginia	128	16.4	Montana	37	9.4
			Idaho	37	8.6
North Carolina	279	9.5	Wyoming	17	6.9
South Carolina	160	10.8	Colorado	140	8.9
Georgia	214	8.0	New Mexico	60	9.9
Florida	469	9.5			
Kentucky	184	10.7	Arizona	144	10.4
			Utah	59	8.7
Tennessee	255	11.8	Nevada	55	11.3
Alabama	263	15.3	Washington	255	12.4
Mississippi	125	11.9	Oregon	156	11.9
Arkansas	103	10.0			
Louisiana	201	10.7	California	1,340	11.0
			Alaska	20	9.8
Oklahoma	95	6.6	Hawaii	32	7.0
Texas	562	7.6			

Data not seasonally adjusted.
p=preliminary
Source: Bureau of Labor Statistics, U.S. Department of Labor, "State and Metropolitan Area Employment and Unemployment," November 1982

Unemployment Insurance Benefits

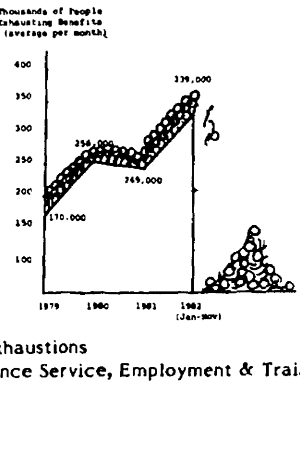
Millions of jobless workers and their families are in disastrous circumstances because they are without the protection of the unemployment insurance system. For all of 1982, only 38 percent of the officially unemployed and discouraged workers received unemployment compensation benefits.

Moreover, as high unemployment continues, more and more people are seeing their unemployment benefits expire while job prospects continue to be bleak. Termination of benefits removes their safety net, and further reduces consumer buying power. Over four million workers saw their regular state unemployment benefits run out in 1982, and 1.3 million jobless workers lost their extended benefits.

Prior to the current deep Reagan recession, additional unemployment benefits had been provided during periods of high unemployment to workers whose 26 weeks of regular state benefits had run out. In the 1975 recession, workers were eligible for up to 65 weeks of unemployment insurance. Reagan-mandated budget cuts in 1981 and 1982 made eligibility for extended benefits much more restrictive and has deprived hundreds of thousands of the jobless of needed extended benefits. If the same percentage of officially unemployed and discouraged workers had received unemployment compensation as in 1975, an additional 2.1 million jobless workers would have received benefits in 1982.

A modestly funded Federal Supplemental Compensation program went into effect in the latter part of 1982, providing an additional 8 to 16 weeks of unemployment benefits, depending on the unemployment situation in each state. Supplemental benefits are in addition to regular state benefits and 13 weeks of extended benefits, if a state qualifies for extended payments. During December and January, between 600,000 and 800,000 people were receiving payments under the supplemental program. Unless Congress acts to extend it, the present federal supplemental program will expire on March 31 of this year.

Regular State Unemployment Benefit Exhaustions*
1979 - 1983



*excludes extended benefit exhaustions
Source: Unemployment Insurance Service, Employment & Training Administration, DOL

III. EMPLOYMENT FALLS

The number of jobs has to grow by about 1.5 percent a year in the United States, or about 1.5 million jobs per year just to keep up with population and labor force growth and hold unemployment at the same rate. During the Reagan Recession employment has of course, been declining.

In the past 18 months of the Reagan Recession, from July of 1981 to January 1983, total nonfarm payroll employment has declined by 2.8 percent, with a net loss of 2.5 million jobs. The largest losses have occurred in manufacturing, construction and government. Manufacturing employment has fallen by 2.2 million from July of 1981 to January of this year. This represents a decline of 10.9 percent. Construction employment has decreased by a quarter of a million since July 1981, and the normally stable government sector of the economy, has declined by an even larger number, 296,000, with most of this decline at the state and local level. Many states, cities, and school districts have laid off employees during the past months and the continual squeeze on state and local funds will necessitate further employment cutbacks in the future.

Employment in the transportation and public utilities sector has fallen by 195,000. Employment in wholesale and retail trade has declined by over 70,000 employees or 0.3 percent from July of 1981 to January 1983. However, from 1970 to 1979, this sector grew by an average annual rate of 3.3 percent and generally has not been affected by declines. Other sectors have shown some gains, although at rates considerably below the pace of their expansion in the 1970s. Employment in the financial sector has increased by 1.7 percent during the recession, compared to an average rate of growth of 3.5 percent during the 1970s. The largest gains in employment were in services, with an increase of 555,000 jobs. Yet, this 3.0 percent increase is well below the average annual rate of increase during the 1970s of 4.4 percent.

Employment has declined in every one of the manufacturing industries during the recession, except printing and publishing which remained the same. Losses were heaviest in the durable goods industries, particularly: primary metals (which includes steel), down by 322,000 jobs or an alarming 28.4 percent; nonelectrical machinery, down by 459,000 or 18.2 percent; fabricated metals, down by 253,000 or 15.6 percent; and transportation equipment (which encompasses autos), down by 256,000 or 13.3 percent. These metal and machinery industries constitute the core of U.S. industrial strength and largely account for this nation's manufactured exports. During the Reagan Recession, their employment has declined by an average of 18 percent. It is widely recognized that the sustained unemployment of the human and capital resources in these industries constitutes a serious and perhaps irreversible drag on U.S. industrial output.

The depression in housing construction largely accounts for the 8 percent decline in employment in the lumber and wood products industry. This decline has produced double-digit unemployment rates in the lumber-dependent states of Oregon and Washington.

Employment has contracted by 6.1 percent in nondurable goods. Leather goods and textiles had the most precipitous declines, 15.1 and 13.9 percent, respectively. Apparel employment has fallen by 121,000 from July 1981 to January 1983 for a decline of 9.6 percent. In the auto-related rubber industry, employment is off by 9.2 percent.

Employment By Industry, July 1981 - January 1983

			Change	
	July 1981 (000's)	January 1983p (000's)	Number (000's)	Percent
TOTAL	91,396	88,874	-2,522	-2.8%
Goods producing	25,718	23,113	-2,605	-10.1
Mining	1,164	1,028	-136	-11.7
Construction	4,175	3,927	-248	-5.9
Manufacturing	20,379	18,158	-2,221	-10.9
Service producing	65,678	65,761	+83	+0.1
Transportation and public utilities	5,168	4,973	-195	-3.8
Wholesale and retail trade	20,620	20,549	-71	-0.3
Finance, insurance, and real estate	5,311	5,401	+90	+1.7
Services	18,615	19,170	+555	+3.0
Government	15,964	15,668	-296	-1.9
Federal government	2,775	2,751	-24	-0.9
State and local government	13,189	12,917	-272	-2.1

Establishment data seasonally adjusted.
p=preliminary

Source: Bureau of Labor Statistics, U.S. Department of Labor, Supplement to Employment and Earnings, June 1982 and "Employment Situation," January 1983.

Employment By Manufacturing Industry, July 1981 - January 1983

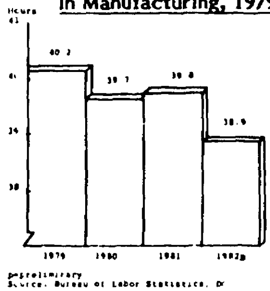
	July 1981 (000's)	Jan. 1983 (000's)	Change Number (000's)	Change Percent
MANUFACTURING	20,379	18,158	-2,221	-10.9%
Durable Goods	12,266	10,540	-1,726	-14.1
Lumber and wood products	683	629	-54	-7.9
Furniture and fixtures	476	435	-41	-8.6
Stone, clay and glass products	644	551	-93	-14.4
Primary metal industries	1,132	810	-322	-28.4
Fabricated metal products	1,617	1,364	-253	-15.6
Machinery, except electrical	2,527	2,068	-459	-18.2
Electric and electronic equipment	2,112	1,955	-157	-7.4
Transportation equipment	1,925	1,669	-256	-13.3
Instruments and related products	731	683	-48	-6.6
Miscellaneous and manufacturing ind.	419	376	-43	-10.3
Nondurable Goods	8,113	7,618	-495	-6.1
Food and kindred products	1,678	1,634	-44	-2.6
Tobacco manufactures	70	66	-4	-5.7
Textile mill products	835	719	-116	-13.9
Apparel and other textile products	1,255	1,134	-121	-9.6
Paper and allied products	691	648	-43	-6.2
Printing and publishing	1,268	1,270	+2	+0.2
Chemicals and allied products	1,110	1,055	-55	-4.9
Petroleum and coal products	217	208	-9	-4.1
Rubber and miscellaneous plastic products	750	681	-69	-9.2
Leather and leather products	239	203	-36	-15.1

Establishment data seasonally adjusted.
Source: Bureau of Labor Statistics, U.S. Department of Labor. Supplement to Employment and Earnings, June 1982 and the "Employment Situation," January 1983.

IV. HOURS OF WORK DECLINE WHILE OVERTIME CONTINUES

Average weekly hours of work for all private sector workers declined in 1982 to 34.8 hours, dropping 0.4 hours from 1981. In manufacturing, the falloff in hours worked was even greater, dropping 0.9 hours from 39.8 hours in 1981 to an average of 38.9 hours for 1982. These 1982 levels were considerably below the levels of the late 1970s.

Average Weekly Hours of Production or Nonsupervisory Workers in Manufacturing, 1979 - 1982



Although overtime hours have diminished during the recession, considerable overtime continued in nearly every manufacturing industry. The hours of overtime worked in each week since the beginning of the recession in July 1981, are the equivalent of 820,000 full-time jobs.

Overtime hours in manufacturing declined from 2.9 hours per week for the first six months of 1981 to 2.3 hours per week in the fourth quarter of 1982.

Overtime Hours of Manufacturing Production Workers and Equivalent Full-Time Jobs
July 1981- January 1983

Manufacturing	
Average Weekly Overtime Hours	2.5
Average Number Production Workers	13,113,631
Total Overtime Hours Worked	32,784,077
Number of 40-Hour Full-Time Equivalents	**820,000**

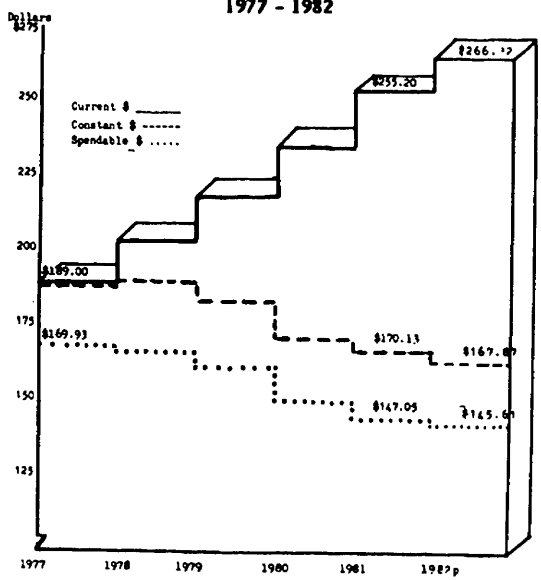
seasonally adjusted monthly data.
Sources: Bureau of Labor Statistics, U.S. Department of Labor, "Employment and Earnings" and "The Employment Situation".

V. WORKERS' BUYING POWER DECREASES

The buying power of American workers' paychecks continued to decline in 1982 and remains considerably below the levels prevailing in the late 1970s. While gross average weekly earnings for workers in private industry increased by 4.6 percent from $255.20 in 1981 to $266.92 in 1982, the real buying power of that increase actually declined by one percent as real spendable earnings were reduced by inflation and taxes.

This decline in workers' buying power erodes the living standards of workers and their families and contributes to the recession as reduced buying power leads to lower production and further layoffs. Since 1977, average real spendable earnings have dropped by 14.3 percent.

Average Weekly Earnings Versus Real Spendable Earnings,*
Production or Nonsupervisory Workers
1977 - 1982



*Earnings adjusted for taxes paid by a worker with three dependents
Annual Averages
Source: Bureau of Labor Statistics, U.S. Department of Labor. Spendable earnings for 1982 calculated by the AFL-CIO using BLS methods.

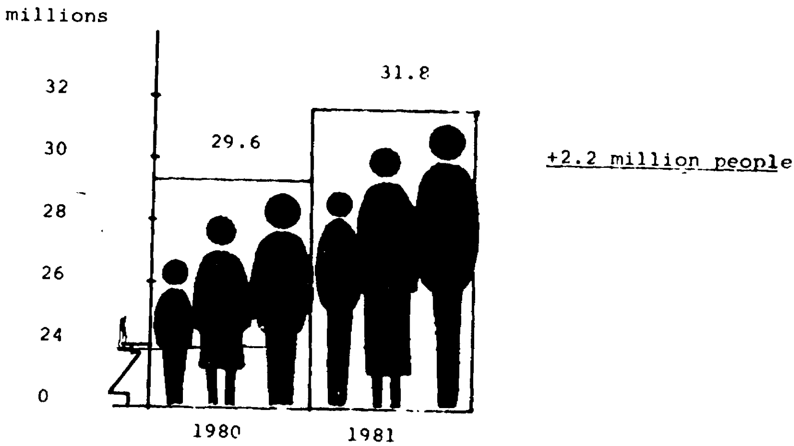
VI. POVERTY INCREASES SHARPLY

The slack economy and extremely high unemployment are forcing more and more Americans into poverty. There were 31.8 million people living below the poverty level in 1981, an increase of 2.2 million over 1980, or 7.4 percent. The percentage of the total population living in poverty rose from 13.2 to 14.0 percent or one out of every seven Americans. The increased unemployment in 1982, and the cuts in the federal budget protecting the working poor, the unemployed, the disabled, and the destitute will add millions more to the poverty count for 1982.

Both the number of people in poverty and the poverty rate are already at their highest levels since the mid-1960s.

Poverty is particularly widespread among blacks, children, and women who maintain families. More than one-third of blacks and women who maintain families live in poverty. One out of five children lives in poverty. The number of married-couple families who are poor increased 10 percent from 1980 to 1981.

Persons Below the Poverty Level
1980 - 1981



Source: Money Income and Poverty Status of Families and Persons in the United States, 1981, U.S. Department of Commerce, Bureau of the Census (Advance Data)

VII. INCOME SHIFTS TO INTEREST RECIPIENTS

Wage and salary incomes were severely eroded by inflation in 1982 while gains were made by those receiving income from interest and dividends. Wage and salary incomes -- including "fringe" benefits -- rose 4.9 percent from 1981 to 1982, compared to a 6.0 percent rise in the inflation rate. Income from interest rates, on the other hand, rose 13 percent in 1982 while income from corporate dividends rose 7.2 percent.

The share of personal income represented by wage and salaries continued to fall in 1982. The slide which has taken place over the last ten years has become much steeper since the recession began The wage and salary share of personal income which stood at 71.3 percent in 1972 had fallen to 68.2 percent in the first quarter of 1981, and was down to 66 percent in the last quarter of 1982.

The interest income share of personal income rose from an 8.5 percent share in 1972 to a 13.1 percent share in the first quarter 1981 and to a 14.4 percent share in the last quarter of 1982. Corporate dividend income rose slightly from a 2.5 percent to a 2.6 percent share from the first quarter of 1981 to the last quarter of 1982.

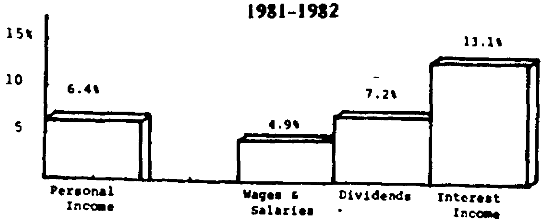
The distribution of interest and dividend income is highly skewed toward the upper income brackets. In 1979, the top 15 percent of the nation's taxpayers received 41 percent of the taxable interest income and 71 percent of the dividends.

A major cause of the adverse shift in income is the high interest rate policy of the Federal Reserve System which has choked the economy and raised unemployment but has been a boon to those who receive income from interest rates.

Corporate stockholders have increased their income due to increased dividend payments by corporations. Despite the fall-in profits, corporations have actually increased dividends by 16 percent since the recession began. Corporations have been able to increase dividends due to the large corporate tax cuts given them by the Reagan Administration and by cancelling investment plans. Also, profits were at a historically high rate in the late 1970s before the decline began.

The Percent Change in Wage, Salary, Interest and Dividend Income

1981-1982



Source: Commerce Department, Bureau of Economic Analysis

VIII. HIGH INTEREST RATES SQUEEZE THE ECONOMY

While interest rates have declined from their 1981-1982 peaks, they are still high by all historical measures, far exceeding the rate of inflation. Interest rates reached a peak in early 1981 with banks charging a prime rate (the rate charged their best customers) of 21.5 percent. That rate still was as high as 18 percent in November 1981, falling very slowly thereafter to a 16.5 percent rate in July 1982. But by year-end these rates had fallen to 11.5 percent.

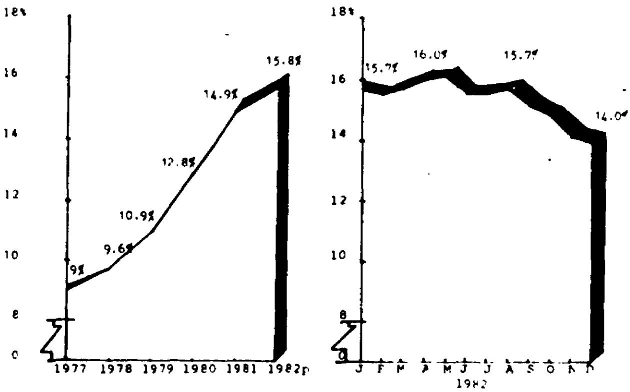
Mortgage interest rates and consumer loan rates however, have not receded as rapidly from their year earlier peaks and are still at exceptionally high levels. The prolonged period of these and other high interest rates resulted primarily from the persistent pursuit of "tight money" policy by the Federal Reserve Board, with the active encouragement of the Reagan Administration.

The punishing debt service burdens inflicted by the high interest rates were a major factor in causing high levels of commercial and industrial business failures. As rising costs of financing froze millions of consumers out of the market, housing, construction, and auto production suffered the longest and deepest declines since World War II. Supplier industries also were forced to undergo drastic cutbacks in production. The effects of high unemployment and accompanying income declines in these industries had a ripple effect upon the rest of the economy to help bring about the 1982 economic depression.

Extraordinarily high interest rates also meant that the U.S. dollar became a desirable earning asset, and it gained in value relative to other countries in international exchange. Between December 1980 and December 1982, for example, the Japanese yen and the German mark declined by 13 percent and 18 percent respectively in dollar value on the international exchange. That meant that the prices of foreign imports in the U.S. fell and U.S. exports rose in price in foreign countries, thus putting U.S. goods at a disadvantage.

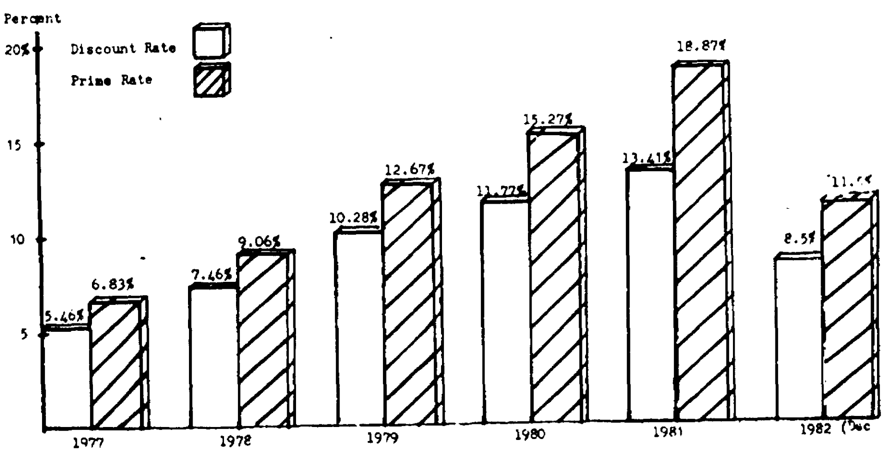
While inflation currently has been reduced, and a weak economy plus some easing of monetary policy have brought interest rates down from record heights, they are still at levels that impede recovery. The prime stood at 11.5 percent and mortgage rates at 14 percent as 1983 began.

Mortgage Interest Rates*
1977 - 1982



*Effective rate on conventional mortgage reflecting fees and charges as well as the contract rate

Prime and Discount Rates
1977 - December 1982



Source: Federal Reserve Board

IX. BUSINESS AND CONSUMERS IN DISTRESS

Business Failures and Bankruptcies

Continued recession and high interest rates are driving companies of all sizes and in all industries and regions out of business more rapidly than at any time since the Great Depression. In 1982 there were 25,346 business failures. The business failure rate, considered in relation to the total number of businesses, is at its highest level since 1933, one of the worst years of the Great Depression.

The depressed purchasing power caused by continued high unemployment keeps sales down and makes it more and more difficult for corporations to pay their bills. Hard-pressed firms resort to layoffs to cut their expenses and to short-term borrowing to pay their bills. But layoffs further worsen consumer spending and sales, and high interest rates rapidly add to the burden of debt. For this stage of a recession interest rates have remained unusually high. In addition, the decline in production and sales has been particularly steep. As a result, many firms are finding it impossible to stay afloat.

Business bankruptcies have become all too common as this recession continues to strangle the economy. For every business which fails and closes down entirely, three or four more file for bankruptcy. Some will try to stay in business by selling off assets and reorganizing, which usually entails large layoffs. Bankruptcies threaten to escalate as firms which are owed money by bankrupt firms are forced to write off those debts. But this, in turn, weakens their own financial position, making additional bankruptcies more likely.

Because small businesses must pay higher interest rates, on less favorable terms than large corporations, small firms are particularly vulnerable. The House Small Business Committee has noted that extended high interest rates and recession constitutes "the death knell" for thousands of small businesses.

Weakness in Financial Institutions

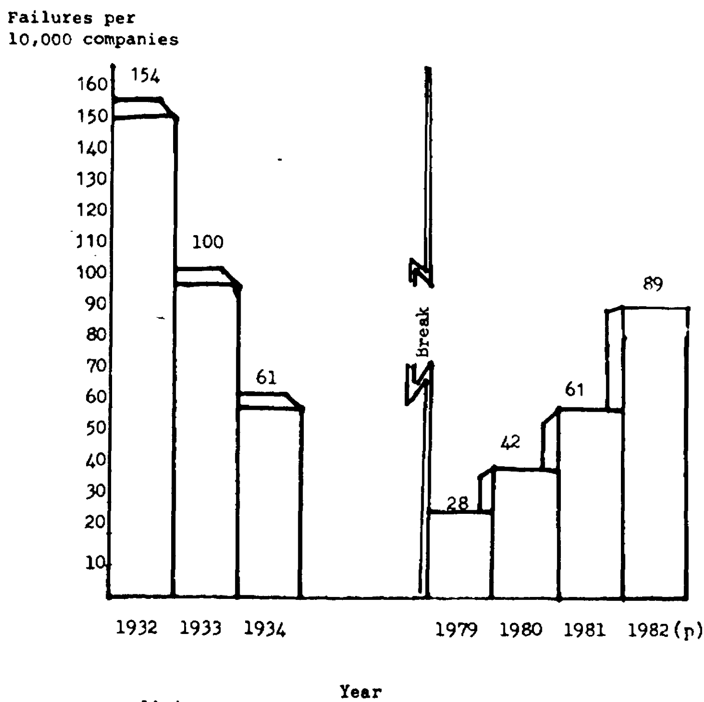
Sustained high interest rates have also had disruptive effects in the financial sector. Savings and loan institutions, in particular, have been hard-pressed to pay the high rates necessary to keep deposits, since they derive their income from low-yielding loans made when interest rates were much lower.

The ripple effects of a bank failure or the collapse of a bond dealer can reverberate across many institutions and regions. The collapse of the relatively small Penn Square National Bank in Oklahoma City in 1982 led to large loan losses among some of the largest

New York and Chicago banks and resulted in the layoff of 400 employees by a Seattle bank which experienced heavy losses. One hundred and thirty-two credit unions with deposits in Penn Square were also affected.

By the end of 1982, there had been 42 bank closings due to financial difficulties. This is more than during any other year since 1940, when there were 48 bank closings.

Business Failures Per 10,000 Companies
1932 - 1982



p=preliminary
Source: Dun & Bradstreet, Inc.

Personal Bankruptcies

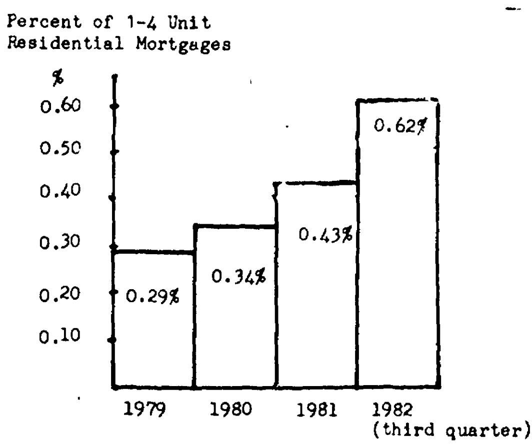
Individual and family incomes have suffered greatly from high unemployment and the slack economy. Thousands are finding it impossible to sustain their living standard and have filed for bankruptcy as their indebtedness has swamped their ability to repay. Personal, non-business bankruptcies are being filed at a rate of 38,000 per month, twice the level prevailing during the last decade.

Home Mortgage Delinquencies and Foreclosures

As of September 30, 1982, over 5 percent of all outstanding home mortgages were delinquent, a near-record high since the Mortgage Bankers Association started its survey in 1953. The Mid-Atlantic and Great Lakes states experienced the highest delinquency rates, ranging from 5 to 9 percent in all of these industrial states.

Continued record high unemployment and interest rates are forcing tens of thousands of people to lose their homes through foreclosure. For the third quarter of 1982, foreclosure proceedings were underway for almost 170,000 homeowners. The third quarter annual average of mortgages in the process of foreclosure, 0.62 percent, marked a significant and continuing upward trend from recent past experience.

Mortgage Foreclosures in Process
1979 - 1982
Annual Average of Percentage of Mortgages
in the Process of Foreclosure



Source: Based on Mortgage Bankers Association of America data.

X. GROSS NATIONAL PRODUCT DOWN

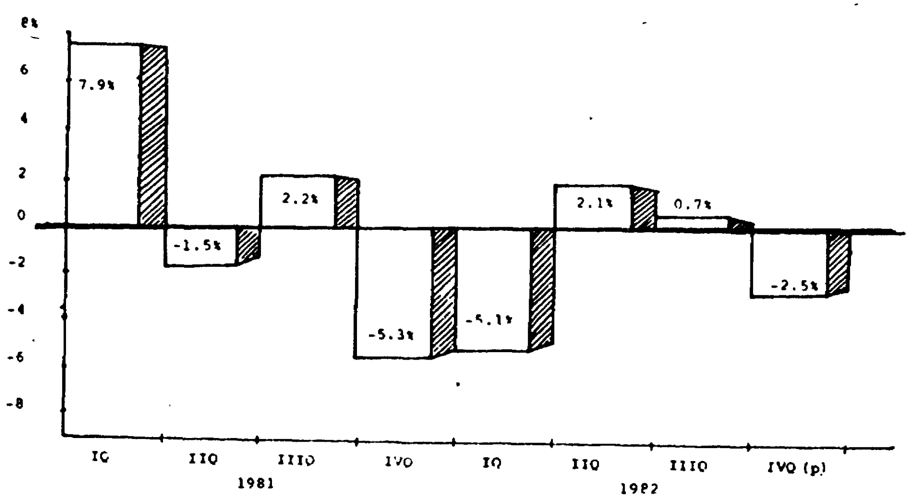
The nation's total output of goods and services for the full year 1982 was down 1.8 percent from 1981, the steepest economic decline of the last 36 years.

The nation's total output in 1982 was lower than in 1979.

The quarterly changes in output during the year were uneven, with rises occurring in the second and third quarters due to changes in inventory levels,and a sharp decline in the fourth quarter of 2.5 percent. The output of each quarter of 1982 was below that of the same quarter in 1981.

The fall in the nation's output of goods and services in 1982, and particularly in the fourth quarter, shows no turnaround in the recession.

Change In Gross National Product
First Quarter 1981 - Fourth Quarter 1982



p=preliminary
seasonally adjusted annual rate
Source: Commerce Department, BEA

XI. CORPORATE PROFITS DECLINE BUT NOT DIVIDENDS

Corporate profits have recovered slightly from their sharpest plunge since World War II but are still severely depressed. The slight rise in profits in the second and third quarters of 1982 which occurred despite falling sales was due to further layoffs, plant closings and price increases.

Corporate profits rose 4 percent in the second and third quarters of 1982 but were still 26 percent below their first quarter 1981 level.

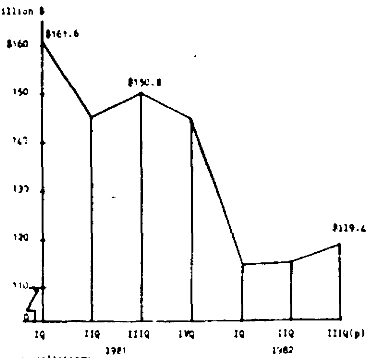
Profits before-tax were 29 percent lower in the third quarter of 1982 than in the first quarter 1981. The fall in after-tax profits was less than in before-tax profits because the Reagan tax cuts contributed to a decline in tax liabilities. Corporate tax liabilities fell 33 percent compared to the 29 percent fall in before-tax profits.

Corporate after-tax profits are divided between dividends paid to stockholders and retained earnings held for reinvestment. Despite the sharp decline in profits, stockholders, on average, have not been hurt in terms of their income from dividends. Corporations have actually increased corporate dividends 16 percent since the first quarter of 1981.

Corporations have been able to pay out high dividends because of the historically high rate of profit before the recession began, the Reagan tax cuts, and the curtailment of investment plans.

The Reagan tax cuts to corporations were justified on the basis that corporations would invest more, but since the first quarter of 1981, corporations experiencing shrinking pre- or after-tax profits have chosen to increase dividend payments rather than invest.

Corporate After-Tax Profits
First Quarter 1981 - Third Quarter 1982



p-preliminary
seasonally adjusted annual rate
Source. Department of Commerce

XII. INVESTMENT DROPS

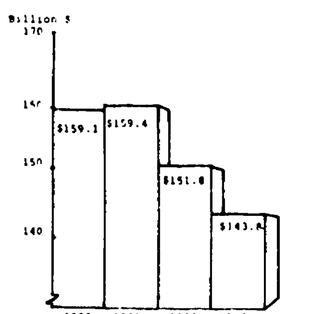
Expenditures for new plant and equipment in real terms decreased by 4.8 percent from 1981 to 1982, and the U.S. Department of Commerce has estimated that business investment will decline an additional 5.2 percent in 1983.

Reagan's massive tax giveaways to business have been an abysmal failure in stimulating business investment. Any argument that these cuts haven't been in place long enough to judge their effectiveness can be totally rejected. Retroactive to January 1981, the business cuts have had two years to generate the promised investment boom. It hasn't worked.

In actuality the huge and unbalanced tax cuts have deterred business expansion. The resultant deficits and the Administration's support for a policy of slowing down monetary growth have pushed the cost of credit to levels which make investment prohibitively expensive. In addition, the Reagan recession has reduced business sales and cash flow as a source of funds for investment. The large proportion of existing capacity lying idle also serves to dampen business investment plans. Moreover, even during periods when the economy is growing, corporate tax cuts are not necessarily invested in new productive plant and equipment. The increased cash flow may be used to finance investment overseas, speculation, dividend increases, mergers, acquisitions, and relocations.

In the hysteria to cut taxes to promote capital formation, the underlying strength of investment was conveniently overlooked. By 1979, the share of real investment in real GNP rose to match its highest two peaks during the entire postwar period. Moreover, during the seventies, as a whole, investment's share in GNP was higher than during the sixties.

Expenditures For New Plant and Equipment
By U.S. Nonfarm Business, 1980 - 1983
(Billions of 1972$)



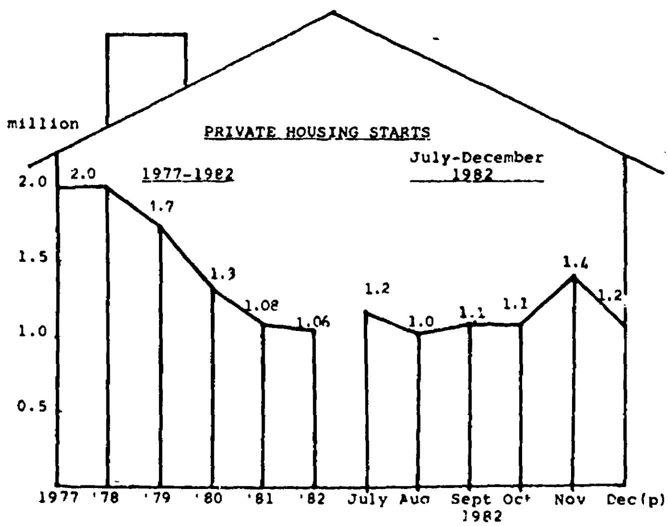
Source: Department of Commerce

XIII. HOUSING STARTS SLUMP

Housing starts were in the range of just over one million in 1981 and in 1982. These numbers represent record lows dating back to World War II and are due to the recession, high interest rates, and the Reagan Administration's attack on government-assisted housing construction. Starts in 1983 are expected to amount to 1.3 - 1.4 million units at current interest rates. Any increase in mortgage rates would reduce that number. There were over 2 million housing starts in the previous cyclical high years of 1977 and 1978.

The recent decline in mortgage interest rates has resulted in lower monthly payments needed to borrow a given amount of money. During 1982, for example, home mortgage commitment rates went down from about 17.5 percent to about 14.25 percent on certain loans. This meant that a home buyer's monthly payment for principal and interest on a $60,000 25-year loan would cost about $715 per month instead of $858. This is an improvement in housing affordability, but still leaves housing out of reach for most families who are not well housed. Mortgage interest rates are still higher than in any post-war year prior to 1980.

The effect of lower interest rates will be partially offset, however, by rising home prices. The median price of a new home rose to a level of $74,200 in November 1982, higher than the $70,000 range that prevailed earlier in the year. The extent to which the decline in rates will permit sellers to raise their prices in the future is not known.



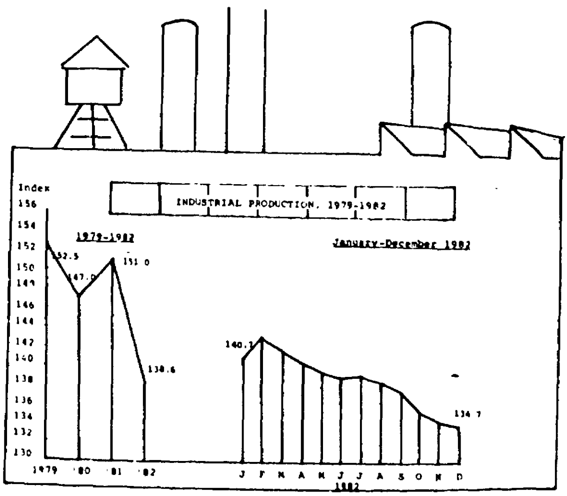
Source: U.S. Department of Commerce

XIV. PRODUCTION FALLS AND PLANTS STAND IDLE

Industrial production fell by 10.3 percent between July 1981 and December 1982. The Federal Reserve Board index, which covers manufacturing, mining, and utilities, has declined every month in 1982.

The falloff in industrial production is accompanied by the drop in utilization of industrial plants and equipment. In December of 1982, more than 30 percent of the nation's manufacturing capacity was idle (67.3% utilization). This is the highest level of idle capacity since the Federal Reserve began collecting such data in 1948. The percent of plant and equipment utilized in the iron and steel industry dropped to 38 percent; and utilization in the motor vehicles and parts industry barely exceeded 50 percent (52.3%). These latest figures show that the current recession has been the most damaging economic setback to our nation's factories since World War II.

Industrial Production
1979 - 1982
(Federal Reserve Board Index 1967=100)



Source: Federal Reserve Board
Federal Reserve Board Index 1967=100

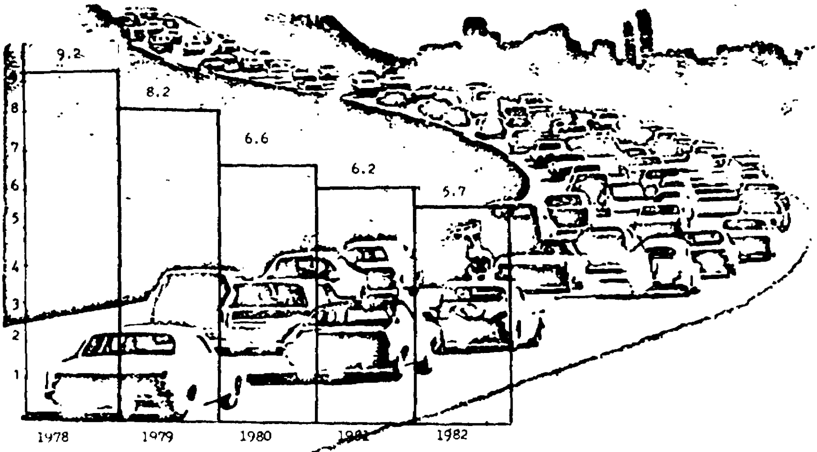
IV. AUTO PRODUCTION NOSEDIVES

American auto production declined drastically in 1982, down 16 percent from 1981 and 41 percent below the 1978 production level. A slight improvement in production in mid-1982 was reversed by a 19 percent production decline in the last three months of the year.

New car sales picked up at the end of 1982 with auto companies giving special sales promotions with lower interest rates. The improved sales reduced bloated inventories but were not high enough to raise production. Only 5.7 million American cars were sold in 1982, 8 percent less than were sold in 1981 and 38 percent less than the 9.2 million cars sold in 1978.

Sales of imported cars accounted for 28 percent of the domestic market in 1982, up from 27 percent in 1981, but sales of imported cars were also down, falling 4 percent in 1982.

New Domestic Car Sales
1978 - 1982
(Millions of Units)



Source: Department of Commerce, Bureau of Economic Analysis

XVI. FOREIGN TRADE DEFICITS MOUNT

In 1982 the overall U.S. merchandise trade balance suffered a record $47.8 billion deficit,* in spite of a recession-induced $16.8 billion decline in oil imports. The Reagan Administration projects a trade deficit for 1983 in the range of $60-70 billion. The very large size of deficits in recent years basically reflects the inability of the U.S. to pay for high-priced oil imports and rising imports of manufactures with exports of manufactured goods and farm products.

Food exports fell by 40 percent in 1982, a decline of $6.3 billion, while food imports declined by less than one billion dollars, cutting the food trade surplus to $7.6 billion.

There has been a sharp turnaround in manufacturing trade. Despite the recession in the United States manufactured imports continued their upward climb in 1982, increasing by $1.3 billion, while exports fell off sharply, dropping $14.6 billion, a decline of over 9 percent. Whereas the U.S. usually runs a dollar surplus in manufacturing trade -- in 1982, there was a record deficit of $10.6 billion, a huge swing from the $5.3 billion surplus in 1981.

The Reagan Administration has done little if anything to halt this erosion of the U.S. trade position. The worldwide economic downturn has reduced the foreign demand for U.S. goods. Depressed industrialized nations have cut back on imports and debt-burdened developing countries have been forced (by their lenders) to sharply reduce imports. Both types of countries have also sought to step up their exports to the U.S. in order to bolster their own faltering economies. The Reagan Administration refuses to develop a realistic policy in response to these developments. Unfair trade practices in foreign countries, both in subsidizing exports and in unduly restricting importation of U.S. goods, have further weakened domestic industries, intensifying the decline of basic manufacturing industries and clouding the outlook for recovery. For example, imports of Japanese integrated circuits doubled during the first nine months of 1982, compared to the comparable period a year earlier, causing the U.S. trade deficit in integrated circuits with Japan to jump sevenfold.

The Administration and the Federal Reserve's tight monetary policy has directly weakened the country's trade position. Reagan's and Volcker's tight money policy has kept interest rates high. This helped to increase the value of the U.S. dollar by 30 percent since January 1981, in relation to the currencies of our major trading partners. An increase in the value of the U.S. dollar makes our exports more expensive abroad and foreign imports into the U.S. cheaper.

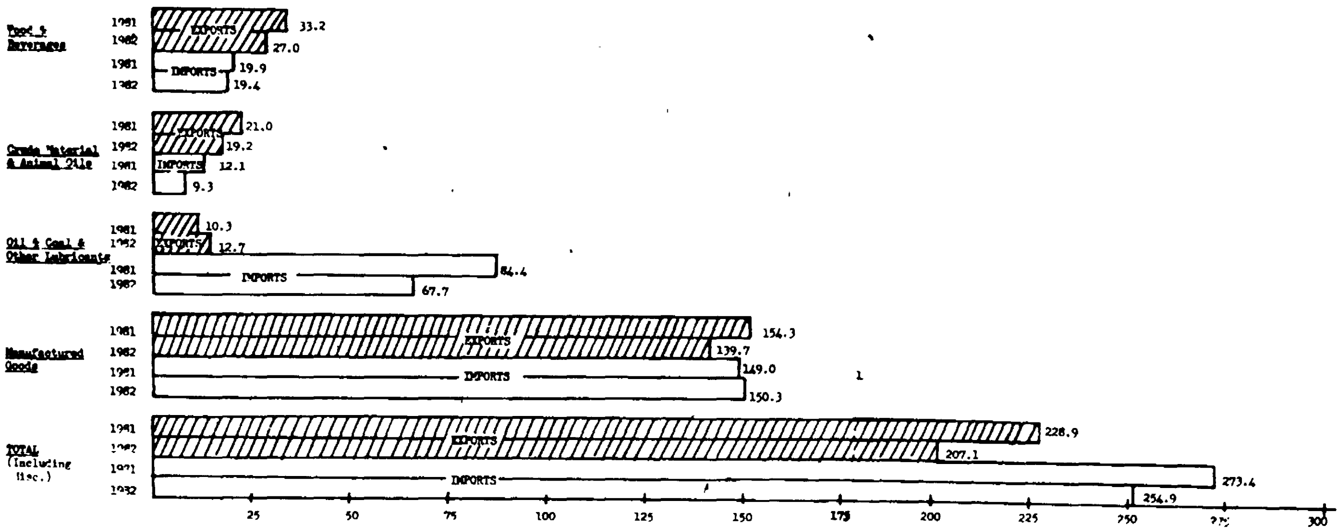
These factors -- worldwide economic decline, debt-burdened developing countries, foreign trade barriers and unfair practices, and a severely restrictive monetary policy -- have particularly weakened trade in manufactured goods. Exports have fallen off in the industries which were America's pride and source of industrial strength. These include such capital equipment industries as industrial machinery, computers and communications equipment, autos, and aerospace. The U.S. trade surplus in capital equipment fell by more than 50 percent in 1982, a drop of $12.1 billion. Exports declined while imports increased in most of these industries.

There is a clear relationship between growth in imports and job displacement in many industries. For example, electrical machinery imports increased by about 50 percent in value, while production employment dropped by 16 percent from 1979 to December 1982. Automobile imports increased in value by 31 percent while production employment fell by 36 percent. For apparel, imports have increased by 38 percent and employment has fallen by 16 percent. Despite shrinking domestic demand, iron and steel imports have increased by more than a quarter while production employment has fallen by nearly half. In footwear, imports have increased 20 percent since 1979, and employment has declined by 18 percent. Even in a "high tech" sector like electronic instruments, U.S. production employment has been falling since 1979, by 7 percent, while imports have increased 44 percent in value.

Trade related job losses have been spreading rapidly beyond manufacturing into service industries. "Services" is a catchall term that includes many different industries and financial flows. Imports of services have cost jobs in construction, theatrical jobs, computer service work, and shipping employment. Industries are interrelated in the economy. For every manufacturing plant there is a set of service jobs, and each affects the other.

The American balance of payments (current account) on combined trade in goods and services was in deficit by about $6 billion in 1982.

Balance of Trade
(Billions of Dollars)
Cumulative Comparison of 1981 with 1982



Note: Exports do not include reexports of imported goods.
Source: U.S. Department of Commerce, Bureau of the Census

Senator PROXMIRE. Thank you very much, Mr. Oswald.
Mr. Thurow.

STATEMENT OF LESTER C. THUROW, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. THUROW. The 1983 Economic Report of the President is based upon a slow growth strategy that cannot work even if the economy were to perform as the administration forecasts in 1983. Just as you must change inflationary expectations to stop inflation so must you change growth expectations to start any sustained period of economic growth. Given a 4-year history of no growth and a worldwide economic shutdown, a couple years of very rapid growth are necessary at the beginning of a recovery to turn growth expectations around. Businesses must be persuaded that if they start to build new factories and hire people now, they will be needed when the new facilities are brought on line a year or two from now despite the current level of idle capacity. With the 3- to 4-percent growth rate projected by the Reagan administration, we would need 10 years merely to digest the idle capital capacity that already exists. And as their own forecasts show, unemployment will remain very high for the rest of the decade.

America had six recessions between World War II and the current depression. They averaged only 11 months in duration and the longest was 16 months. In each and every case the recovery was rapid—averaging a 7.3 percent GNP growth rate after correcting for inflation in the 12 months following the bottom of the recession. A couple of years of growth at least this rapid are needed to turn this recession around. If we don't have such a period of vigorous growth, 1983 will prove to be like so many of the periods that we have had since the first quarter of 1979—a few quarters of positive growth followed by a few quarters of negative growth.

We also know how to get a vigorous recovery. Those previous recoveries did not happen by accident. Whenever Government spotted a recession, it rushed to the rescue with lower interest rates, fiscal stimulus, jobs programs, and extended unemployment insurance benefits. This time Government has done none of those things quickly enough or vigorously enough and with its inaction has turned what could have been a normal recession into a worldwide economic disaster.

Consider monetary policies. In the year in which the economy hit bottom in previous recessions the real interest rate for Federal funds was negative—minus 0.6 percent. In the last week of January the Federal funds rate was 8.44 percent. Given a 3-percent inflation rate, the real Federal funds rate is about 5.5 percent. If an investor can get such a real rate of return on riskless overnight lending, he is certainly going to get more on risky long-term lending. But with such real interest rates, no sustained vigorous economic recovery is possible.

Yet everyone admits—even the monetarists—that short-term interest rates are under the control of the Federal Reserve Board. The economy is not dying on inevitable natural death—it is being murdered by its monetary policies.

Real interest rates are high and will remain high as long as the Federal Reserve Board remains attached to monetarism—for the economic theories of the monetarists have just failed. Monetarists of the Reagan brand initially told us that they could stop inflation without even a slowdown in the economy. The President now says that, "the unemployment that many of our citizens are experiencing is a consequence of the disinflation that must necessarily follow the accelerating inflation of the last decade." The Council of Economic Advisers talks about the "adverse short-run effect of a slowdown in nominal GNP" due to a slow rate of growth of the money supply. But our economy is now below where it was in the first quarter of 1979, the year in which we adopted monetarism, and has had no sustained economic growth since then. One is justified in asking just how long is the short run—a decade, two decades?

Monetarists of all stripes have also always maintained that real interest rates were invariant to the rate of growth of the money supply. According to the "Fisher" equations real interest rates should be constant regardless of how fast or slow the money supply is growing. Yet, recent experience has just proved the "Fisher" equations wrong. A slow rate of growth of the money supply leads to very high interest rates.

The monetarists tell us that monetarism failed because it wasn't really tried. There was too much shortrun variance in month-to-month money supplies due to "bureaucratic lethargy" at the Federal Reserve Board. As an explanation for failure, this just isn't credible. If there has been too much variance in the shortrun rate of growth of money supplies, it isn't for lack of effort at the Federal Reserve Board. The demand for money is simply shifting so rapidly that the Fed cannot control the money supply in the way that the monetarists now—let me emphasize the word "now," since no monetarist talked about the importance of shortrun variance until recently—say is necessary. Too much shortrun variance can be used as an explanation for high long-term interest rates—seeing the short-term variance and not the long-term trend, the public is confused about the policies of the Fed and expects inflation to rise in the future—but it cannot be used as an explanation for high short-term real interest rates. Future inflationary expectations play no role whatsoever in overnight loans. As a consequence, monetarists are without an explanation for high short-term real interest rates.

When economic theories fail to deliver what they promise, it is time to junk them and move on to other alternatives. The right alternative is for the Federal Reserve Board to target real short-term interest rates such as the Federal funds rate. The Economic Report of the President argues against real interest rate targets but none of their arguments are convincing.

While it is true that the same real interest rates can be produced by many different combinations of money rates and rates of inflation, investors and savers respond to real rates of interest. Higher real rates of interest will lower aggregate demand and dampen inflation to the extent that inflation is in fact caused by too much aggregate demand. While it is true that no one knows what the future rate of inflation will be, that is irrelevant if the Fed is targeting real short-term rates of inflation. We know today's inflation rate even if we do not know tomorrow's inflation rate. While it is true that different individuals fall into different tax brackets, we know the average tax bracket of the average saver or investor. Real interest rates can be adjusted for average tax effects and that is all that is necessary. While it is true that no one knows for sure what real interest rate would lead to noninflationary growth, the observation is equally true with respect to the rate of growth of the money supply. Interest rate targets have an advantage, however, in that investors and savers think in terms of interest rates and not rates of growth of the money supply and they can give analysts an indication of how they would change their plans as real interest rates vary.

The Reagan economic strategy is also flawed in that it ignores the economic blows that are going to be coming from abroad. America, if the forecast is right, is to have an economic recovery while the rest of the world is economically sinking. This is unlikely to happen. With falling GNP's in the rest of the world and an overvalued dollar in 1982, America is apt to have happen to it in 1983 what happened to the French in 1982. The French stimulated their economy to engineer a recovery. They half succeeded—consumption went up to 4 percent—but they were then inundated with imports from the sinking economies around them. As a result French production went up only 1 percent. Suppose that you are in one of the Third World countries that is going broke. Given your need for foreign exchanges you are going to be willing to sell in the American market even if American prices do not cover local production costs.

The French fate lies ahead for us unless we have a real program of coordinated reflation by the major economies of the world. Yet, in this economic report there is no reflection of any need for coordinated policies among the world's major economies. America is no longer big enough relative to the rest of the world and economically isolated enough to pull itself out of the economic quicksands. The rest of the world is much more apt to pull us back into economic stagnation.

Technically speaking, this recession will end. We will have some quarters of positive economic growth. It should be remembered, however, that in the 4 years since the first quarter of 1979 we have had several periods, as long as 9 months, of positive economic growth. But we have had no period of growth sustained enough or vigorous enough to provide the acceleration necessary to restore economic prosperity.

Given the current economic strategy of the Reagan administration, 1983 is apt to be more of the same—a modest but weak recovery followed by economic decline.

Thank you, Senator.

Senator PROXMIRE. Thank you very much, Mr. Thurow.

Well, those are two very fine statements and there are areas where I'm sure we would find disagreement.

Let me just start off with Mr. Oswald because I think disagreement can often bring out greater strength in your statement.

Have you worked out a budget to show what kind of expenditures and what kind of revenues we would have if all your recommendations were put into effect, roughly?

Mr. OSWALD. Roughly, what would happen is an increase in the current deficit of about $210 billion by another $10 to $15 billion as a result of the additional $22 billion expansion in this fiscal year. In fiscal year 1984, the budget deficit would be about again $20 billion higher, but for fiscal 1985 and 1986 the budget deficit would start coming down by some $10 billion less approximately than the administration forecasts and by maybe as much as $30 billion in 1986, $30 to $50 billion, both by growth and by the higher tax revenues.

Senator PROXMIRE. How much would you increase expenditures for 1984?

Mr. OSWALD. The direct outlays that we are asking for is some $46 billion. We would think that there would be cuts in the defense spending budget and the executive council of the AFL-CIO will be looking at that issue in its meeting next week and I think will have a specific recommendation and that there would be some offsetting elements that I think need to be done in terms of the specific cuts that the President is asking for even in the nearly $23 billion in social programs. We think those can be offset by additional revenues and that you would get more growth by putting the people back to work and paying taxes.

Senator PROXMIRE. So, you would have about a $46-billion increase in expenditures in 1984?

Mr. OSWALD. Yes.

Senator PROXMIRE. And you would have increased revenues of maybe $20 to $30 billion?

Mr. OSWALD. Directly in 1984, yes.

Senator PROXMIRE. Now, what effect would that have on unemployment in your estimate in 1984, 1985, and 1986?

Mr. OSWALD. We think that in 1984 the decline in unemployment would be about 1.8 million, so instead of the nearly 10-percent unemployment level that's projected, it would be approximately 8 percent; and in 1985-86 those differences would widen in terms of the differences between projected unemployment and actual unemployment.

Senator PROXMIRE. Do you estimate any change in either the level of interest rates or inflation in this period?

Mr. OSWALD. We indicate that there would be no change in inflation. The roughly 5-percent rate of inflation we think is already relatively high considering the amount of slack that's in the economy and seeing no pressures for any inflationary buildup by reductions in unemployment. Interest rates we think would also not be affected, there again depending upon the policies of the Federal Reserve Board. We believe that the Federal Reserve Board needs to target interest rates and bring them down substantially from where they are.

Senator PROXMIRE. Mr. Thurow, you have an interesting expression of the real interest rate when you say, "Given a 3 percent inflation rate"—well, it's true that you can find figures that show a 3 percent rate if you look hard enough on a short-term basis, but do you really argue that investors are going to look at the level of inflation that we had in the last 6 months, for instance, of 1982, which was based of course on an almost unprecedented drop in commodity prices, oil prices and so forth, and invest on the basis of that; or are they going to look at inflation on the basis of projecting it over the next 6 months and recognize it's likely to be more than 3 percent?

Mr. THUROW. We're talking about investors that are making 12-hour loans and the only thing that is relevant in a 12-hour loan is what the inflation rate is today.

Senator PROXMIRE. You can put it on a 6-month basis or whatever, but——

Mr. THUROW. But the only thing that matters is the inflation rate today.

Senator PROXMIRE. You know that the liquidity isn't that rigid.

Mr. THUROW. The only thing that's relevant is can the Fed and the investors figure out what the real rate of interest is on that 12-hour loan, and you only have to know today's rate of inflation. To figure that out whether that's the best investment or some other investment is better, then clearly you have to think about rates of inflation in the future. But if you're really asking what is the real interest rate, today's inflation rate is what determines it.

Senator PROXMIRE. That's not the option for corporate treasuries and that's not an option open to other investors. They are not going to look at just what the short-term money is yielding.

Mr. THUROW. What I'm arguing is that the Federal Reserve Board should look at real short-term interest rates, 12-hour rates, and that's what the appropriate target should be. Now, the Economic Report of the President gives four arguments as to why that's not the appropriate target and I think I systematically rebut all four of them.

Senator PROXMIRE. Your very interesting analysis of why it's important for us to do our best to help the rest of the world economy, that we don't live in an isolated world, that our recovery depends upon the recovery internationally—I think that's exactly right. Then you point to the French experience and point out they went down because of the imports and so forth, and I think that's a good analysis.

On the other hand, wouldn't that apply to us no matter what we do? Is there any way this country, with all our great influence and power, would be able to make that much difference in the international recovery if we do vote, as we probably will, to help the IMF and the World Bank and take any other steps?

Mr. THUROW. The Germans and the French and the Japanese asked the Reagan administration for a coordinated program of forcing down interest rates and reducing the fluctuations in international currencies and we said no. If that program had been put in place last June, obviously we would be better off in 1983 than we're going to be. You can't say that it's impossible to do some coordination since the rest of the world has been asking for it.

Senator PROXMIRE. I'm not saying that at all. You may be absolutely right. I'm just saying we have a real situation now on February 14, 1983, and on the basis of what is realistically available to us to do, are we going to be able to have such an effect on the world economy that we won't also suffer the problems that the French suffered if we stimulate our economy too much?

Mr. THUROW. At the moment we in the United States are collectively talking ourselves into the idea that this recovery is going to be bigger and more vigorous than we thought even a few weeks ago. In order to do that, I think you have to systematically be blind as to what's going on in the rest of the world. It's just impossible to get a really vigorous recovery going in the United States while you've got the Third World declining in GNP and Europe declining in GNP and Japan declining in GNP throughout 1983. In that kind of a context, I think you are not going to get a big boom going.

Senator PROXMIRE. Mr. Oswald, table 6–10 on page 144 of the Economic Report projects 4-percent annual growth in real GNP between 1984 and 1988, about 1.7-percent annual growth in productivity, and a decline in unemployment of about 0.9 percent a year. Are these three figures consistent or is the administration projecting too large a decline in unemployment? I'm asking on the basis of what they should do but on the basis of what they propose.

Mr. OSWALD. They are about correct. At about a 3-percent growth one just about takes care of the growth in the labor force of about 1.5 million over the same period and the projected effects of productivity.

Part of the problem is that productivity may be much more rapid as we come out of this recession than typically, in which case the 4-percent growth wouldn't even bring about that 0.9 percent decline in unemployment. And if that happens, as many are projecting, unemployment would remain even higher than this very dismal projection.

Senator PROXMIRE. I don't want to be too technical and picky on this, but I notice that there is a difference of opinion between some people who argue that every 1 percent decline in unemployment means a $25 billion reduction in the deficit and those that say $30 billion. It makes quite a difference over a period of time.

You use the $30 billion figure. I notice the Congressional Budget Office uses a $25 billion figure. That's the figure that's been used. Did you have any documentation or any studies that would support the $30 billion figure?

Mr. OSWALD. At one time the CBO had also been using a $30 billion figure with some $25 to $27 billion in foregone tax loss and about $3 to $4 billion in additional expenditures for unemployment compensation and other programs.

To the extent that the data is available, we had checked the CBO work and thought that the $30 billion was a more accurate figure than the more recent $25 billion.

Senator PROXMIRE. Thank you very much. My time is up. I'll be back. Representative Holt.

Representative HOLT. Thank you, Senator Proxmire.

Thank you, gentlemen, and I apologize for missing your statements. I've tried to read them carefully and I will do it more thoroughly.

Mr. Oswald, you say that this $46 billion in 1984 can bring unemployment down to 8 percent. Historically, have we ever been able to bring any kind of jobs production on line that fast? I talked with Mr. Shultz last week about his experience and he is really regretting some of the things that they did in that administration in trying to stimulate jobs through increased Federal spending. He felt that that fired inflation and did not bring the jobs on line as quickly as they had hoped they would. In other words, they didn't produce the jobs until the recession was over.

Mr. OSWALD. I don't think that's accurate, and here we clearly don't have that problem because it shows unemployment will remain above 8 percent until 1986. At the time that public service employment was being expanded rapidly, new jobs were being started and put into effect by nearly 40,000 a week. In the accelerated public works program that was passed in 1976, the jobs essentially started 90 days after passage of the act. There have been some recent studies by OMB that says the money wasn't paid out until 2 years later, but the money was paid out long after the jobs were finished. Jobs started under lines of credit that were put out by the banks who were performing that work and a study by EDA stated that most of, or some 85 percent of the jobs, were started within 90 days.

Representative HOLT. But didn't unemployment continue to increase during that period?

Mr. OSWALD. No, it came down substantially.

Representative HOLT. How much did it come down?

Mr. OSWALD. From 8.5 percent which was the peak in 1975 to 7.7 percent in 1976 and 7.1 percent in 1977, but we had a better experience in 1961 with the new jobs programs that were put into effect there. For the first time we had an area redevelopment program and we had job training programs. Unemployment dropped from 6.7 percent in 1961 to 5.5 percent in 1962, a full 1.2 percentage points in that 1-year period.

Representative HOLT. Well, I don't have my charts here, but I find that—it's difficult to explain it. I think that the recession was over before the jobs actually came on line.

Let me ask you another question.

Mr. OSWALD. My background statement here, this newspaper, does have facts in it from the official report of the Economic Development Administration which administered the accelerated program. As you recall, the program was for very small projects all of which had been designed and were able to be started within 90 days.

Representative HOLT. Yes, that's the problem now.

Mr. OSWALD. The act that Congress passed was for $2 billion on the public works program. Some new projects were immediately proposed, all of which had engineering finished for those projects.

Representative HOLT. But that's the problem today, isn't it, being able to bring those jobs on line very quickly?

Mr. OSWALD. But we have a problem where the projection for unemployment for the next 3 years is higher than any period except for the 1975 depth of that recession.

Representative HOLT. I understand that and I know that's our greatest concern and that's why I'm struggling to find ways of doing it. But historically I have never seen this great surge of money to produce public service jobs—I've never seen it work to my satisfaction.

Let me ask you another question. The venture capital industry testified before this committee that the large reductions in the capital gains tax provided the stimulus behind the current boom and yet you testified or I read in your prepared statement that the capital gains tax reductions ought to be taken back.

Wouldn't your proposal severely hamper job creation by reducing capital flows? I'm very interested in seeing us produce real jobs in the private sector.

Mr. OSWALD. The only gains that I have seen is a big upturn in corporate merger activity. We don't think that provides any new jobs. There has not been an increase in the number of jobs. As a matter of fact, there's been a big decline in the last 2 years. If anything, that should put a lie to the notion that it's this sort of tax change that provides new investment. We find substantial declines in real investment in 1982 and 1983 and, as you recall, the cutbacks in both capital gains and depreciation were made retroactive—one for January of 1981 and the other one for June of 1981—and all the projections, even for real investment in 1983, are further declines. So it has not provided the sort of stimulus we want.

Representative HOLT. Don't you have to start with the venture capital down the road to produce the jobs?

Mr. OSWALD. But they are not going to invest unless people have the money to buy things and unless we put people back to work there won't be the hope of people having the money to buy goods and services. People aren't going to invest if they have no hope for a market, and that hope for a market will only come if people are at work.

Representative HOLT. Well, I certainly disagree with that. I think that we have to start developing new industry. We have to go from the old industry, the manufacturing, to the high technology which everybody seems to recognize, so we've got to start up new businesses and I think that's where the venture capital serves is to start these new businesses and not the mergers.

Mr. OSWALD. We would be happy if you restricted capital flows against mergers and such items and therefore we asked for the extension of the Credit Control Act of 1969. We think then the Federal Reserve would do that and we think that the Fed should be directed to channel capital to new investment and not just for mergers and for speculation.

Representative HOLT. What is labor doing to attempt to help relocate people? This seems to me to be the biggest concern we have today is getting people—I know it's tough to get a 55- or 60-year-old person who's worked in a steel mill all his life to move into high technology, but what is labor doing to try to train the young guy that could move on out of the automobile industry or a place where I feel they will never be able to provide the number of jobs that they have in the past?

Mr. OSWALD. First of all, I think we should understand that high technology is not an answer to the 12-million jobless that are there today. At the most, people estimate that there are only 3-million high technology jobs in America today and we don't foresee that number to grow by anywhere near the millions that we're talking about in terms of 12-million unemployed people.

But in terms of specific programs, the auto workers, in their recent contract with Ford had negotiated a special new free training program to try and help auto workers obtain new skills in terms of the dislocations that they face.

Representative HOLT. Ford will provide that?

Mr. OSWALD. Under the contract with the UAW, there are joint new training facilities and new training activities.

Representative HOLT. Is that for jobs that are available at Ford?

Mr. OSWALD. No, for jobs in general in the community and to the extent that they are available at Ford itself. Similar attempts have been made in other contracts but they are far from sufficient, and I think the big problem is that, unless we have more net new jobs, retraining isn't an answer.

Representative HOLT. Mr. Thurow, you criticize the monetary policy that has been practiced over the past several years. What policy would you have implemented to bring down the inflation rate if you had been king of the world?

Mr. THUROW. The Fed policy from 1913 to 1979 was to control money rates of interest. I think the Fed made a very serious mistake back in 1977 and 1978 when they let the real rate of interest go negative although we were not in a recession at that time. That was one of the things, along with oil shocks and other supply shocks, that got us into the high inflation rates of the late 1970's and early 1980's.

The way to correct that is to have the Federal Reserve Board watch real interest rates. It is important to understand that what the monetarists have told us has just been proven wrong in the last 2 years. Two fundamental things that they said couldn't occur have occurred. They said real interest rates couldn't go up and they said any recession would be short, brief, and mild. But nobody would describe this one as short, brief, and mild.

If you look for the explanation the monetarists give for their failure, they said the Fed is just too lazy to do it right. That just isn't a credible explanation. If a theory fails, you've got to do something different.

In terms of stopping inflation, I don't believe the Fed can do it by itself. If we get something like the 1979 oil shock where you double the price of energy, you're going to have inflation in the American economy no matter how well run the U.S. Federal Reserve Board is or how well run the Congress is. It's a matter of simple arithmetic. In 1979, the price of oil doubled. Ten percent of the Consumer Price Index is energy, directly and indirectly. So energy by itself would produce 10 percentage points of inflation when energy doubles. If you want a zero inflationary world, that means the other 90 percent of the Consumer Price Index has to go down to offset the energy increase. You can work out the algebra. It has to go down by 11 percent. That means every American that doesn't work in an energy industry has to take an 11-percent cut in their salary in 1979, including Senators and Congressmen, in order to have a noninflationary world; and the problem is that the rest of us just aren't willing to live up to that algebra. You and I won't take an 11-percent cut in our salary.

Representative HOLT. Doesn't it take a combination of all of the above? I mean, you can't just say, well, we're going to let the rest of it go.

Mr. THUROW. The Fed can lean against the wind and the right way to lean against the wind back in 1979 would have been to let real interest gates go up. But once you see the inflation rate falling, as it has, and once you see the great depression No. 2 underway, then a smart Federal Reserve could vigorously get in there to lower real interest rates.

Representative HOLT. What is the real rate of interest that you would target?

Mr. THUROW. Real Federal funds.

Representative HOLT. That determines the real rate?

Mr. THUROW. The Fed should focus on real Federal funds—overnight loans. You take the money rate and subtract the current rate of inflation and that is what the Fed should target.

Representative HOLT. The expectation of inflation does not enter into it at all?

Mr. THUROW. You have to use some judgment. If you think there are a lot of inflationary expectations out there, you may let that real rate go up, but you don't stick to any simple monetary target the way we are at the moment.

Representative HOLT. Inflation is down. Interest rates are down.

Mr. THUROW. Real interest rates are still very high.

Representative HOLT. Well, I know they're still very high, but they are—the prime rate is not 21.5 percent now.

Mr. THUROW. The real prime is just as high as it ever was. It hasn't come down at all.

Representative HOLT. Well, you do say, though, that the expectation of inflation should be a factor.

Mr. THUROW. Absolutely. If you want to get inflation out of the economy, you've got to take those things into account.

Senator PROXMIRE. Mr. Oswald, how do you meet the argument that whatever historical experience you have—and you gave a good response I thought to Congresswoman Holt—we have an entirely different ball game now because the deficits are so colossal—if we have a jobs program under present circumstances, we'll be taking borrowing or taxing money out of the private sector and therefore there won't be any net increase in jobs.

For example, in the first 3 months of this fiscal year, October, November, December, we had a deficit of $68.3 billion in 3 months, bigger than any deficit in the history of this country on an annual basis, in only 3 months, and the projection is that we will have a bigger than $200 billion deficit in 1983 and almost the same in 1984.

Under those circumstances, unless you look entirely to monetary policy which maybe we should, unless you look entirely to monetary policy, don't you feel that if we go ahead with a jobs program that we will be simply transferring jobs in effect from the private sector to the public sector and spinning our wheels?

Mr. OSWALD. I would be worried about that if there were jobs in the private sector, but there aren't any jobs in the private sector. The problem isn't as much the shortrun deficit. The problem is the longrun deficit. Under our proposal there's a substantial reduction in the longrun deficit much faster. In the shortrun——

Senator PROXMIRE. Let me just interrupt to say that there are jobs in the private sector, not enough by any means, but we have a higher percentage of people who are employed in relationship to the adult population than in periods where we have had 3 or 4 percent unemployment. We have a terrific increase in the work force and it's true there are not enough jobs—we'd like to have more, but we do have almost 100 million jobs.

Mr. OSWALD. But almost 3.5 million less than we did in July 1981 when this recession started.

Senator PROXMIRE. Absolutely, but it is certainly possible if we proceed with a big jobs program we may not make any progress in the private sector. Both you and I would like to see a big increase in jobs in the long run. Those are much better jobs.

Mr. OSWALD. Yes, but I think the fear is just the opposite. Unless we put people back to work, those people will have no hope of jobs in the private sector for years and years and years.

Senator PROXMIRE. I agree, but doesn't that beg the question? Isn't it possible we're not putting people back to work but actually simply transferring the jobs? Let me spell out what I mean.

If you have a situation where you borrow billions of dollars more for a jobs program and the Federal Reserve Board follows the same policy that it intends to follow, that it has followed, doesn't that mean that there will be less credit available for people to borrow money to buy homes, to borrow money to buy cars, business to borrow money to buy equipment, farmers to borrow money to buy tractors, and therefore people won't be building tractors, homes, and cars. Instead, they'll be doing work paid for by the Federal Government.

Mr. OSWALD. I would turn the issue around the other way, Senator, at this particular time. None of the statistics indicate that there is the buying power by those Americans to buy those cars and things. In fact, there is the projection that investment in real terms by corporations will be less in 1983 than it was even in 1982 or 1981, far below that in the late 1970's.

Senator PROXMIRE. Have you looked at the real income figures. In December, in the pit—we hope the pit of the recession—maybe it's not—in December, real income was very close to the highest level it's ever been in our entire history on a per capita basis. So what we need is credit. If people have the credit available, they've got the income.

Mr. OSWALD. No. The income is very badly distributed.

Senator PROXMIRE. Well, I agree with that.

Mr. OSWALD. All the income gains essentially in the past year have been among interest recipients. We have had a big drop in real wage and salary income and among wage and salary earners their real wages have not kept pace with the inflation. Les Thurow indicated earlier the problems of the big inflation with everybody needing to take a wage cut. Workers did take real wage cuts, not all in 1979, but 1979, 1980, 1981, and 1982 and cumulatively wages, except for the very end of 1982, have failed to keep up with the rate of inflation, and the result has been substantial declines in real wages. But I think unless we put that money in terms of additional borrowing—and we have had larger borrowings in wartime and in other periods—and employ people, it's not a problem in the short run that we're going to squeeze the market from not having enough liquidity.

The question is, do you have a program that provides enough rope in the long run to substantially reduce those deficits and do you have a tax program not in terms of the one the President sets forth as some sort of a contingency plan for 1986 but one that really does begin to provide revenues in an equitable way in the outyears, and I think that's what our program would provide.

Senator PROXMIRE. Mr. Oswald, you and I look at things somewhat differently. You're 100 percent right that real hourly wages have declined and they have declined steadily and year after year. Real weekly earnings have not declined as much but they have declined too because the hours are shorter. You have a different kind of situation there.

But when you look at the overall income, somehow it's not the farmers who are getting it, heaven knows they're in bad shape—small business isn't doing very well—but real per capita income was higher in December 1982 than it had been in any other month—there may have been one or two——

Mr. OSWALD. Because of big increases in interest payments to individuals.

Senator PROXMIRE. Well, maybe. That's certainly a big part of it, that's right; but nevertheless, there does seem to me to be the basis for a substantial recovery in homebuilding and so forth if we can get interest rates down.

Mr. OSWALD. Interest rates should be brought down, particularly for homebuilding. It is still at historically high levels.

Senator PROXMIRE. That's really hard because—of course, Mr. Thurow can have all kinds of fun playing with those 12-hour rates, but when you're talking about the 30-year mortgage rate, then expectations play a very important part.

Mr. THUROW. It's going to to be more than 6 percent on 12-hour loans.

Senator PROXMIRE. There we go again. That's right. There's a relationship.

Mr. THUROW. That's right.

Senator PROXMIRE. The reason why you can't say take your real interest rate based on the inflation rate in the last month or last 2 or 3 months is because your capital moves around.

Mr. THUROW. But that 12-hour loan sets a minimum. It can't be below that level. So if you set the minimum at 6 percent, that is very different than setting the minimum at minus 0.6 percent, which is where we set it in previous recessions.

Senator PROXMIRE. Now, fellows, I'd like to see you do a little fighting if you will. Let me just ask you.

Mr. Thurow, do you agree with the program that Mr. Oswald has put forth? Do you think that's sound? If you were a Member of Congress, would you support that program?

Mr. THUROW. I think we need a jobs program for two reasons.

Senator PROXMIRE. As big a program as he proposed? President Reagan agrees we need something.

Mr. THUROW. Well, I'm not sure he really does.

Senator PROXMIRE. He says he wants to speed up the things we would do anyway 2 or 3 years from now.

Mr. THUROW. You need a very substantial jobs program for two reasons. One, high unemployment, even with the best of economic conditions, is going to be here for a very, very long time. I think it's right that in the past oftentimes jobs programs got started so slowly that they hit their peak after the recession was over. This time this just is not going to happen.

Second, I think you have to deliver a message to the public that you care, that when unemployment hits you're going to do something to ameliorate the situation. The impression in Detroit, Cleveland, or Milwaukee is that they can go to pieces and people in Washington don't care.

Senator PROXMIRE. Along that line, I noticed a quote in the Washington Post by Les Aspin. Les Aspin used to work on my staff. He has a Ph. D. from MIT in economics. He's a Rhodes Scholar. He's a brilliant man and he said that there's not much we can do with a jobs program except to show our heart is in the right place. How about that? Do you agree with that?

Mr. OSWALD. I think having the heart in the right place is important. I think you can show you're not going to cure a 12 million unemployment problem with a jobs program. That we all agree on because the size of that program would be too great. The size of the jobs program comes back to the question of monetary and fiscal problems. The initial problem with Reaganomics is that he stepped on the monetary brake while stepping on the fiscal accelerator. The fiscal side is going to be offset because you've got one foot planted firmly on the brake and one on the accelerator and the economy isn't going to go. If you say I must take monetary policies as an absolute restraint that I cannot touch, then I think you're right; the jobs program is not going to create on a net basis many new jobs. If you say we're going to have coordinated policies within the United States, both fiscal and monetary, then I think you could get some net new jobs.

Senator PROXMIRE. What's been the increase in the money supply, M_1 and M_2?

Mr. THUROW. In the last 3 months it's been very high because the Fed got scared and backed off on monetarism.

Senator PROXMIRE. Either they get on target with their targets or—the fact is that in the last 3 months there was a 15-percent increase annual rate in M_1 and about 30-percent increase in M_2.

Mr. THUROW. Yes. You can make the argument that the Federal Reserve Board has abandoned monetarism. I think the real problem the Fed faces is——

Senator PROXMIRE. What has it done?

Mr. THUROW. Monetary interest came down.

Senator PROXMIRE. You have just been making a small case that the real rate is very high anyway.

Mr. THUROW. The real rate is very high.

Senator PROXMIRE. In spite of the——

Mr. THUROW. The Federal Reserve should announce we are no longer paying any attention to money supplies; we are focusing in on interest rates. What have they tried to do for the last 3 months? They've blamed it on all the new money market instruments and said, "We haven't abandoned monetarism but we can't practice it with all these new funds—M_1 and M_2 are all fouled up." Have they really abandoned monetarism or is this——

Senator PROXMIRE. How about all the people who say—they don't criticize but they follow the kind of program you describe, the Thurow policy, that the inflation fears will be such there is a feeling that they are monetizing this enormous deficit, that interest rates will go up because the anticipation is that we are just on the road to a terrific inflation.

Mr. THUROW. I don't think that's true with all the idle capacity we've got. You get inflation out of real things. You don't get inflation out of psychology. Psychology can make it worse, but at the moment we have falling energy prices, falling farm prices, over a third of our capacity is idle and something like 17 to 20 million workers are idle, depending on how you count it. In that kind of world——

Senator PROXMIRE. You think you can continue with a 30-percent increase in M_2 for 1 year or so?

Mr. THUROW. I would announce that I'm not paying any attention to money supplies because as long as the Fed pretends it's paying attention to money supplies I think it's in trouble.

Senator PROXMIRE. Of course, if you do that, they haven't been doing as well as you would like them to do in getting interest rates down. If they do that, they might have to increase the money supply a lot more. You might not pay attention to it if you were Chairman of the Federal Reserve, but you know a lot of people in the investment community do.

Mr. THUROW. I think a lot of people in the investment community also pay attention to real interest rates and that's what I see out there in the real investment community. We're worrying about corporations investing. If you think about a housing boom, I find it very hard to think we're in a housing boom when we have a 13- or 14-percent mortgage rate and everybody says it's now at the minimum.

Senator PROXMIRE. I take it from what you said about the present condition that there's little prospect that inflation will become a problem in the next few years in view of the fact we're operating at two-thirds industrial capacity and 12.5 million people actually out of work in January.

Mr. THUROW. Nobody can see a negative shock coming along. Projections are for energy prices to fall and for food prices to fall. In that kind of world, I don't think you can get inflation restarted by these 7.5 percent growth rates that we have traditionally had in recovery years.

Senator PROXMIRE. Mr. Oswald, the AFL-CIO has called for restrictions against imports that are reducing jobs opportunities for American workers. I happen to be a cosponsor of the content bill and so I'm not exactly asking this as one that's critical of it. What criteria would you use to select imports to be restricted?

Mr. OSWALD. Where serious injury has taken place, there is provision under the GATT rules for temporary relief to be provided where injury takes place under title 19 of the GATT rules.

Senator PROXMIRE. Is there anything we can do to protect the industries that are in exporting, that are so important to us, and provide a large proportion of our jobs, maybe 12 or 15 percent of the jobs, if our trading partners retaliate?

Mr. OSWALD. It would help if our monetary policy was better because clearly the overvalued dollar has a tremendous impact in terms of making our goods less competitive. Overall targeting of real interest rates I think would reduce the overvaluation of the dollar and would have a major effect.

Senator PROXMIRE. If we do that—I would agree with you on the overvaluation of the dollar, but none of that would be very encouraging to foreign countries. Wouldn't foreign countries, if we restrict imports, restrict our exports?

Mr. OSWALD. I don't think anybody is talking about restricting all imports. It's a question of when the large surge has a disastrous effect upon an industry and the problem of saying how do we allow that industry to adjust. When you have the sorts of swings in exchange rates that we have had in the past 2 years, it seems that the whole problem shouldn't fall just upon the workers. On a trade weighted basis our exchange rate has led to a dollar upward valuation of almost 30 percent in the last 2 years. It doesn't seem appropriate, nor can we, go into a plant and say, "Take a 30-percent wage cut because the policies that the Fed has undertaken has led essentially to this overvalued dollar and the only way that you can become competitive is now to take a wage cut." That's asinine.

What we need to do is make sure that we pursue both a better fiscal and monetary policy to bring that in line and to make sure the immediate impact isn't a disastrous result for the workers that are doing whatever they can to produce the goods and products that they have been hired to produce.

Senator PROXMIRE. As a matter of fact, with respect to the Japanese, I don't see how they could possibly retaliate in view of their balance of trade. Any retaliation is really cutting off their nose. They benefit far more as far as jobs in terms of trade.

Mr. Thurow, I understand you have some interesting ideas on what we can do about this problem.

Mr. THUROW. Yes, two things. The overvalued dollar is a big product of the monetary policy. Getting the dollar down would be tremendously important.

Second, I think you have to realize that we economists made a mistake back in 1971 when we went onto flexible exchange rates. The economists of the world assured the world that there wouldn't be major fluctuations in major currencies over short periods of time. That has proven to be false. We've had these 30, 40, and 50 percent swings between major currencies in 6 months. Recently the mark and the dollar changed 5 percent in 1 day's worth of trading. In that kind of a world nobody can invest.

Let's suppose you're going to build a farm machinery plant—a $1 billion investment. At 277 yen to $1 you would never build it in the United States. At 177 yen to $1 you would never build it in Japan, and if the exchange rate goes back between 277 and 177 you would never build it because wherever you build it will be in the wrong spot.

We need to go back and figure out some system—not fixed exchange rates—that mitigates the fluctuations.

In terms of the Japanese, I think the right way to handle that problem is what I call general reciprocity. You figure out what is the maximum deficit we could afford to have vis-a-vis Japan. We have a surplus vis-a-vis the Common Market, so surely we could afford deficits vis-a-vis the other parts of the world. It's simple arithmetic. We can afford an $8 billion deficit but we can't afford a $25 billion deficit. What we then tell the Japanese is that we will get rid of all of our specific restrictions on this product or that product, but we're going to have a rule that you can only export to us in any quarter $2 billion more than you imported in the previous quarter. If you imported $12 you can export $14. The ball is back in their court. We're not telling them how to control the price of rice or what to do about safety inspections, but if they can't find something to buy in the United States there's a limit as to what you can sell in the United States. That's a preferable way to go than to put quotas on this and that or informal agreements here and there. It's a general thing that gets you most of the benefits of free trade and still keeps the bilateral problems under control.

Senator PROXMIRE. That's a fascinating proposal. I dread to think of what would happen if that proposition were ever made in this country. Imagine the fights that would go on between various industries as to who's going to have to take the gaff on both exports and imports. Government would have to decide it and you would have a terrible situation.

Mr. THUROW. The fight wouldn't be here.

Senator PROXMIRE. I realize that.

Mr. THUROW. The fight would be in Japan.

Senator PROXMIRE. I realize it would be in Japan but, after all, they have a democracy and an economic system similar to ours. Is it realistic to expect them to resolve that?

Mr. THUROW. I think you have to throw some of the burden in that direction. I don't think the Japanese deliberately discriminate against the American exports, but they do have a system. Take the system of long-term relationships where if you're in the automobile industry you would have the same firms supplying parts to you for 20 or 30 years. That means an American firm can't suddenly start selling parts simply by offering to sell them for less.

There is a legitimate problem of breaking into the Japanese economy with manufacturing goods. We can't solve that for them. All we can say is there's also a legitimate problem that we can't afford a $25-billion deficit, politically or economically. I think what I have just described, general reciprocity, is much better than what we are doing.

As you pointed out, the tennis ball is now essentially in the Japanese court. The squabbles are on their side of the net. We don't have to fight about it in the United States. We'll let them.

Senator PROXMIRE. Mr. Thurow, the current services budget shows a deficit of $300 billion in 1988. Assuming the economy grows as the administration predicts and unemployment falls to 6.5 percent by then, what would be the impact of a $300-billion deficit?

Mr. THUROW. I think you may need to make a very sharp distinction between a deficit at full employment, which I guess in the new jargon in Washington is now called structural employment, and the cyclical deficit. If you look at the American economy vis-a-vis the rest of the world and you look at it at full employment, you ought to be running a surplus, not even a balanced budget.

Senator PROXMIRE. With 6.5 percent unemployment?

Mr. THUROW. Well, let's say running a surplus at a 5-percent unemployment rate. The Government ought to be running a surplus at that level.

Senator PROXMIRE. So, if you have that big a debt, $300 billion deficit——

Mr. THUROW. In the long run it's just impossible. You're basically saying the Government is going to absorb all of the private savings and therefore we are going to invest nothing in plant and equipment. That clearly doesn't fly. On the other hand, you can't cure a deficit in the middle of a recession. Herbert Hoover tried that and we have a real experiment that that doesn't work.

This administration dug its own hole back in 1981 with the combination of the supply-side tax cuts and the defense buildup. We have simply cut taxes more than we can afford to cut them given what we also want to do in our economy, defense and civilian. Now Congress is going to be faced with a very tough task of how do you raise taxes to get us back to something that will give us full employment, a sensible budget balance. And do it in such a way that you don't extend the current recession. It's not easy.

Senator PROXMIRE. Do you foresee at any time in the near future, 5 to 7 years, when we could balance the budget?

Mr. THUROW. I think that depends very much on whether you can foresee within the next 5 or 6 years an economy at full employment, and under current policies I don't see that. I think we are still stuck—I think it's a mistake to think of recessions because we define recessions based on whether the real growth is above or below zero. If we get one-quarter of 0.1 positive growth, the press will say the recession has ended. But that's not what we're really talking about. We're talking about a 4-year period of time starting the first quarter of 1979 and in that 4-year period time we have had 15 quarters and 7 of them have been negative and 8 of them have been positive. The question is, how you break out? The real question is how you get something sustained and vigorous, not just one or two quarters of positive growth. That's the thick that I don't think anybody has stumbled on the answer and certainly the economic policy in the President's report isn't a solution.

Senator PROXMIRE. Let me ask each of you gentlemen if you will give me your forecast for 1983 and 1984. The economic assumptions in the 1984 budget include a 1.4 percent growth rate in real GNP for 1983. Real GNP in the fourth quarter of 1983 would be 3 percent higher than in the fourth quarter of 1982.

Chairman Feldstein said that if recovery began during December or January. if it's already begun, real growth could be as high as 5 percent, fourth quarter over fourth quarter.

Let me ask you first, Mr. Oswald. Is recovery underway and, if so, would 5 percent be realistic?

Mr. OSWALD. I'm not sure that recovery is underway. Part of the problem is how you measure recovery. Clearly, for unemployment, the drop in January is a statistical seasonal adjustment problem rather than an actual drop. There was no change in the number of people employed according to the household survey at all, and in the other establishment survey much of it seemed to be seasonal in retail and construction. So, the most recent figures on the increasing number of people drawing unemployment insurance benefits indicates that we are far from recovery.

Senator PROXMIRE. What astonished me about the January unemployment is the President called a press conference to say what good news it is, and it did by measures indicate a drop. But actually, in January we had an increase of 900,000 in the raw figures in unemployment. We went to 12.5 million unemployed, the highest figure it's ever been in history except 1933. We had 700.000 people drop out of the work force. So, we ended up with losing 1.6 million jobs.

Now, the seasonal adjustments explain it and I think you put your finger on it. We had a weak Christmas and people didn't hire that many people so we overestimated unemployment in December. We had a marvelous January. In my State, Wisconsin, it was super and, of course, even in Washington it was very good compared to what we usually had. So, there was a lot of construction on the outside and so they undoubtedly underestimated employment in January. So, the difference was exaggerated, if there was any difference. There probably wasn't much improvement at all.

Mr. OSWALD. One had much the same problem a year ago that we have forgotten, when the initial figures showed a drop of 0.3 percent, also some 300,000 people, so that I have real problems saying it's an improvement. There are some signs. Some auto sales were better currently than before. Housing starts were slightly better.

So, the real question is, is any of this sustainable and is it rapid enough? We continue to have cutbacks in areas that have been strong. In State and local governments, which in previous recessions have been helpful, they are cutting back. There have been cutbacks in retail trade much more substantially and previous recessions had offered growth. This time they're cutting back and I think some of those cutbacks will continue in the months ahead and the gains haven't been strong enough. It isn't that one sees the economy going down at a substantial rate that it had been as recently as the fourth quarter of last year, but there are no signs of vigorous, healthy recovery.

Senator PROXMIRE. All right. Give us a forecast. What do you expect it to be in 1983 given present policies? Assume that the Reagan budget is enacted into law.

Mr. OSWALD. Given present policies, there may be a very slight pickup for the next 2 or 3 quarters with then maybe another downturn.

Senator PROXMIRE. So, you would expect the estimate of the administration to be about right, 1.4 percent?

Mr. OSWALD. For the year, yes.

Senator PROXMIRE. Mr. Thurow.

Mr. THUROW. Two things. All forecasts are now based on econometric models. The econometric models are no better or worse than the data put into them, but the thing to remember about those models is that they are now all operating outside the realm of their history. No model has ever seen 11 percent unemployment because the data only goes back to 1949 in those models. No model has ever been an American economy with 300 little banks going out of business in the course of a year.

What did the models forecast for 1981 and 1982? They were all overoptimistic. What model forecast the American economy would fall in late 1982? What model forecast that the American economy would be falling into 1981? Nobody knew, yet there they were. What model forecast that the German economy would go downhill in 1981 and 1982? There are some forecasting it for 1983, but none forecasted that for 1981 and 1982. The models are essentially estimated on an optimistic period and they are giving overoptimistic results at the moment. That's one of the things you should keep in the back of your mind.

Senator PROXMIRE. So, even that very forecast is optimistic?

Mr. THUROW. I think Feldstein took his model and divided it by two. The 1.4-percent growth isn't bad. You've got housing and autos improving, plant and equipment down, and exports minus imports down by a very large number, but nobody knows how much, and I think that last thing is going to be huge.

Senator PROXMIRE. What was the last thing?

Mr. THUROW. Exports minus imports. We're going to have exports way down and imports way up for two reasons. In the industrial world you've got Germany falling at an annual 6-percent rate. They are going to pull Europe right down with them. So, that means exports to Europe are going to fall dramatically. We've got 35 countries that can't make their interest and principal payments that are essentially broke in the Third World. If you're sitting in one of those countries, you're going to be willing to export to the United States at any price.

Senator PROXMIRE. That's the French syndrome you discussed earlier?

Mr. THUROW. And that is going to hit us as we get farther into the year. So, I don't think 1.4 is a bad forecast, although I recognize the kind of consensus at the moment is the administration is a little bit below reality.

Senator PROXMIRE. Mr. Oswald, yesterday's Washington Post carried a story titled "Reagan Denies Budget Unfair" in which the following paragraph appeared: "He denied the social safety net is tattered and said his administration was doing more for the truly needy than any before it."

Is that statement true?

Mr. OSWALD. No; it is not. Senator, the cutbacks in budget in terms of food stamps, aid to women with infants, the continued cuts for low-income housing, the cuts in medicaid—and unemployed workers 3 years ago might have had some hope of having help under medicaid—has been so tightened by the budget cuts that there is no hope unless he sells his home, his automobile, and anything else that he has.

Senator PROXMIRE. And I notice in my State all kinds of complaints about the present policy on social security disability. People who are disabled and who appeal, we find many of them get their disability restored but there's a whale of a lot who are discouraged and don't appeal, and that seems to be pretty prevalent.

Mr. OSWALD. But people who have been on disability for many years are arbitrarily knocked off the rolls before the appeal, rather than doing it the other way. If they have some basis for doing it, they should go through a normal process that reviews the case and the person shouldn't be disadvantaged during that period because we're talking about the poorest of the poor.

Senator PROXMIRE. Mr. Thurow, I'm very anxious to get your judgment on what the targets for monetary policy should be. I recognize you want to target interest rates. You've made that very clear. You made a very powerful case for that position, but that's not going to be what the Federal Reserve is going to do.

What would you posit as the proper monetary target for 1982?

Mr. OSWALD. I would encourage them in the belief that there are so many changes in the money markets that they look at more than the 30-percent increase in recent months.

Senator PROXMIRE. That's a very interesting response.

Mr. THUROW. Make the fig leaf as defendable as you can possibly make the fig leaf.

Senator PROXMIRE. Mr. Oswald, some people are very pessimistic about the outlook, no matter what policies are followed. They feel the international situation is very grim and we may have at least a partial repeat of the 1930's and they recognize that we have had no change in the work hours, the 8-hour day, and the time and a half overtime and the 5-day week for almost 50 years. We changed them drastically for about a 30-year period in the beginning of the century and then we left them. Meanwhile, we have had a big increase in the work force. We have an unprecedented number of women with school age children in the work force. I think it was one out of four in 1950 and now it's much more than half and increasing all the time.

Under the circumstances, do you think that we ought to give some consideration to the possibility of changing the workweek from an 8-hour day to a 7-hour day and overtime from time and a half to double time? I notice there's still a whale of a lot of overtime even in 1982 and the last quarter of 1982. If we shared the work, that would be one way of providing jobs and providing more leisure so parents, including mothers, could spend more time with their school age kids.

Mr. OSWALD. The AFL-CIO has supported shortening of the workweek very strongly. I think that's crucial in terms of meeting our long-range change in job opportunities in the labor force.

The current time and a half was established back in 1938 when there were, for all practical purposes, no fringe benefits among blue collar workers, so that the time and a half was a relatively substantial deterrent against working overtime hours versus hiring new employees. We believe that has to be increased to at least 2 to 2½ percent.

Senator PROXMIRE. Two and a half times?

Mr. OSWALD. Two and a half times the wage in order to have the same deterrent effect. Clearly, the hours worked need to be shortened and we think that Congress should begin to do that on a step-by-step basis, just as in 1938 when it passed the Fair Labor Standards Act, it did so on a step by step basis. It, initially, set the overtime after 44 hours and after 2 years after 42 hours and then after 40 hours, so we think that it's time for Congress to start a step by step reduction in the hours worked to 35.

Senator PROXMIRE. If you do that, don't you increase our cost and make us less competitive internationally? Don't you have a situation in which if people come on, a new hire, the fringes now are very substantial in some areas and you would have to train these new people and so forth and you wouldn't have the symmetry you've got with an 8-hour day with three shifts and all that kind of thing? Won't these costs be substantially inflationary?

Mr. OSWALD. We don't think that the cost involved in the small reduction of an hour a week, for example, which would amount to about 2½ percent would be a major inflationary element. If you made the total move from 40 to 35 in one step, that 14.5-percent increase might be a problem.

Senator PROXMIRE. How about the double time for overtime? Wouldn't that be an increase in cost that would be substantial?

Mr. OSWALD. Its purpose is to deter overtime rather than increase earnings to people who are working and, as a result, we think that its deterrence would result in more hirings rather than increased overtime.

Senator PROXMIRE. Mr. Thurow, the Senate Banking Committee is drafting a proposal to tighten restrictions on U.S. bank lending abroad as it considers increasing the U.S. contributions to the IMF.

The Foreign Relations Committee has also held hearings on this and is going to consider the IMF replenishment. Among the proposals are: impose specific limits on the amount any bank could lend to an individual country; increase loan-loss reserves; and require large banks to stretch out the fees they charge for arranging syndicated loans.

What is your view of these proposals and what other things might you suggest to improve current banking regulations in the area of foreign loans?

Mr. THUROW. I think those are all positive things to do. The banks kidded themselves. All of them have some rule about what's the maximum fraction of their equity they can lend to any one lender. But when they're lending to a country they say, well, this is the hydroelectric authority as borrower, this is the petroleum authority as borrower and this government agency is a borrower and when they added it all up they've got 90 percent of their capital at risk in one country. You're basically lending it to the central bank of that country and they can't pay back the loan. So I think there's a real issue here.

People partly lend a lot of money because they don't know how much was being lent. If I lend $5 billion to Mexico and that's the first five but somebody adds $90 billion on to that number, then the whole $95 billion becomes unviable, including my first $5 billion which was eminently sensible at the time I lent it. How to get information about what other people are lending in stock loans and earlier loans and bad loans is also a key item.

Senator PROXMIRE. How do you do that except to give him the information so he can use his judgment?

Mr. THUROW. Well, you can't. It has to be an informational thing. With private lenders what we do is make them sign an agreement stating that they can't borrow any money from anybody else without permission from us, the bankers. With governments you can't do that.

The other thing you have to worry about is how do you do all of this so that it doesn't become a disguised bail-out of the bank shareholders.

I think our social safety net is in tatters and we are going to build a real gold-plated social safety net for the owners of bank shares. These guys were big boys and playing a big capital game. I know of no reason why the little taxpayer should pick up the bill for Citibank or Chase Manhattan, recognizing at the same time that you don't want them to go out of business.

Senator PROXMIRE. Mr. Oswald, with regard to the $8.6 or $8.8 billion for replenishing the IMF, do you think it's a wise policy?

Mr. OSWALD. Senator, it's one of the matters that has been of considerable concern to the AFL-CIO and we will be considering it at the upcoming council meeting. We have been concerned, of course, with development of other developing countries around the world, but we are concerned with who is being helped. Is it the bankers or is it those developing countries? And we will have a review of that and we will be testifying before the Congress on that issue.

Senator PROXMIRE. How about the fact that if you don't get a full accommodation in policy by the Federal Reserve that's going to come out of lending to American domestic industries, including automobiles, home building, etc. Isn't that a consideration?

Mr. OSWALD. That's a major concern.

Mr. THUROW. That's the real reason why we're going to have an easy monetary policy, no matter what the Federal Reserve tells you on Wednesday. The Federal Reserve Board can with equanimity watch the International Harvester crash. It would not allow the Bank of America to crash. Therefore, it will print however much money is necessary to keep the banking system from going down the tubes. It will have an easy money policy because tight money policies would simply lead to ripple effect in the banking system which they won't be willing to see happen.

Senator PROXMIRE. Well, that's very interesting to hear because I'm going to read that response to Chairman Volcker and find out if he would agree with that.

Mr. THUROW. I would be interested in seeing if you can get him to say, yes, he would be willing to see the Bank of America go broke. I would be surprised.

Senator PROXMIRE. Well, I'm inclined to agree that that certainly is in sync with the policy. I don't want to be unfair to Chairman Volcker because it's been true with every Federal Reserve Chairman in the 25 years I've been on the Banking Committee. They all have that same view.

Mr. Thurow, some people, especially bankers, fear that further declines in oil prices could affect loans to both foreign and domestic producers of oil. What's your view?

Mr. THUROW. I think that's right. I think it would be good for the country and bad for the banks.

Senator PROXMIRE. How about bad for some of our very important trading partners like Mexico?

Mr. THUROW. I think that's also true, but, of course, they've borrowed the money already and that ends up becoming bad for the banks on the bottom line. On the other hand——

Senator PROXMIRE. It would be good for our economy.

Mr. THUROW. It would be good for our economy. The average citizen would be better off. If your energy bills go down you've got more money to spend on other things. It's essentially taking a tax off the economy. The OPEC price increase was a tax. It just wasn't a tax legislated by Congress, but it was a tax imposed by the King of Saudi Arabia. If you take the tax off, it's a good Keynesian thing to do.

Senator PROXMIRE. Gentlemen, I want to thank you very much. I think this has been very enlightening and I very much appreciate it.

The committee will stand in recess until 10 o'clock tomorrow morning. Thank you.

[Whereupon, at 11:35 a.m., the committee recessed, to reconvene at 10 a.m., Tuesday, February 15, 1983.]

THE 1983 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 15, 1983

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

The committee met pursuant to recess, at 10 a.m., in room 6226, Dirksen Senate Office Building, Hon. William Proxmire (member of the committee) presiding.

Present: Senators D'Amato and Proxmire; and Representatives Hamilton, Hawkins, Holt, and Snowe.

Also present: James K. Galbraith, deputy director; Charles H. Bradford, assistant director; and William R. Buechner, Mark R. Policinski, and Robert Premus, professional staff members.

OPENING STATEMENT OF SENATOR PROXMIRE, PRESIDING

Senator PROXMIRE. The committee will come to order.

This morning the Joint Economic Committee will conduct the last in the series of hearings on the Economic Report of the President on the economic outlook for 1983.

We are very, very pleased, believe me, to have with us two very prominent economists, in the private sector. Two gentlemen who have certainly shown over the past 10 or 15 years particularly their perceptive understanding of our economy and two people who are relied on very heavily by both the Republican and the Democratic Party. And so I'm honored as acting chairman today, and certainly the committee will be very interested in the testimony that you gentlemen will give us.

During the past 2 years our economy has been guided by the policies of this administration which has included tight money, high interest rates, social spending cuts, combined with large increases in defense spending and the 3-year tax cut, the third phase of which is due to take effect in July.

It's time to ask whether or not these policies should be changed or at least changed in part.

First, monetary policy. Should the Federal Reserve reduce interest rates further and in a broader sense should the Federal Reserve abandon its current policy for setting targets for monetary aggregates and instead focus on real interest rates?

Second, the deficit. Is the President's proposal to reduce the deficit from $208 billion in 1983 to $148 billion in 1986 adequate? Should we rely on a standby tax to close the gap as the President has recommended or should we take more forceful action like repealing indexing or forgoing the third year of the tax cut?

Third, jobs. Should Congress enact a jobs program? If so, how large should it be and how can we prevent it from causing inflation in future years?

Fourth, international trade. If the United States has a strong recovery, if the dollar remains overvalued, what can Congress do to alter any of the conditions which result in an overvalued dollar? What other actions should we take? As you know, we have a recommendation before Congress for an increase in the International Monetary Fund. There have been proposals that we should double our contribution to the World Bank in conjunction with similar contributions from other countries and, of course, bilateral foreign aid is another way of assisting other economies. We know that while we have a recession in our economy we have an even more serious economic problem in other countries and that's going to affect our foreign trade and affect our economy.

Finally, economic growth. Is the administration's proposal for 1.4 percent real growth in 1983 followed by 4 percent through 1988 a reasonable growth path, a realistic growth path, or should we attempt to achieve a faster growth rate at least in the short run and could we achieve that faster growth rate? There are signs that recovery has begun. If so, then the strength and duration of the recovery will depend heavily on the monetary and fiscal choices we make this year.

I hope and I know our witnesses today will provide some guidance in our search for the right economic policies.

Representative Holt, would you like to make an opening statement?

Representative HOLT. No, thank you, Senator. I have no statement. Welcome, gentlemen. We appreciate your coming.

Senator PROXMIRE. Gus.

Representative HAWKINS. I have no statement. Thank you.

Senator PROXMIRE. Gentlemen, we are delighted to have you. I suppose the best way to proceed is alphabetically, so Mr. Eckstein, go right ahead.

STATEMENT OF OTTO ECKSTEIN, CHAIRMAN, DATA RESOURCES, INC.

Mr. ECKSTEIN. Thank you, Senator. It's always a pleasure to come back to the Joint Economic Committee. I'm going to focus on two issues today, although I will briefly deal with the other questions that you have raised. One is the outlook, of course, and the other is the budget which is the biggest problem that Congress faces.

The budget for 1983 actually is worse than it was a year ago. Now this is happening in the context of a recovering economy, but whether that recovery can go far enough and whether we can restore an acceptable employment level, and whether we can recapture our productivity trend we seemed to have lost about 6 years ago depends very much upon our ability to bring this budget into a reasonable shape.

The signs of recovery are very widespread by now. Retail sales took a jump in January, manufacturing orders are up, unemployment insurance claims have improved quite a bit, construction is rising but it's a miracle that it hasn't collapsed in the face of the interest rates the last few years. Housing starts are up almost 50 percent from the trough at the bottom of the recession. And all of that in the happy context of a very dramatic improvement in inflation dramatized by the 1-percent drop in the Producer Price Index and even a slight drop in the Consumer Price Index.

Wages are rising half as fast as they were and it does appear we are out of the woods on double digit inflation.

Now the fact that the weather was so good in January and that the first quarter growth rate may well be as high as 4 percent has made us reexamine a little bit the forecast and we have prepared an interim solution for the purpose of today's hearing and it's a little better than our forecasts of the last 2 months.

We've been projecting 3.5 percent real growth from fourth quarter of 1982 to fourth quarter of 1983 and now we figure 3.8 or 3.9 looks more reasonable and it may be even better than that. That includes automobile sales up from 8 to 8.7 million and further gains in later years, housing starts above 1.4 million, and in general an economy that is showing a 2-percent year to year gain in GNP. The inflation we think will stay down around 4 percent for the next 12 months which is a pretty dramatic improvement.

Now, these figures are very close to the budget office. It's no accident. We looked at the same data at the same time. It is better than the administration but I would not fault the administration for that. After the rosy scenarios of recent years, it really was a matter of desperate necessity to establish the credibility of the Government's economic work and producing a forecast in which there was a little caution was certainly the wise thing to do and I applaud it.

If it turns out that things go better, I think we will all be pleased and that will be much more desirable than going to a totally unrealistic scenario which would justify the budget.

Now, even though we're very cheerful about recovery, and are indeed persuaded that it is indeed here and it's not just a projection now, but a reality, nonetheless we have to recognize that there are four major negative elements still in the picture which are not going to go away very fast and will keep this a subnormal recovery.

The first of these four is business fixed investment which usually takes 6 months to 1 year to turn around after the rest of the economy turns around and if you recall the climate and opinion and conditions last fall and winter when these investment decisions were made, there were many companies losing dangerous amounts of money, some threatening their survival and practically everybody having earnings down except a few very successful companies. If you consider that and the fact that a third of our industrial capacity was idle and still is idle, it's not hard to understand why investment in 1983 will not be a very large number. We think it will be down to about 6 percent or perhaps a little bit more.

Second, State and local governments, which used to grow at 5 to 6 percent a year in our economy, are going nowhere and we all understand why. It's taxpayers resisting increased taxes, the grants from the Federal Government are almost cut by a third in real terms over a space of 4 or 5 years. So, we'll be lucky if they do not cut their spending and employment further. They're certainly not going to grow.

Then third, we have the outside world. We all understand that the export markets show very poor prospects. Chart 1 in my prepared statement shows that beginning in mid-1982 exports went down the chute and some of that was Mexico which almost cut its imports in half from us. The less developed countries simply no longer have the ability to borrow to pay for our sales to them. The advanced countries are waiting for us to recover. The socialist countries have lost their ability to borrow and even the OPEC countries, by methods that are beyond my comprehension, seem to have managed to ruin their foreign exchange position in some cases and are unable to buy as much as they did.

We know our exports are going to do badly. In that connection, let me respond to one of the questions the chairman raised, and that is this issue of the funding of the International Monetary Fund. I can sympathize with the criticism of many people, the media, and the public and some of the Members of Congress, on how did the banks ever get into this situation; why did the banks make all these loans which they surely could have recognized were impossible to be repaid, and indeed even to pay the interest. The banks have committed certain sins, but whether they have committed those sins or not, the fact of the matter is, we are in the same boat with those banks and we cannot afford to have the world debt problem snowball into a substantive collapse of the world finance system.

Unless the IMF gets an infusion of more money and, unfortunately, a lot of that comes from the United States—unless they get that infusion, it is very questionable whether the world financial system can, in fact, be kept whole because the IMF is a lender of last resort in the world to move in when the private sector can't handle it any more and it really is better to have it done by the IMF than to have it done bilaterally by the United States or somebody else. So, you've got to do it.

Now, whether you choose to impose some rules and regulations on what the banks do in the future or whether you limit the amount of loans they can make to any one country in relation to their capital position, whether you want to put in some other tightening of regulations to make sure that—plus all the information requirements so we know what's going on so we have a continuing running total of what Americans are lending to each particular country—I think you ought to put some of those restrictions on your funding of the IMF.

I do believe that this situation hasn't worked out very well and the Congress owes the country some remedial steps. You shouldn't just underwrite these losses. There's even no harm in making the banks take some losses. They ought to be punished. After all, if they're going to change their internal lending program on how these loans are made, they're not going to have a structure where the loan officer gets essentially a windfall if he makes a loan, good, bad, or indifferent. Unless you change that incentive, this situation isn't going to change and the only way they'll change incentives is to get into their earnings and their stock price and so on. So, you ought to do some more regulation in this area. We're not in favor of regulation in general, but in this case you've got to do something. But the main thing is you've got to give the money.

Now, the fourth risk on the recovery, of course, is the Federal Reserve and there, I think, since the recovery is now underway it is going to be fairly difficult for the Federal Reserve to achieve a major reduction in the interest rates of money. DRI does forecast a further decline of 100 and some odd basis points in long-term interest rates where the public is only slowly adjusting to the fact that the inflation rate has gone from 12 percent down to 3 or 4 right now or less.

In the end that will make itself felt in those long-term interest rates on mortgages and on bonds, but it may take time and in the interim, as the financial markets watch the economy beginning to pick up, obviously, they no longer believe that massive short-term reductions are in the wind, and even if the Federal Reserve were to attempt to bring down the Treasury bill rate and other bonds two or three hundred basis points, which would be great for the recovery, I don't believe they could do it because the market simply will not believe that. They can increase the money supply required to accomplish it and the increase of bank reserves necessary for it would, in fact, be quite frightening and indeed there is a danger that it would be counterproductive, that the people would just run away from the market in the fear that the Fed was back into its old ways.

So, I think to push for substantial further reductions at this juncture is fairly difficult, although I'd love to see the rates go down still more and I think the Fed would like to see them go down, but I do believe it is a matter of great importance not to let the Federal Reserve throttle the recovery before it gets going. The money supply is now rising rather rapidly. If the Fed were on a monetarist tack right now it would be raising interest rates substantially.

And indeed, my own belief is that if the Federal Reserve sticks to a target for M_2 of 9.5 percent and M_3 of a similar amount and M_1 of a much smaller amount, then this recovery cannot get very far. I do not believe, unless there is a very surprising retention of all the inflation gains—if inflation stays at 2 or 3 percent, we'll be all right, but if inflation goes to 5 or 6 percent, which is our forecast and which is most people's forecast, then the likelihood of achieving a healthy recovery with 9 percent M_2 growth is quite small.

If the economy is going to grow at 4 or 5 percent, the prices will go up 5 percent, the GNP is going up more than 10 percent and there is no trend in velocity for M_2 so the GNP is going to go up much faster than M_2, and so the monetary target really at the moment is inconsistent with normal recovery, even a recovery of growth rates of 4 or 4.5 percent.

Well, let me now turn to the one other question you asked—could we grow faster? Well, let's not kid ourselves. Our skill at forecasting isn't that precise. It may be luck will make it grow faster. Certainly, if our inflation improvement were to be retained, to really have the inflation down to 2 or 3 or 4 percent, then I believe it would grow faster. We might get back to a growth rate of 5 or 6 percent for a brief period, but I don't believe that's the realistic prospect and I don't believe that there is very much we can do to achieve it.

Now, of course, we can give the economy a very small boost with a jobs bill. I think, given the depth of the recession, a jobs bill is a very reasonable response by the Congress to the situation. I do hope, however, that when you do that jobs bill you really look at the long-term problems of the country. The recession is over anyway. It's in the up stage now. This is not going to be the turning point—this jobs bill. The jobs usually will be put in place rather late and I don't believe it's that important that all aspects be dealt with in the next 6 months, although it would be nice if the budget were.

I would put the money where it would affect long-term growth, be specifically targeted on the areas in deepest trouble; it should be targeted to people in deepest trouble; as much of it as possible should be spent on training, as little as possible spent on just casting it broadly across the country into more public works.

I also applaud the current proposals which, unlike previous jobs bills, really recognize that the way to help the country through these expenditures is to put it into purposes that the country really needs, and that is mainly purposes for which there are already existing programs. The older jobs, especially the accelerated public works program, which required that the money go into places where there is no Federal program really meant that the only places open were public works of marginal necessity. The current approach of trying to amend temporarily the funding of programs of real merit looks to me to be much better and the magnitude of the jobs program, as long as it's in the $5, $6, or $7 billion area, I don't think anybody should get very upset about the deficit effects.

My only concern would be if the $7 billion were built in permanently and I think that everybody is aware of the necessity that it is meant to be a program that tapers off as the recovery gets underway.

Let me now turn to the real core of my statement which is, for better or worse, the budget. You know, each year I come down here and testify and this year I even went back to see what I told you in recent years. And I found that in my 1980 testimony I was very alarmed because we were confronting a $45 billion deficit. In 1981, I was very alarmed about a $100 billion deficit. In 1982, a $102 billion deficit. And this year I'm very alarmed about a $200 billion deficit.

How did we get into this situation? How did the country wind up with a deficit of $200 billion?

Well, let me first give you a projection which is shown in table 2 of my prepared statement. Now, this is not a current services projection. This is Data Resources serious forecast projection which assumes that the Congress has the wisdom to accept the recommendations of the Greenspan Commission. It assumes that the defense budget isn't $240-some-odd but $231 billion. It assumes that you enact some savings that the President is asking for below the current services level.

But it also, on the other side, adds some expenditures to the budget in places where a casual reading suggests they were a little optimistic. I think this budget is better than most in terms of its quality of the work, not having the most gross kind of overoptimistic assumptions, but a little optimism crept into the budget anyway.

For example, there's a belief that agricultural outlays will drop from $21 billion to $9.5 billion and of that, only about $7 billion is predicated on the President's proposed legislation. The Export-Import Bank is supposed to spend less in the future than in the past when it's obvious they must spend more and you already have a proposal coming to you which is for a big step-up for the Export-Import Bank financing. The IMF refunding is not in the budget and it says it's not in there and coming. The budget projects that the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation will spend less money in the next few years than in the past and given the thrift institution bailouts to which they are committed and the other bailouts that are probably still out on the horizon, I think to expect that they will become more profitable is a bit optimistic.

And then in defense, you all are familiar with that. The weapons systems that we are launching will cost more and 20 to 50 percent is an estimate. I think even the operation and maintenanee outlays are a little unrealistic in the budget. So, you have to add something to defense even if the Congress doesn't give them all the money they want.

So, I think, the realistic assumption, without quarreling over the last $5 or $10 billion, is that the budget deficit will be $200 billion and it is not going to get any better. It may creep up a little or it may go a little below $200 in a couple of years, but $200 billion is really the baseline and it has no prospect of improving.

Now the President, recognizing that situation, proposed a contingency tax as a way of at least being able to tell the American people that he has dealt with the problem. I don't think he's dealt with it at all. The contingency tax would be a $5 tax on oil which will never materialize given the strength of lobbying. In any event, why try to save the budget by having a tax on oil entirely or almost entirely? It would yield nearly $30 billion according to the budget.

The other contingency tax is a small increase in the personal income tax which now sounds like a 5-percent surcharge which might bring in $10 billion to $15 billion and then the whole total of the two things together is supposed to be $46 billion.

Now all of this legislation is only to be accepted by the President if the Congress does everything he wants about the budget, which of course is implausible since that is not what the Congress was elected to do. So even if the President in the end overcame his requirements that the Congress must do this and this before he signs, I think it's unreasonable to expect the Congress to vote these tax increases to be effective 3 years from now when in the meantime the President is adamant about not giving back any of the tax cuts that he has so successfully managed to get the Congress to pass.

Now, of course, we ought to keep on fighting the battle of economy in Government. You try to do that year after year and the chairman and others on this committee have certainly done their share in doing that. You've got to look at social security proposals. You've got to look at escalation of the other entitlement programs and treat them as tough as social security or maybe even tougher.

But it is an illusion to believe that solution of the budget crisis lies in the civilian area. Only a combination of defense savings and sizable tax increases can bring the budget crisis to an end.

Now the next question we all have to deal with is how damaging this is to the economy and we must recognize that we are in unknown territory. We have never done this. This is not the way it used to be. The historical average deficit in the postwar years is about 1.5 percent of GNP or a little less. We are now talking about deficits of 5 or 6 percent and without end, not only in the bottom of the recession, when we have had figures as high as 4 or 5 before, but in the recovery through 1988, and why would it be better in 1989 or 1990 if you project those figures?

We've taken a lot of revenue growth out through the indexing and of course the tax cuts of 1981 which cut the Federal tax system by nearly 30 percent and we have done that at a time when we have this enormous rearmament program which perhaps is needed but certainly is not being paid for.

If you look at chart 2, you really see the nature of this problem in the simplest form. What the Federal deficit is going to do is it's going to absorb about one-half of the savings of the American people. Now we know we want to accelerate capital formation. We know our savings is a little low anyway. If you add State and local savings it's only about 9 percent in a good year at the moment and it's less than that because of the lack of business savings because of low profits, and of that 9 percent the Government is going to take 6 or 5.5, leaving only 3 or 4 for all other purposes.

Now then you ask yourself, how can the economy function under these circumstances with savings so absorbed by the Federal Government? Well, there are some outs. One out is the outside world. We're going to draw into the country an enormous amount of capital from the outside world, so we're really going to drain the world economy of capital to finance our own deficit even though we are the wealthiest country in the world, and I think from a moral point of view to do that is really very hard to defend.

So one way or another, we know that this enormous deficit is going to be very damaging to housing. We have done studies suggesting losses in the 200,000- to 300,000-unit range. It's very damaging to car sales and it's damaging to capital formation by business and we think it will cost us maybe 5 or 6 percent of capital formation if you do it long enough this way. So it is really the single most important problem facing the country.

As I tried to argue earlier, you cannot deal with it on the expenditure side alone. You do what you can, but in the end, one way or another, you're going to have to come to grips with the tax side and I realize this isn't going to happen very imminently.

Well, let me take you for a minute to charts 3 to 6 of my prepared statement because they focus for you what the choices are, not just for the current Congress because I don't believe you will take major measures and I doubt you will do so in 1984, but come 1985, for those of you still here, you're going to be dealing with this tax issue in a way that now is not wise to consider.

There essentially are two ways the country can go. One is we try to rescue what we can of the income tax after all the cuts and that means something like the Rostenkowski plan; whatever hasn't gone into effect by July 1, 1983, forget it; take out the indexing which costs you $10 billion the first year and $20 the second and $50 the fifth, so indexing is a very major chunk in this problem and it is really a top priority to get the indexing out of the taxes before the people begin to enjoy the indexing because you will never get rid of it once it's in effect. Indexing is the No. 1 priority. If you do that, you might as well also stop the substantial reductions in the estate and gift taxes that lie ahead and a few other cuts that have not been fully enacted by mid-1983, and so I would say the Rostenkowski plan is a beginning, but the Rostenkowski plan is not enough.

So then the question is, in 1985—and I think this problem will really be politically ripe and economically very visible at that point—you can either put on a surcharge to cure the deficit, revise the income tax in some other drastic way like the Gephardt-Bradley proposals but even more because they don't gain revenue in their present form; they only hold it flat; and what we need is increased revenues. You can do that or—and this is the other alternative—you can go for the consumption tax. You can have a VAT. You can have a sales tax. You can have an expenditure tax, but that I think is impractical. But that is the other way we can go.

If you look at those charts, you can see what that does to the Federal tax system. The solid line is really not much if you just do the small proposals. The dotted line is the excise tax solution. The dashed line is the income tax solution.

If you want to have the income tax continue to play a traditional role, if you don't wish to switch to an enormous reliance on excise and sales taxes, you're going to have to deal with it now to defend as much of the income tax as you can. Does it make any difference whether you go one way or the other on these taxes? It does. There are some benefits of the consumption taxes. People will save more and it will be some help to the capital formation of the country. But my own belief is that we made it in this country for the last 50 years by having an income tax which does produce income. We have a system which has enormous variances of income and wealth and the income tax is the one vehicle which redresses that in a modest degree and also to some extent the estate tax. And it's one thing to lower the income taxes of the upper income people as we have done. It is another thing to increase very substantially the taxes on low and middle income people through consumption and sales taxes.

Therefore, the bottom line of this whole deposition is that we are in very deep budget trouble. We must do what we can in the short run to try to work our way out of it. We will not work our way out of it in truth until we face up to the tax side and when you do that—and I realize that isn't all that imminent—I would suggest that you try to do as much as you can to save the income tax and not rush into a value added tax or a consumption tax which really would change the tenor of our society.

Thank you very much.

[The prepared statement of Mr. Eckstein follows:]

Prepared Statement of Otto Eckstein

The budget crisis that faces this country looks worse in February 1983 than it did a year ago. On the other hand, the economy clearly has entered a revival stage. Whether the recovery can restore an acceptable employment level and whether the productivity trend can be restored depend very much on the willingness and ability of the Congress to deal more seriously with the budget crisis than the Administration has been willing to do.

My testimony today will review the economic outlook and present the current DRI forecast, and then examine the budget issue in its more fundamental terms.

THE OUTLOOK FOR THE ECONOMY

The signs of recovery have now become sufficiently widespread to leave little doubt that a recovery from the most severe recession since World War II is indeed underway. Aided by exceptionally favorable weather, retail sales took a leap in January. Manufacturing orders turned up very substantially in December, led by defense, but including many other industries. Unemployment insurance claims have retreated from their fourth-quarter average of 608,000 per week to 509,000 in the last four weeks, and payroll employment showed a very large gain in January, of 339,000 people, the first sizeable gain since June 1981. Construction activity held up amazingly well during the period of extraordinarily high interest rates and deep recession. Housing starts averaged 1.313 million in the last two months of last year, up some 50% from the figures prevailing near the trough of the housing cycle. At the same time, inflation showed dramatic improvement, with the rise in the consumer price index at a 2.6% rate in the last half of 1982, and the mix and overtime corrected index of average hourly earnings rising at only 5.4% in the last 12 months, compared to figures in excess of 9% just two years ago. The probable real growth rate of GNP in the first quarter of 1983 may well approach 4%, aided by the favorable weather in January and a swing in inventory investment.

On the basis of DRI's estimate of first-quarter activity, I have prepared an interim forecast solution (Table 1) which gives a small boost to our near-term projections. Whereas our forecasts of recent months have looked for a 3.5% real growth trajectory, fourth-quarter 1983 over fourth-quarter 1982, the interim solution ups that trajectory to just under 4%. For the year 1983, the forecast calls for an improvment in automobile sales from 8.0 million last year to 8.7 million, to be followed by further 10% gains in each of the next two years. Housing starts average 1.4 million this year, with substantial further increases ahead. The inflation rate, as measured by the consumer price index, should be 4.2% for the 12 months ending next December.

This interim DRI projection is very close to the Congressional Budget Office estimates. But I find no fault with the somewhat more pessimistic estimates of the Administration prepared by the Council of Economic Advisers. At the time the Administration projections were made, over a month ago, the outlook was somewhat worse. There was no way to know that January would have such extraordinarily favorable weather to boost retail sales, employment and incomes, and to get the year off to an exceptionally good start. The Administration is certainly to be commended for basing its budget analysis on conservative projections which make the Congress and the public face up to the depth of the budget crisis, rather than to paper over the difficulties with "rosy scenarios." While the Administration projections now look as if they will prove to be a little too conservative, they were an important step in reestablishing the credibility of the government's economic work.

Table 1
Data Resources Summary Table of the U.S. Economy
INTERIM021283

	1982 IV	1983 I	1983 II	1983 III	1983 IV	1984 I	1984 II	1984 III	1984 IV	Years 1982	Years 1983	Years 1984	Years 1985
GNP and Its Components — Billions of Dollars - SAAR													
Total Consumption	2034.6	2067.5	2090.7	2141.3	2192.1	2236.6	2284.9	2334.1	2384.9	1972.0	2122.7	2310.4	2510.3
Nonres. Fixed Investment	336.4	324.0	324.3	329.1	330.9	347.6	360.4	370.0	382.9	347.5	320.3	340.0	418.5
Res. Fixed Investment	99.0	111.4	118.1	130.5	132.3	137.0	144.5	152.3	160.0	95.0	121.9	148.6	179.6
Inventory Investment	-38.5	-2.4	5.3	5.7	0.0	19.6	18.9	21.8	25.3	-21.4	4.4	21.4	31.3
Net Exports	-4.9	-8.0	-10.7	-13.4	-18.0	-14.4	-13.0	-12.1	-8.7	16.6	-12.3	-12.1	-8.3
Federal Purchases	274.5	275.7	270.5	303.7	293.1	304.4	304.3	313.6	331.4	257.3	301.3	313.9	344.9
State and Local Govt. Purchases	399.6	403.0	410.0	417.0	424.1	429.3	434.0	445.3	483.3	389.0	413.7	441.1	477.7
Gross National Product	3101.3	3161.3	3216.1	3300.0	3373.6	3460.9	3536.9	3627.7	3729.1	3057.5	3260.0	3588.6	3947.1
Real GNP (1972 Dollars)	1471.7	1488.7	1492.4	1509.3	1520.7	1547.3	1562.0	1583.1	1603.3	1475.5	1504.3	1573.4	1641.9
Prices and Wages - Annual Rates of Change													
Implicit Price Deflator	4.3	3.9	5.0	4.9	5.2	5.5	5.0	5.2	6.1	6.0	4.6	5.2	5.8
CPI - All Urban Consumers	2.6	2.9	4.7	4.4	5.0	5.4	4.8	5.1	5.6	6.1	4.3	5.0	5.6
Producer Price Index - Finished Goods	4.3	-1.5	1.7	3.0	4.8	4.0	5.0	5.5	6.3	4.0	2.3	4.7	6.1
Compensation per Hour	6.7	5.7	5.4	6.0	6.1	7.9	6.1	6.5	6.3	7.1	5.6	6.5	6.6
Core Inflation	7.3	6.0	6.3	5.9	5.9	5.3	5.2	5.1	5.1	7.0	6.1	5.2	5.3
Production and Other Key Measures													
Industrial Production (1967=1.000)	1.381	1.367	1.380	1.417	1.484	1.481	1.513	1.544	1.570	1.384	1.407	1.536	1.625
Annual Rate of Change	-8.6	5.0	4.3	0.2	11.0	7.6	9.4	8.9	7.1	-8.1	1.5	8.5	6.4
Housing Starts (Mil. Units)	1.281	1.325	1.387	1.440	1.504	1.561	1.629	1.686	1.750	1.060	1.419	1.654	1.898
Retail Unit Car Sales (Mil. Units)	8.7	8.3	8.5	8.7	9.2	9.3	9.7	10.0	10.1	8.0	8.7	9.8	10.6
Unemployment Rate (%)	10.7	10.6	10.5	10.4	10.2	9.9	9.7	9.3	9.1	9.7	10.4	9.5	8.4
Federal Budget Surplus (NIA)	-179.5	-193.1	-188.3	-215.4	-230.0	-217.3	-206.2	-200.3	-204.1	-140.6	-206.6	-207.0	-196.0
Money and Interest Rates													
Money Supply (M-2)	1908.7	2043.5	2109.4	2154.4	2216.9	2287.4	2304.5	2361.6	2430.6	1908.7	2216.9	2430.4	2656.2
% Change: 4th-Qtr. to 4th-Qtr.	9.3	17.5	8.6	8.0	12.1	7.3	9.0	9.9	10.4	9.9	11.6	9.2	9.7
New AA Corp. Utility Rate (%)	12.54	12.04	11.43	10.95	10.87	10.56	10.58	10.60	10.72	13.13	11.30	10.61	10.90
New High-Grade Corp. Bond Rate (%)	11.97	11.24	10.59	10.26	10.32	10.09	10.10	10.16	10.28	13.09	10.88	10.16	10.53
Federal Funds Rate (%)	9.29	8.41	8.53	8.60	8.01	7.99	9.32	8.63	8.81	12.26	8.60	9.09	9.01
Prime Rate (%)	11.96	10.99	11.29	11.00	11.37	11.90	11.63	11.29	10.92	14.86	11.18	11.42	11.50
Income - Billions of Dollars													
Personal Income	2632.0	2665.7	2710.3	2773.4	2842.1	2905.9	2971.0	3041.0	3116.2	2569.6	2747.6	3000.9	3284.6
Real Disposable Income (%Ch)	-0.3	4.1	3.1	6.7	5.6	3.9	3.0	3.9	3.0	1.1	2.9	4.4	3.4
Saving Rate (%)	5.0	6.4	6.1	6.9	7.1	7.4	7.4	7.3	7.5	6.5	6.6	7.4	7.5
Profits Before Tax	180.6	180.1	183.1	190.5	200.9	210.0	221.4	225.1	251.0	174.1	188.6	229.6	274.0
Profits After Tax	120.4	120.0	121.9	126.0	133.2	139.1	146.3	154.9	164.7	117.0	125.4	151.3	181.7
Company Profits	88.2	90.3	99.4	109.9	113.3	116.5	118.0	122.1	126.7	90.7	103.3	120.8	137.6
Four-Qtr. Percent Change	-16.3	1.9	8.0	16.9	28.6	29.0	18.7	11.1	11.7	-18.4	13.9	17.0	13.9
Composition of Real GNP - Annual Rates of Change													
Gross National Product	-2.5	3.9	2.0	4.3	5.3	4.9	3.9	5.2	5.2	-1.8	2.0	4.6	4.4
Final Sales	3.1	-0.1	1.0	4.4	5.0	3.7	4.0	3.0	4.9	-0.6	1.3	4.2	4.2
Total Consumption	5.0	1.5	3.1	3.2	4.0	2.5	3.0	4.1	3.1	1.0	3.0	3.6	3.4
Nonres. Fixed Investment	-9.0	-15.1	-2.2	3.6	5.7	9.6	8.5	9.1	8.4	-3.0	-7.0	7.0	8.1
Equipment	-12.1	-10.1	0.0	9.0	11.7	12.3	11.3	11.3	9.7	-6.0	-4.4	10.6	9.0
Nonres. Construction	-2.3	-24.6	-6.3	-7.4	-7.0	2.0	3.1	3.0	5.1	3.1	-10.5	-1.0	5.7
Res. Fixed Investment	24.3	40.9	19.5	30.5	17.1	10.0	14.1	16.1	14.4	-10.9	23.1	14.9	13.1
Exports	-26.9	-2.1	5.5	5.0	6.0	7.9	6.3	5.7	6.6	-6.9	-4.7	6.3	5.9
Imports	-14.0	0.0	5.0	7.1	6.4	5.9	3.6	3.6	3.3	0.6	5.6	5.1	4.1
Federal Government	20.1	-7.0	-15.2	10.2	5.0	7.1	-3.4	4.4	12.5	8.2	3.3	4.1	2.4
State and Local Governments	1.1	-1.1	1.0	1.5	1.5	-0.9	1.4	2.2	1.6	-0.9	0.4	0.9	2.2

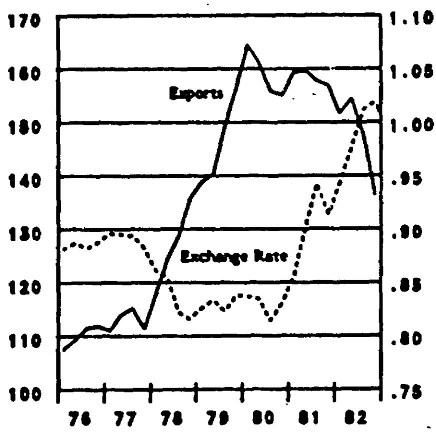
While recovery now seems assured, the case remains very convincing that it will fall far short of the normal 7% growth rates experienced in the past. There are at least four major negative factors that will hold back the recovery.

First, business fixed investment will take six months to a year to achieve a major turnaround. The capital budgeting decisions of 1983 were made in the worst possible environment, with profits very depressed and one-third of industrial capacity idle. Even if the outlook is now brightening, this will not be converted into a resumed growth of capital spending until past mid-year, and even then continued high real interest rates and weakened financial positions will hold back the investment recovery.

Second, the state and local government sector, which accounts for 13% of GNP and used to grow at over 5% a year, has no growth prospects at this time. The continued reduction of federal grants-in-aid and taxpayer resistance will keep its spending flat. While many states are in the process of trying to raise taxes, these increases are necessary to overcome the recession-induced deficits of the last few years and to compensate for the decline of federal aid.

Third, the outside world offers exceptionally poor prospects for our export markets. The industrial countries are reluctant to undertake significant stimulative measures; fiscal policies have been paralyzed by large deficits, and real interest rates are high everywhere. The advanced countries are waiting for the United States to lead the world out of recession, and with some justice since we led the way into it. The less developed countries, which are major markets for our capital goods exports, have been forced to reduce their development plans because of their debt problems. And even the OPEC nations, who have certainly benefitted from large infusions of purchasing power, have reached a stage where many of them have been forced to retrench their imports. The results of these international developments have been a very sharp decline in American exports (Chart 1), and we are still in the early stages of solving the debt problems, but it will be years before normal export growth can resume.

Chart 1
The Over-Valued Dollar Has Hurt Exports
(Exports—billions of 1972 dollars, annual rate SA, line, left scale)
(Exchange composite index, June 1970=1.0, dash, right scale)



Finally, though we make no allowance for it in the DRI forecast, there is the continuing danger that the Federal Reserve will return prematurely to a policy of tough monetarism. While the Fed neither could nor should abandon its long-run strategy of holding down inflation through a policy of moderate growth in monetary aggregates, there is lots of room for discretion within that general guideline. The DRI (and the government's) forecasts assume that the Federal Reserve will not drive short-term interest rates up sharply over the next two years. But it is certainly a continuing danger that they will return to the stop-go policies of the last three years, and react to the admittedly somewhat scary money supply figures by turning off the supply of new bank reserves and driving short-term interest rates back into double-digit territory. At the moment, the policy seems to be one of unchanged ease, with the pressures for recovery through lower interest rates offset by monetarist pressures for tighter money.

In summary, then, the economy is recovering, but the case for an abnormally weak recovery, with continued high unemployment rates, remains convincing. It would be a mistake to interpret the weather-aided favorable January economic data as indications of a dramatic change in the outlook. A mild recovery has long been expected for early 1983, and we should not be totally surprised if economic forecasts actually prove to be correct sometimes.

THE DEEPENING BUDGET CRISIS

In my 1980 testimony I warned of $45 billion deficits. In 1981, $100 billion deficits, in 1982, $132 billion deficits, and this year the prospect has worsened to $200 billion deficits without end.

Table 2 shows the current DRI unified budget deficit forecast, assuming that Social Security reform is enacted, the Congress accepts some civilian spending proposals and adopts a 1984 defense budget of $231 billion with 5 1/2% growth thereafter, but rejects the "contingency" tax. Deficits remain near $200 billion in the early years, and drift higher thereafter. The projections assume the DRI economic assumptions.

Table 2
Budget Prospects Without Major Tax Actions
(Billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Outlays	577	657	728	806	875	955	1,044	1,140	1,254
Revenues	715	599	618	620	669	761	843	930	1,024
Deficits	60	58	111	186	206	194	201	210	231

The reasons for the budget crisis are clear enough: President Reagan inherited a $60 billion deficit created by the excessive civilian spending increases of the 1970s. He then reduced the yield of the federal tax system by nearly 30% while launching the country on a massive program of rearmament. The recession and the incompleteness of the expected recovery cost many billions of revenue and expenditures only compounding the problem.

While the projected deficits may be reduced by $15 or $20 billion by the somewhat better economic prospects that seem to be materializing, there will be inevitable cost overruns of individual programs. While the current budget is probably among the better ones in attempting to provide realistic estimates of budget costs, there still is enough optimism in the specifics to make a cost overrun in the $20 to $40 billion range very likely. For example, the budget assumes a reduction in agricultural outlays from $21 billion in 1983 to $9.5 billion in 1986. Only $7 billion of that reduction is predicated on the President's statutory proposals. The Export-Import Bank, whose loans will be desperately needed to retain a reasonable volume of exports in a increasingly competitive world economy, is forecast to cut its outlays in half by 1986, yet proposals to step up outlays substantially are being advanced. No budget provision is made for the large, coming U.S. contributions to the International Monetary Fund. Revenues are projected to increase from oil royalties and uranium sales. Large and rising profits are to be earned by the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation in the coming years. Within the defense budget, one can anticipate the usual 20% to 50% overruns of particular weapons systems, only part of which will be converted into stretchouts, and the levels of operations, maintenance, and troop pay expenditures look to be unrealistic in the face of the enormous procurement outlays for sophisticated weapons systems. As a basic working assumption for the 1980s, it would be realistic for the Congress to take $200 billion plus as the baseline for considering changes on the revenue side of the budget.

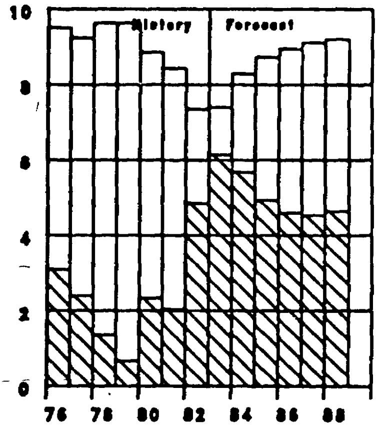
The President has proposed a "contingency tax" ostensibly designed to provide an insurance policy that the deficits ultimately will be brought down to 2 1/2% of GNP. It provides a basis for the Administration to state that it is dealing with the budget crisis. The actual proposal, only to become effective if the Congress meets various Presidential criteria, would call principally for a $5 tax on oil, designed to yield nearly $30 billion. Such a proposal would be almost certain to fall prey to the lobbyists community, and in any event it would be strange for the Congress to vote such a tax three years before its possible application. The remaining $10-$15 billion or so of revenues are to come from a 5% surcharge on the personal income tax. It is also hardly likely to find Congressional approval at a time when the President is carefully preserving the enormous income tax reductions of 1981 at least past the 1984 election. Combined with the President's unwillingness to offer even a moderate program of defense savings, one has to reach the unhappy conclusion that the President did not face up to the budget problem, except by proposing civilian spending cuts. Those measures alone can make only a small contribution to solving the budget crisis, given the cuts that have already been enacted and the small share of the total budget that they represent.

The Congress should pass Social Security proposals which will restore a balanced budget to that segment of the federal programs, and should face up to escalation and excessive coverage of other entitlement programs, and should continue to scrutinize all federal expenditures very carefully. But it is an illusion to believe that the solution to the budget crisis lies in this area. Only a combination of defense savings and sizeable tax increases can bring the budget crisis to an end.

HOW DAMAGING IS A LARGE BUDGET DEFICIT TO ECONOMIC RECOVERY AND GROWTH?

Can the economy thrive without facing up to the budget crisis? Chart 2 shows that the deficits swallow about half of the country's savings, boosting interest rates, absorbing foreign capital and reducing investment.

Chart 2
Federal Deficit as a Percentage of the
Total Personal, Corporate, and Local Government Savings



How damaging are federal deficits in the range of 5% to 6% of GNP over a prolonged period? It must be recognized that we are in unknown territory in evaluating this condition. We have never, in normal times, run deficits of this magnitude so we are far beyond the range of observation. However, first approximations of the effects can be calculated with the use of an econometric model assuming that the "crowding out" relationships are reasonably close to proportionate with the actual size of the deficits. In some previous DRI studies[1], we analyzed the effects of budget deficits. These studies

In some previous DRI studies[1], we analyzed the effects of budget deficits. These studies show that the deficits boost short-term interest rates by several hundred basis points, raise bond yields by over 100 basis points, lower housing starts and car sales by several hundred thousand units, and reduce business investment by several percentage points. Productivity recovery is set back by the reduced capital formation. A policy of persistent large deficits is the worst kind of supply-side economics, with the effects so large that they far outweigh the supply-side stimulus that the 1981 tax program will be providing.

WHAT SHOULD BE DONE? WHAT FEDERAL TAX SYSTEM FOR THE 1980'S?

Many of the ingredients of the solution to the budget crisis are well known: the Congress must enact savings in defense and entitlement programs, and the Federal Reserve must pursue a monetary policy of sufficient accommodation that the economy can achieve a sustained, moderate recovery which will aid revenue growth and reduce unemployment-related expenditures.

But the key issue which the Congress will have to face over the next few years lies on the revenue side of the budget: how will the Congress close the remaining deficit gap? The President's policy is clear: he is determined to resist any givebacks of the enormous personal tax reductions of 1981, including indexing. While he hopes that economic recovery will bail out the budget—an unrealistic hope, in my judgement—he would

---

1 Otto Eckstein and Christopher Probyn, "Do Budget Deficits Matter?" Data Resources Review, December 1981, pp. 9-15. A more recent study, using expected budget deficits as an important interest rate variable, finds even larger effects. See Allen Sinai, "Stage II: Reaganomics and the Financial Markets," Data Resources Review, February 1983, pp. 37-45.

probably favor some kind of consumption tax, a sales or value-added tax, or a collection of excises, if further action should be needed. If this program were to be enacted, the federal tax system would undergo a very dramatic shift in these years.

A set of DRI simulations trace the basic magnitudes (Charts 3-6). It is assumed that the deficit will be cut to 2 1/2% of GNP in two ways: one would adopt the Rostenkowski proposals to stop the enacted tax cuts from 1985 on and would impose a 10% personal tax surcharge beginning in 1984. The other simulation imposes a consumption-based tax of 2 1/2% of GNP also beginning in 1984. It can be seen that the personal income tax strategy pushes the share of this revenue source up to the late 1970's level. Corporate taxes have been cut so much that their role has become minor. Payroll taxes would keep rising, but would be a falling fraction of total revenues because other revenues would be advancing so rapidly. Under the consumption tax strategy, these taxes would become 18% of all federal revenues, a doubling of recent levels. They would, inevitably, be regressive, raising the tax burden on lower and middle-income families, leaving upper income groups largely immune to the rising tax burden created by the defense outlays. The middle- and low-income taxpayer would be asked to pay for the military burden. The nature of our society would be changed by this change in the tax system: the spread between low and middle-income and upper-income families would widen. While savings might, indeed, be enlarged by this strategy, so would the concentration of wealth and the increasing disparity in the standards of living of different segments of our society.

CONCLUDING COMMENTS

The economy is in a recovery, and we should all breath a great sigh of relief following the frightening months when both the U.S. and the world economies were shrinking at alarming rates. The probability is still very high that the recovery will be quite

Chart 3
Personal Taxes as Percent
of all Federal Taxes

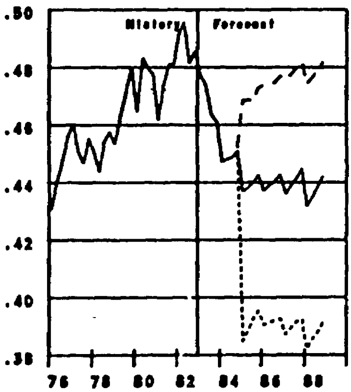


Chart 4
Payroll Taxes as Percent
of all Federal Taxes

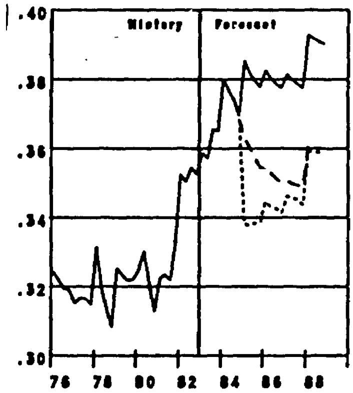


Chart 5
Corporate Income Taxes
as Percent of all Federal Taxes

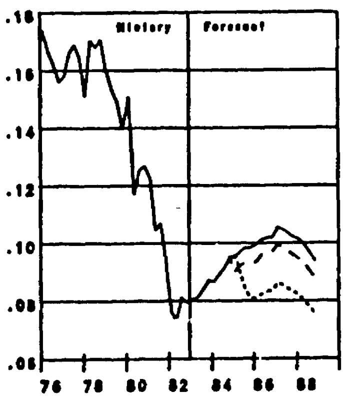
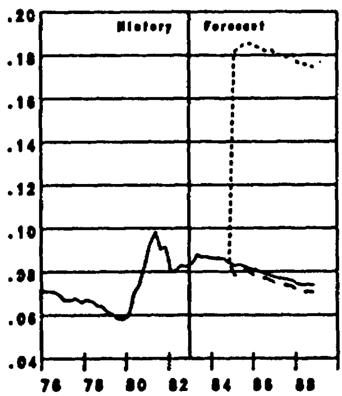


Chart 6
Indirect Taxes as Percent
of Total Federal Taxes



———	No Action
······	Consumption Taxes
- - - - -	Personal Income Tax Increases

subnormal, given the troubles of the outside world, the weak near-term prospects for business fixed investment, and the no-growth prospects for state and local governments.

But economy recovery will not solve the budget crisis. The "structural" budget deficit, i.e., the deficit that remains once recovery is well advanced, is enormous, and the actual budget deficit gives every sign of exceeding $200 billion throughout this decade. The President's tax proposals are unrealistic. The key question that will confront the Congress and the country over the next several years is this: what kind of tax system does this country want? Do we want to preserve the personal income tax as a partial equalizer of incomes? Or do we wish to drift into a system of consumption taxes of one sort or another, under which middle- and lower-income families would bear a much larger share of the burden?

I have confidence that the Congress and future administrations will ultimately take the difficult step of enacting tax measures that will be necessary to end the budget crisis. The more quickly the Congress rescues at least portions of the income tax through repeal of the indexing provisions to begin in 1985, the other Rostenkowski proposals and perhaps other measures, the greater the chances that income taxes will play their traditional role. If nothing is done now, budget deficits will stay in the $200+ billion range. The country will then have little choice except to swallow a large dose of new consumption taxes. I therefore endorse the proposal by Chairman Rostenkowski calling for a suspension of tax reductions until the year 1985. These proposals will make a dent in the prospective budget deficits, though they will hardly be sufficient to deal with the problem fully. The big tax decisions still lie ahead.

Senator PROXMIRE. Thank you very much, Mr. Eckstein.
Mr. Greenspan.

STATEMENT OF ALAN GREENSPAN, PRESIDENT, TOWNSEND-GREENSPAN, INC.

Mr. GREENSPAN. Senator Proxmire, I won't take the time of the committee to essentially repeat a number of the issues that Professor Eckstein outlined because I find that we are in surprising agreement about a very substantial part of his testimony.

I would like, however, to focus on a few issues related to the outlook and policy and hopefully not go over a considerable amount of the ground that Mr. Eckstein just has completed.

First, there's been a great deal of talk about the turn in the economy. We are taking it as a given and I think that's right. The evidence of the turn at this particular stage is pretty conclusive. It's conclusive in the sense that what we are observing is not only a series of generalized indicators, but there is a process going on which is classical to an economic turn. Hence, one would expect to see for the next several months very substantial evidence of recovery.

We had in late December a situation in which the rate of inventory liquidation was very large. It was a last gasp of liquidation which American business was going through as its fears about the depth of the recession finally exhausted themselves in final action, so to speak.

What that meant, of course, was that production was well below the level of consumption, in fact probably quite significantly so. We also were getting a continued decline in unfilled orders in the basic heavy industry structure, and what that, of course, meant was that the level of new order intake was below the level of production. So what we had as of late December was a new order level very substantially below the consumption level and that can persist for just so long. Either consumption falls or new orders begin to move up. Indeed the bottom of the business cycle is most clearly signaled when new orders begin to move. Even though we do not have yet at this stage enough information to suggest that the turn is not only here but formidable, we have a number of indirect indicators.

We have a major move now underway in commodity prices, in steel scrap, copper, in a number of the general small but important nonferrous metals, nickel for example. What this signifies is that the currently weakest part of the economy, that is, that part of the industrial structure which is at the bottom of the pyramid of industrial development, so to speak, is the area where the rebound is most pronounced. This is a necessary condition for the turn. And the evidence continues to mount day by day that that will continue.

I think, however, it is a bit premature to take the types of numbers that we're going to be seeing for the first quarter as indicative of the strength of the recovery. Mr. Eckstein has mentioned that there were seasonal factors involved and indeed there are. A substantial part of the recovery in employment from the payroll establishment series, in January is clearly of that nature. However, even making that adjustment, the decline in employment by any measure is over. The layoff rate is falling, and the very dramatic rise in average hours worked in January is indicative that the first sign of increased need for labor is beginning to emerge. That invariably reflects itself in a rise in average weekly hours before it begins to affect employment.

The layoff rate continues to slip, which is another indication of the fact that the labor markets are improving at a fairly pronounced rate. What one can say about all this is that we should in the months ahead see a fairly dramatic recovery in new orders, a perhaps surprising pickup in industrial production which for the month of January was up quite significantly and is holding its own in February if not going further. What we will see in all of this is the early stages of a very significant classical rebound, and I'm fearful we will read into those data that this is nothing more than a standard post World War II recovery which will carry through at a very dramatic rate and that all of our problems are over.

I share Professor Eckstein's view that they are in fact not over, and the major reason they are not is what is different in this particular business cycle. Interest rates are far higher than they should be whether one defines them in real terms or nominal terms. They will be an inhibiting factor which will create problems as the recovery endeavors to move beyond its initial and perhaps fairly rapid recovery stage.

The problem is twofold as I see it. One is the general Federal budget problem which I believe is by far the most important. That is creating a very unstable long-term outlook. There is no question that the current rate of inflation is down and its decline is real. There is nothing phony in the statistics of the Consumer Price Index or in the Producer Price Indexes. There is a true disinflationary process going on, and were it not for the fear of the financial markets that the huge Federal borrowing requirements in the so-called outyears would induce a major expansion in money supply growth to finance it, we would have inflation expectations now down very sharply.

Mortgage interest rates, instead of being in the 12- or 13-percent range, would be at 6 or 7 percent. And if one wants to simulate a major recovery for this economy, take any of our models and insert 6 percent mortgage interest rates in them and the hypothetical economy just goes wild, as indeed it would in the real world.

Consequently, financial observers are saying that the short-term disinflation, although real, is temporary and within the next year, 2 years, maybe even 3, a reignition of inflationary forces will again hit us. That creates long-term interest rates which are currently too high to sustain a normal restoration of prosperity.

The second issue reflects the issue of debt in the private sector. One of the reasons why we are having so much difficulty in money markets and will continue to have is that we have financed both domestically and internationally a major expansion inordinately through short-term debt. The use of short-term debt to finance long-term capital investment has been unsustainable. The effect of this has been a significant rise in the ratio of short-term to long-term debt and this is true not only among American corporations, it's a characteristic pretty much worldwide. That clearly creates a situation in which something has got to give. You cannot continue this particular form of balance sheet constriction. What is now beginning to occur as a consequence of this, wholly independently of the interest rate levels, is a rise in risk premiums, a rise in uncertainty in corporation financing, which essentially reflects the fear of having too much short-term debt on the balance sheet and, hence, the uncertainty with respect to interest costs in the later years. This process itself is creating a large element of uncertainty and has been a factor in the general lethargy of the economy both here and abroad.

Concurrent with that and perhaps reflecting much the same thing has been until very recent years a significant decline in capital asset ratios in the international banking system. One would assume that if you're dealing with a world economy in which floating exchange rates and volatile interest rates are becoming the more prevalent state, what you are in effect looking at is an asset side of a commercial bank's balance sheet whose market value is fluctuating very substantially. In fact, the ratio of market value to book value in recent years for these banking institutions has undergone a high degree of instability.

As a consequence of that, the risks of a significant loss to the bank is obviously substantially increased as indeed significant gains as well. But that means you need a higher ratio of book capital to book assets than in the earlier periods when this was not the case. Therefore, for stability in today's international financial environment one would need a significantly higher ratio of book capital to assets than we now have. Instead of a decline in the last decade in the ratio of capital to assets, we should just to stay even have undergone a significant increase.

We are caught in a situation in which not only are borrowers in very significant debt trouble or balance sheet trouble, but so are the financial institutions. And one can see the solution to this very simply. All we need is to take 4 or 5 percentage points or more off long-term interest rate. That would create an environment in which a significant amount of funding of short-term liabilities was possible and clearly also make the financing of existing outstanding debt very much easier. And that rests basically on bringing down long-term inflation expectations which essentially means removing the fear, a rational fear, of the financial community that the huge budget deficits, the hemorrhaging of our fiscal system, so to speak, will be brought under control.

Now, there are a number of ways of doing this, none of which are appetizing. The Congress will confront in the years immediately ahead the problem of making unsavory choices. Those choices are the same types of choices we in the Social Security Commission had to face. Hopefully, our basic conclusions will be ratified by the Congress, but this is only the first in a long series of actions which are by their very nature the types of actions which are very difficult to implement in a democratic society.

They have got to be done. There is no choice. Many of the solutions which Mr. Eckstein raised I don't like. I don't like a value added tax. I think it's terrible. But own personal view is that it's the least worst way of getting out of the revenue shortfall. Curbing the growth in defense expenditures unquestionably is not a desirable thing from the point of view of our military posture. Yet, if we don't do that we are probably creating a greater undercutting of our national security in the sense that the soundness of our economy is perhaps the most important element in our broadest definition of national security.

In short, there are a large number of undesirable actions that the administration and the Congress will have to confront in the years ahead. Yet I see very little choice but to do so.

Thank you.

Senator PROXMIRE. Thank you, Mr. Greenspan.

Both of you gentlemen, it seems to me, stress the same fundamental problem we have which is, of course, the colossal size of the deficits, unprecedented, nothing like it, far bigger than ever before. Mr. Eckstein, you put it into relationship with the GNP so that we are not just talking about an inflation figure that isn't related to our economy, and I think that you're absolutely right.

I, particularly, want to congratulate Mr. Greenspan on the way he concluded in pointing out this is going to be extremely difficult for us to do. There's nothing less popular if you're an elected official than cutting popular spending programs unless it be increasing taxes. Both of them are riding into the valley of death. I guess we have to face those grim prospects.

In spite of all the grim situation, it's funny that we have two really brilliant economists, sophisticated and understanding, and yet no mention of the fact that yesterday the stock market hit an alltime high. It seems to me that you probably noticed that but I think you probably also realized that that may not be a bet on long-term recovery but a bet on the likelihood of inflation in view of the colossal deficits we face.

Mr. Eckstein, you gave us a good beginning, but only a beginning, of what we do to get around this deficit problem. You recommended the Rostenkowski formula which I think is certainly sound as far as it goes, but wouldn't it be necessary for us on the basis of your predisposition with respect to progressive taxes to forego the 1983 tax cut completely and not just cap it but forego it?

Mr. ECKSTEIN. Well, 6 weeks ago I held the view that the economy was so shaky—the recovery was not yet visible—that you should do nothing to get in the way of the recovery in the next 6 months.

Senator PROXMIRE. This doesn't increase the tax, of course. I'm just talking about not cutting it.

Mr. ECKSTEIN. The only really good item out there in the economy to lift it at that time was the tax cut. As the economy looks better and better, the argument that maybe we should forego the July 1 tax cut comes back.

Now, if you ask me today, I would still say it's too early. We need that tax cut to get the economy moving. That's in the very short run, a shortsighted point of view.

Senator PROXMIRE. Well, pardon me for interrupting, but isn't that a permanent decision that we make when we do that? Once you cut it, as you indicated, it's gone. And it would seem to this Senator that since we haven't made the cut as yet and since the poll that I showed a couple weeks ago showed that a majority of the American people, including a higher percentage of Republicans, interestingly, favor foregoing that tax cut in view of the size of the deficit.

Mr. ECKSTEIN. There's no doubt in my mind that if you take the 1980's as a whole we would be better off with that tax cut foregone. We would not be better off in 1983. If you want to take a farsighted point of view, which I suppose is a better point of view, then particularly given the fact that the recovery is underway, small though it may be, it would probably be wise to forego it if it could be done.

Senator PROXMIRE. And you would cancel indexing?

Mr. ECKSTEIN. I would certainly cancel indexing. That's not a close decision.

Senator PROXMIRE. Mr. Greenspan, do you have any specific recommendations with respect to what we might do about increasing revenues?

Mr. GREENSPAN. Yes, Senator. This is one area in which I think Mr. Eckstein and I disagree. First of all, let's start with the indexing question. Let's remember that indexing is a means by which we try to keep the ratio of tax liabilities to taxable income unchanged unless there is specific action by the Congress, acquiesced in by the President or initiated by him, to literally raise tax rates. That was one of the most important aspects of the 1981 tax legislation. It is very useful to have in our basic structure of taxes.

Now, while I am not in favor of an increase in individual income taxes, I would prefer, as tax policy, to have indexing and if need be, raise individual income tax rates.

I must say, however, that I find that the rate structure initiated in the 1981 act is something I would prefer to see unaltered. If it comes to a question of raising revenues, as indeed I think part of it will be, although I don't think that it's the fundamental solution, I would much prefer to move toward some form of consumption tax.

I must also emphasize that the type of budget problem we've got is far more deepseated than can be readily resolved by twisting a few dials, changing only a few things. There is a very significant danger that we are looking at an underlying rate of growth in Federal outlays which our current institutional structure is driving up as a percent of GNP. That can continue for quite a while, but if we endeavor to close the gap wholly or primarily from the tax side we are in effect mandating that the ratio of taxes to GNP or to taxable income is continuously rising in the long term. We know that that is something which cannot continue beyond a certain point.

There have been numerous debates of late about whether tax increases can become counterproductive with respect to an increase in revenue. I have always been one who has argued that those who in recent years have postulated major increases in revenues from cuts in taxes are essentially employing a wrong set of numbers.

The thesis, however, that there is a limit has got to be true. Since this budget problem is a long-term problem, I would be very careful about endeavoring to solve it solely from the tax side. And one of the dangers that I find with eliminating indexing is it makes it easy to acquiesce in this rise in both expenditures and taxes as percent of GNP. This problem has got to be addressed and closing the deficit solely from the tax side in the long run, in my judgment, does not solve it.

Senator PROXMIRE. My time is just about up, but I think I have time for one more question.

Many people feel—and you gentlemen are both recognized as probably the best in the country in forecasting—I'm not sure that's a great compliment because forecasting is hardly a science as you know—but you're as good as they come. Some people argue that the administration's economic forecast is rather pessimistic. As you know, it's at the bottom—not at the bottom but, I think, Secretary Regan testified it was eighth out of 45 forecasts from the bottom and therefore seems to be pessimistic.

But in the long run the administration foresees 6 years of uninterrupted growth at 4 percent. That's one of the ways they get their deficit down in the outyears through 1988.

Based on recent history, how likely is that? It seems to me that the only recent experience we've had with a longer recovery was in the 1960's when it was prolonged in part by the Vietnam war. Suppose the typical pattern takes place with a downturn in 1986. What would that do to the forecast?

Mr. ECKSTEIN. Well, if there were a recession in 1986, obviously, the deficit would go beyond $300 billion. Considering the depth of the current recession to the catchup element here is rather large so a pretty hefty growth rate on average is pretty reasonable.

Senator PROXMIRE. Isn't that balanced over by the colossal size of deficits which is going to produce all the problems you told us about?

Mr. ECKSTEIN. The essential problem that you have to deal with is to recapture our productivity trend.

Senator PROXMIRE. Recapture what?

Mr. ECKSTEIN. Recapture the advancing productivity which this country benefited from the Civil War until 1975. Since 1976 productivity is essentially unchanged.

Now we have a labor force growth below 2 percent so to get these high growth rates of 4 percent you need some gap closing which is certainly going to happen in near term and you need to get productivity back on to some normal advance. And that's where the deficit rears its head. Because of its claim on our capital, it will to some extent thwart that productivity recovery.

So that's the big question mark that overhangs all of these figures. Now the Council of Economic Advisers is very careful to say that they don't expect steady growth for 6 to 8 years here, that probably there will be fluctuations, recessions, what have you. But they think what they've put out is a reasonable trend line, a reasonable average. I think they're pretty reasonable.

Senator PROXMIRE. Mr. Greenspan.

Mr. GREENSPAN. I would agree with that. I think in general the economic forecast put out by the Council of Economic Advisers is a sensible one. It probably would have been a bit more optimistic in the short term if it were being done today or 2 weeks ago. But considering when it was done, I thought it was done in an objective fashion.

Senator PROXMIRE. You wouldn't quarrel with the notion that we could have 6 years of uninterrupted growth?

Mr. GREENSPAN. Six years of uninterrupted growth has a very low probability of occurring. But if there was a recession in that period you probably would have 1 or 2 years well in excess of 4 percent to average out. If we can get inflation premiums down, if we can control the long-term budget, that is not an unreasonable forecast.

Senator PROXMIRE. The "ifs" are pretty big.

Mr. GREENSPAN. Well, I'll put it to you this way. If Otto Eckstein next year looks at his series of fears about the size of the deficit and says, "In 1983 I was terribly concerned about a $200 billion deficit and this year being 1984 I'm concerned about '*x*' and it's much higher," then I would say a 4-percent figure has a very small chance of occurring.

Senator PROXMIRE. My time is up. I'm going to have to leave and, of course, the vice chairman will take over.

Representative HAMILTON [presiding]. Representative Holt.

Representative HOLT. Thank you, Congressman Hamilton. I'm confused. I thought after 10 years here in the Congress I knew everything about economics and now I find that some things are being said that I don't understand.

Raising taxes bothers me. I have always felt that this was not the right way to go and I think Mr. Eckstein indicated that this may not be exactly the right time, but isn't there grave danger if we do that? It seems to me unless we get our saving rate up, unless we're able to leave some money with the people to do the things that we have to do, that there is a grave danger there.

You indicated that we should put an end to the indexing before people had the opportunity to enjoy that money. Isn't enjoying it, spending it to create more consumption, more job opportunities, investing it, saving it; isn't that necessary? This really troubles me.

Last year we increased taxes by $98 billion and the deficit just kept right on going. I can't see that any time we've ever increased taxes that it has made any impact on spending. I think, on the contrary, we just see more money that we can spend over here to make more people happy and hope we'll be able to stay here another 4 years. Is that true?

Mr. ECKSTEIN. Representative Holt, I think in the last 15 years we have done three things which are inconsistent. We have substantially liberalized our entitlement programs. We have more older people. We have raised social security quite a lot. We have food stamp programs, medicare, a whole selection of social programs which are beneficial to our people, and I don't think most of us would want to undo them.

We have also, especially beginning in 1979, engaged in a very major increase in our national security and we feel that probably is necessary.

Then the third thing I would indicate was that we also reduced a tax burden which really was too high. I think by 1981 you had a situation where middle income families were facing marginal tax rates of 40 or 50 percent which really is wrong. But the trouble is that we want all those things. We want a tax system that doesn't get in the way of our incentives, productivity, savings, and what have you. We want the defense and we want to take care of our older people, our sick people, and our disadvantaged people and it just does not add up.

It is unfortunate you cannot logically combine a major national security campaign to raise our inheritance—spend all that money on weapons systems and so on—and at the same time bring down the tax burden. The people have to pay for the defense.

Representative HOLT. I think Mr. Greenspan certainly expressed it well that there has to be a balance here between the gross national product and how much we're going to spend, but it seems to me that right now is just not the time to try to make that decision. Can we get real interest rates down unless we improve the savings rate in this country? We've brought it up a little bit.

Mr. ECKSTEIN. The real interest rates will stay high because of the problems that are out there, including the budget. 1983 is not an important year in terms of the deficit because the recession is so uneven. The private credit demand is so small that the deficit does not get in the way of recovery this year. So from an economic point of view, I would say to you, do it next year. That's not very realistic advice because next year is a big election year. If you could do it, it certainly would be very desirable if we came to grips with the issue in 1983 rather than in 1984. Now I realize that the climate of opinion is not ready to deal with it in this large dramatic way of new tax sources or whatever, but at least let's get a start on it.

There are some things we can do now and I endorse indexing. I think indexing is a very logical idea, long overdue, but at this time we just can't afford it.

Representative HOLT. But it would benefit the middle-income people more than the people you alluded to who were overly taxed, right?

Mr. ECKSTEIN. It would help them more than the tax cut we've enacted, that's right.

Representative HOLT. Mr. Greenspan, if you can help me out any, I'd appreciate your speaking up.

Professor Thurow testified yesterday that the Federal Reserve System ought to target real interest rates instead of the monetary aggregates. Can that be the dominant guide to monetary policy?

Mr. GREENSPAN. It would be delightful if one could wave a wand and just reduce real interest rates. In fact, if that could be done, we would have done it by now. The problem is not that it's an undesirable goal. The fact is that it's an unimplementable goal. Real interest rates are something over which monetary policies have very little effect. The basic thrust of monetary policy, as I see it today, is being dramatically affected by the huge outyear budget deficits. The presumption that somehow the Fed can twist a few dials and change policy targets, change their mechanism of dealing with reserve balances and somehow bring real interest rates down, and bring nominal interest rates down, is a wishful illusion.

Representative HOLT. Well, this is what bothers me. As long as we continue the deficit—we're talking about jobs programs now. I talked with Mr. Schultze the other day and he's not feeling too happy about the stimulus that his administration offered and the effects that it had and he didn't exactly say that it wasn't the right thing to do, but you could see that he felt he wouldn't do it again.

Mr. GREENSPAN. I assume you're talking about Charles, not George.

Representative HOLT. Yes, Charles, during the Carter administration. We're talking about the AFL-CIO recommending billions of dollars for jobs creation and all the studies that I have seen show that past jobs programs have not brought the jobs on line. Mr. Eckstein indicated, you have to target them very carefully. But can Government do that? Aren't we going to shut out some private sector jobs, and then aren't we just going to increase the deficit, and isn't that going to add to the lack of confidence down the road, and isn't that going to keep long-term interest rates high, and isn't that going to keep the dollar high, and aren't we just going down the wrong road if we do those things?

Mr. GREENSPAN. Well, the so-called jobs bills don't create very many, if any, jobs. I think certain initiatives probably have a negative effect on the jobs structure. I don't think there's any question that if somebody were to ask me for a creative jobs program, I would say do something to get long-term interest rates down three percentage points. That would create huge numbers of jobs. At this particular time we may have particular advantage from a specific programmatic jobs program. There may be specific things that people want to get done. But the belief that a program could substantially reduce the current 11.5 million unemployed that exist is extremely unthoughtful.

Representative HOLT. There are those who say that the only answer is to reinflate. How serious is that point of view?

Mr. GREENSPAN. I don't think there is a serious group of policy consultants at this stage who argue that. We are all pretty much in agreement that the economy has turned and perhaps while we disagree on a number of different avenues, I don't know of anyone who would seriously talk about a major reinflation in the classical sense of driving the deficit higher than it is currently. I don't think that that would in a sense be stimulative. If anything, it would be a major negative force toward employment and toward the rate of growth in the GNP.

Representative HOLT. Would you agree with that, Mr. Eckstein?

Mr. ECKSTEIN. Well, it's really too late to try to cure this recession with traditional fiscal policy measures. Indeed, in the past, we have not been very effective with fiscal policy in dealing with recession because it's too slow.

The report card on jobs bills isn't all that favorable. The studies that have been done on past jobs programs are kind of a mixed bag. It's not that all of the money is wasted. Some very useful things are accomplished with those jobs bills and the cost really is less so you can do something, and also if unemployment really becomes a large problem as it is today you do have to be concerned not only about the GNP and the interest rates and all those macroeconomic things, but you have to get the money to the people who are unemployed and help them with jobs.

On the real interest rate question, I agree with Alan Greenspan that we cannot control real interest rates, but we can look at—I do believe they are as important a measure of monetary policy as a lot of other things they look at and I don't believe we are violating any deep principle by having a desire to lower those real rates and thinking through how we can get them down.

The fact that we all agree that they are kind of high or probably too high for the country's good is quite an important piece of intelligence and it's probably enough to make the Federal Reserve not raise interest rates to 20 percent in the next year or 2. When they did that, we didn't even think about the real interest rates. That was not in the vocabulary people talked about. So what the Congress did last year is forcing the Federal Reserve to think about real interest rates, I don't think that's damaging at all. I think it's almost constructive.

Representative HOLT. How about reinflation?

Mr. ECKSTEIN. Well, reinflation, I would interpret to mean either a policy of massive spending now or massive tax cuts now. The traditional Keynesian way of getting the purchasing power up and what have you—and we all realize that it hasn't worked that well and it's much too late anyway. The other way to reinflate is by pumping out money like mad, put out the bank reserves so you flood the country with liquidity that it will lift itself somehow, and there again, that works once or twice and it doesn't work seven or eight times. We have been through this change. By now if you pumped out money irresponsibly all you would do is scare the financial community and raise interest rates.

Representative HAMILTON. Congressman Hawkins.

Representative HAWKINS. Thank you, Congressman.

It seems that there's a tendency to overlook the human aspect in recovery. My impression, Mr. Eckstein, is that you have indicated that we may have a recovery of very short duration, which may not be sustained. I think you made reference to the value of a jobs program in connection with it. May I hasten to say that no one who is responsible that I know of is suggesting, as the President seems to imply in terms of a jobs program, that we've got to get people busy building pyramids or filling holes or anything else.

What we are talking about is productive jobs to employ at least the 12 million officially unemployed and the perhaps many more who are actually unemployed and underemployed.

You indicated that the probability of a tax increase is rather remote, that likewise any decrease in military spending is not likely to take place. Do you see any policies that are now in operation that would likely sustain any recovery if indeed there is one? I'm not talking about a technical recovery. Just to move from minus zero growth to positive growth may be a technical recovery, but obviously that is not what I'm talking about. I'm talking about a real recovery in which we have some economic growth in excess of that which is now being projected so as to sustain over a long period of time that recovery.

What I'm asking is do you see at this current time any policies that are in place that will make that recovery reliable and sustain it over a period of time?

Mr. ECKSTEIN. Well, first let me say that the unemployment problem is going to be a major problem for a long time. Our forecast calls for an unemployment rate of 8 percent in 1985 and that still, according to anybody's serious study is substantially more than would be natural. So the problem is very real and is not really going to go away with the recovery.

Now the budget as a whole is highly stimulative. I mean, nobody would want to make the budget more stimulative for its own sake. We are running an enormous full employment deficit because of the tax cuts. Where we've gone astray is not facing up to more of the problems that go with the unemployment. As this recovery takes place, it is not going to lift Detroit by much. Of course, car sales will be up, a lot of them will be foreign. The recovery in steel, textiles, rubber, and many, many industries is going to be very, very incomplete, much more incomplete than for the country as a whole, because of foreign competition and the decline of these industries. We are not really addressing that issue seriously in this country. We have put through a broad reform of depreciation allowances which should be helpful, but these industries aren't making any money. These reforms don't do very much good if you're not making any money. In any event, they are so general and are really of the wrong order of magnitude compared to what needs to be done.

So the missing programs are really the programs that focus on the specific structural problems in the country, the people who are really out of the mainstream, for lack of education or whatever, and the problem industries and the problem regions.

Now, the programs now in place are, if anything, too generous. I mean the budget is in a huge deficit. There's no getting away from it.

For its own sake, you would do nothing to enlarge this deficit. And, yes, obviously if you didn't have—even defense spending creates jobs. They all create jobs to a degree.

Representative HAWKINS. Well, do you see any particular role a structural jobs program would play in the current economy in terms of recovery. Without dismissing the importance of monetary and fiscal policy and agreeing completely with Mr. Greenspan in what he says about getting the interest rates down—agreeing with that, we have had the situation even in times of prosperity where millions were still unemployed, so we do have a structural problem.

For that reason, there are some of us who do advocate addressing those structural problems in a targeted specific manner through an overall employment and training policy.

My question then is, to what extent are we doing at this particular time that which we should have done perhaps before this time? Can we really expect this number of individuals to find jobs even in recovery unless we have somes specific programs that will alleviate the problems of those who structurally are unemployed because of low education or lack of skills, because of discrimination and because of many other factors that are not going to be in any way affected whether we get the interest rate up or down?

Mr. ECKSTEIN. Well, I agree with Mr. Greenspan that the overall recovery is governed by the financial problems in the budget. What I would do on the structural side is to try to do whatever we do well because we had one shot at this problem once before. I served under President Johnson when we passed most of our Great Society legislation and I identify with it. The first time we ultimately let the programs out into the public—too broad a coverage and the cost got out of hand and we made college students and strikers and all kinds of people eligible for food stamps and middle income and indeed everybody eligible for college tuition aid and loans and so on. So, in the end we were too generous so that ultimately the people rebelled at the tax load that was created and we have now made a very dramatic retreat from those programs.

It doesn't mean that those programs aren't needed, but the next time we do it we really are going to deal with the problems for real, not just spend the money, but target the money on the people and the areas and the industries that need the money, and we should administer it in a much more sound institutional structure to administer these programs than really the pretty casual structures that were put up in the early 1970's and late 1970's.

Representative HAWKINS. Could I ask Mr. Greenspan—you made mention of the use of monetary policy and fiscal policy as a means of helping in the recovery. You did not seem to indicate any particular role or any value for structural programs say in terms of reducing the unemployment rate. I'm not sure that is completely a restatement of what you said, but would you agree that in terms of macroeconomic policies that there is still a role which microeconomic policies, including a jobs program, could play in terms of insuring a more stable recovery than what I have been hearing this morning?

Mr. GREENSPAN. I think you interpret me correctly, Congressman Hawkins. The problem of unemployment is to such a substantial extent a basic underlying cyclical or economic growth problem that I'm concerned that we will take our eye off that as the really fundamental problem for the job market. If we do, we will scatter our resources in a way which probably in the long run will not be productive to maintaining the highest level of employment that we conceivably can.

I don't deny that a number of different programs have some advantages and in certain instances they are probably conducive to some modest increase in the level of employment. But when we are dealing with 11.5 million unemployed, any advantage coming from these programs, in my judgment, is almost lost. As a consequence, diverting our resources, diverting our focus from which I think the major job program is, namely getting the economy growing as quickly as we can in a long-term sense, is a mistake. I am concerned that if we are to do that, the net overall effect may not be positive toward jobs creation.

Representative HAWKINS. May I say that I certainly agree with you. Let me reverse the question, however. In agreeing with you that long-term growth is much more essential, do you see that long-term growth in the projections that we now have, either in the administration's projections or in any of those that we have been hearing today? In other words, do you think that a growth rate of less than 5 percent or even around the administration's projected 4 percent level will produce the jobs we need? Now, do you see that growth doing it and removing some 12 to 15 million persons from the unemployment rolls?

Mr. GREENSPAN. No; I see no way in which any realistic expectation of growth in the American economy over the next 5 years is going to essentially remove the unemployment problem that now confronts us.

However, I do come up with numbers not dissimilar to Mr. Eckstein's for 1985 and I assume beyond. Nobody likes an 8-percent unemployment rate. When we were down at 5 or 6, 8 percent seemed outrageously high. When we're at 10.4 percent, 8 percent seems like a very substantial improvement. And as far as I'm concerned, our focus should be to get the unemployment rate down as quickly as we can, recognizing also that merely getting the direction of that rate down and getting the employment growth in a positive direction does create an increased sense of job security for those who already have jobs. That is something which has also an important noneconomic effect.

It's very important that the general insecurity and the fear that the threat to one's job creates be removed. That in itself is a positive event. Clearly, to the extent that job security itself rises, the confidence that American households have in purchasing goods and services and helping to expand the economy clearly increases.

So, that while if you ask me whether I prefer a 5-percent unemployment rate to 8 percent, most certainly. But I don't think we can get there in any way that I know of in a free society. Eight percent is an interim goal. I think we should get there and then keep driving it down as quickly as we can. Unfortunately, that is the limit our system now offers us considering how badly our economy has functioned in recent years. I wish there were a quick fix, so to speak. I regret I know of none.

Representative HAWKINS. Thank you.

Representative HAMILTON. Congresswoman Snowe.

Representative SNOWE. Mr. Eckstein and Mr. Greenspan, everybody who's testified before this committee, including yourselves, have indicated it's necessary to have lower interest rates in order to sustain a recovery.

Well, at what point do the interest rates have to be lowered in order to sustain this recovery in 1983 or beyond? It seems to me there's a great deal of merit in the feeling among the investors in Wall Street and otherwise that there's no way these interest rates can stay at the present level, that the Federal Reserve Board might, in fact, increase interest rates because of the recent upsurge in the money supply.

Mr. ECKSTEIN. Well, Congresswoman Snowe, the future markets are already signaling some increase in rates. That is, if you trade interest rates futures a year out, the rates are 100 basis points higher than they are for the Treasury bill today. So, the futures market is already looking at a 10-percent Treasury bill rate in 1984, but that is really to some extent commonsense. They realize there's a recovery and there's a credit cycle that goes with a recovery and interest rates tend to go up a year or two into the recovery.

One reason it shouldn't be this way is because real interest rates are about six points higher than what they have been in the last 30 years and that six points are refusing to come out. You then have a debate as to why they refuse to come out. One reason is the budget deficit. Another is a monetarist policy which has made the money rate so volatile that they are gun shy and understandably so. There's a foreign problem and a lot of uncertainties out there that make a lot of people frightened and people are afraid that a severe inflation can come back.

Now, that latter fear is unrealistic over the next 3 or 4 years given the world as it is, given the prospect for the mild recovery, given the oil glut, the agricultural product glut, the fact that wages are rising at 5 percent and not at 6 percent. All of these things assure us that there will be moderate inflation for several years.

Now, the lower the rates, the better for the next couple years if you could do it. So, it really is a question of what can the Federal Reserve do to minimize these interest rates, recognizing all the difficulties; and I'm a little more liberal than Mr. Greenspan, maybe a little more liberal than Mr. Volcker, so I would try a little harder to talk down the rates or buy some long-term securities to help that market if necessary, to be a little more generous in the bank reserves than you otherwise might be, but I don't believe for a minute that the Federal Reserve can put interest rates where it wants to.

I mean, they could have done that 20 years ago. They can't any more. The markets have gotten too smart and the amount of leeway they now have, let's say in the next 3 months, to lower short-term interest rates I think is pretty slight.

Representative SNOWE. Mr. Greenspan.

Mr. GREENSPAN. Well, I would generally agree with what Mr. Eckstein has said. Let me say, however, that I do disagree with him on the question of whether the fear that the financial community has that inflation will reignite is unjustified.

The problem is not whether we're going to have a short-term inflation rebound in 2 or 3 years. Why is it that for 20-year U.S. Treasury issues the implicit expectation of inflation is very high? The question is whether or not the financial community considers the current period as representative of what's going to happen to inflation over the next 2, 3, 4, or 5 years. If one looked at it in terms like that, the overwhelming evidence suggests that inflation is not going to reignite now. But the inflation premium that is embodied in the long-term interest rates is the average expectation for inflation for the full maturity of that instrument. If it's a 20-year bond, that's a 20-year average inflation expectation.

Their fear is that there's something fundamentally wrong about our fiscal processes, that the budget processes somehow, aside from all our rhetoric, aside from all our endeavors to prevent it from happening is very much like a Greek tragedy where one can observe a phenomenon coming apart and you don't seem to be able to do anything about it.

The financial market's view is that everybody is endeaving to do the right thing, but will fail. That is what has got to be changed. I don't think it's irrational. I consider it as a very disturbing point of view and one which one should understand. If you reflect on what's happened in the last 15 years, it's perfectly understandable that there is this very fearful point of view.

Representative SNOWE. Do you think the administration or the Congress, because it seems to be a tug of war not between the administration and Congress in this respect but I think with private investors—and those in the Congress that would suggest that the Federal Reserve Board consider the point of view made by Congress—should ease up on their monetary policy? On the other hand, you could find private investors who would suggest that the Federal Reserve Board should tighten up on monetary policy.

What course should we pursue? Should the administration pressure the Federal Reserve Board to reduce its interest rates?

Mr. GREENSPAN. Well, let's not equate easing up with lower interest rates and tightening up with high interest rates. I think that happens to be true in the very short run. The basic problem is that there is no difference in that everybody would like interest rates to go down. There is no advantage that I can even remotely imagine which stipulates that high interest rates, other things equal, are better than low-interest rates.

The issue is how do we do it? Where the big dispute occurs is whether the Federal Reserve Board has remaining in its policy mix sufficient leverage to push rates down by decreasing the Federal funds rate indefinitely. It is certainly true that the Federal Reserve at any particular time for a very short period of time can set the Federal funds rate wherever it so chooses. They cannot maintain the overall rate structure at a low level indefinitely. Any attempt to suppress either short- or long-term rates down inordinately low necessitates a major expansion in bank reserves. In other words, the only way the Fed can do it is to buy debt instruments. But buying those instruments increases the assets of the Federal Reserve System, increases the reserve balances of our monetary system, and while we may not be in the short run very clear on exactly what happens, over the very long run, it almost surely will increase inflation. It is that which is at the root of why there is a dilemma.

At the moment the Fed probably should be endeavoring to move short-term rates down by increasing reserves moderately, but be very careful about what's happening to long-term rates at the same time. It's got to be looking over its shoulder all the time to make a determination as to whether by pushing down short-term rates it's moving long-term rates up. If long-term rates start moving up from here, I don't care what happens to short-term rates, the recovery is going to abort and probably create far greater difficulties for this economy than we have seen in even the last 2 or 3 years.

Representative SNOWE. Mr. Eckstein, you mentioned in your prepared statement that the economic recovery will not solve the budget crisis. What percentage of the budget deficit would you consider to be a structural deficit?

Mr. ECKSTEIN. Well, at the moment, the structural deficit is still a modest fraction of the total. I don't have the exact figure with me, but it's on the order of $60 or $70 billion.

The trouble with it is that over the next 6 to 8 years it converts itself entirely to a structural deficit. The $200 billion plus figures for the end of these calculations in 1988—all of that is structural.

Representative SNOWE. All of that is structural?

Mr. ECKSTEIN. Yes, and the reason is by that time unemployment is down to something reasonably normal. It's happening really because the outyears have a big defense spending.

Representative SNOWE. Just to follow up on that point, to what extent do you think the Congress should reduce the deficits even as proposed by the administration? And the administration proposes $94 billion for 1985 in spite of a budget deficit reduction program. I mean, how far should Congress go beyond those reductions to reduce the deficit?

Mr. ECKSTEIN. Well, I would say, without meaning to be flip, you ought to reduce it more than you're going to.

Representative SNOWE. Is that more or less than the President's?

Mr. ECKSTEIN. The problem is so enormous that you ought to do whatever you can. Again, you can't forget all of the old Keynesian logic. If you really got over the deficit, you would create another kind of havoc.

Representative SNOWE. We're talking about 1984 and 1985.

Mr. ECKSTEIN. Even if you raise personal income tax by $200 billion and get rid of the entire deficit by 1986, the chances are that would have damaging effects you wouldn't want either. Certainly if you cut the deficit it would be wonderful.

Representative SNOWE. Mr. Greenspan, would you care to conjecture?

Mr. GREENSPAN. I think the chances of cutting the deficit too much too soon are so remote that I would say do as much as you can and don't worry about it.

Representative SNOWE. Thank you.

Representative HAMILTON. Senator D'Amato.

Senator D'AMATO. Thank you very much, Congressman.

Mr. Greenspan and Mr. Eckstein, we hear so much about this deficit, and I recall when the rhetoric was a balanced budget and let's eliminate all deficits, and now we seem to be putting that aside. I wonder if really we have a perspective on just how damaging is the deficit. I certainly don't know. I used to adhere to this theory that we've got to try to do away with the deficits of $40 billion and $60 billion, and now we're talking about $200 billion plus. And as Mr. Eckstein says, something that may be a structural $200 billion in the years to come.

Well, how do these deficits, as a percentage of the GNP, for example, compare with other industrial nations? And I'm particularly talking about Japan.

Mr. GREENSPAN. The percent of the deficit relative to the GNP tends to be useful within a specific country over a period of time. It is a proxy, however. It's importance as to how the deficit affects the economy is a very complex system.

Because the Japanese have a much higher savings propensity than we do, very substantially so, it means that they can absorb and finance a much larger central Government deficit than we can without adverse consequences. So international comparisons are not very useful unless one examines a good deal more than merely the percentage of the deficit to GNP.

A balanced budget would be desirable. The reason that number is chosen is not that there's something economically sacrosanct about a balanced budget. It is a point at which one easily understands what is happening in a numerical sense. It's far easier politically and administratively to work toward zero than to 43.4 or 68.2.

That is not to say that something magical happens when you go from minus 3 to zero. Nothing happens. However, whatever one would argue as to where deficits become a problem, I don't know of anybody who considers that whatever that number is, it is a problem today, and it's getting worse.

So many of us who were concerned about the $40 billion and $50 billion deficits were concerned not so much because it was $40 billion or $50 billion, but we were seeing a process emerge in which it might become as much as $100 billion or $150 billion, not to mention something like $200 billion which seems outrageously high.

So it's not the fact that we were in a sense crying wolf at $40 billion or $50 billion. It was the trend. It was a process. It was a concern that I think essentially worries a great number of us. Not that there was a specific point which tilts the economy over, but the larger it gets, other things equal, the greater the risk to the long-term prosperity of this Nation.

Senator D'AMATO. Mr. Eckstein.

Mr. ECKSTEIN. Senator D'Amato, we have done a series of econometric studies in the last year and a half asking that question: What difference does it make to finance the budget and not to finance it? We even did it in the last couple weeks. The studies have some range to them because we don't really know. We have never done this before.

To give you a feeling for it, to reduce the deficit to 2.5 percent of GNP, which is a reduction of about $100 billion and $170 billion or $150 billion in the outyears, would improve housing starts by 300,000 to 500,000 units. It would raise car sales by 400,000 to 800,000 units. It would reduce long-term interest rates by between 1 and 2 percentage points at least. It would change short-term interest rates by twice those magnitudes. It would change the rate of capital formation in the country by 5 to 10 percent.

So you really are entering an era here, if we are really going to go through with this, where we are going to continue to have housing starts in this 1.4 million territory instead of 1.8, in which car sales are 8.75 and not 9.5, in which capital formation does not make it up to 11 or 12 percent or beyond but stays in the low 10's and does not really get back to the 1980 or 1981 levels or even close.

Of course, if you then do all of those things, then you have cut out the productivity trend because after all you need that capital formation to get the productivity trend, so you have really lowered the long term prospects of American people for a rising living standard. So it is an important thing.

Senator D'AMATO. Do you agree with Mr. Greenspan in terms of attempting to let's say ascertain why it is that Japan, for example, has a much higher deficit and for a number of years in relation to its GNP, and yet when we look at its interest rates we find them well below ours?

Mr. ECKSTEIN. Well, the Japanese case is interesting. First of all, since they began to run these 4 or 5 percent of GNP deficits, their growth rate has been cut from 10 to less than 5 percent and currently is about 3 percent. So they are wonderful in making Toyotas or Datsuns, but they are not doing all that wonderful at home.

So it's not exactly a success story. And they don't view it as a success story that they finance these deficits somehow.

The second thing the Japanese do is they have a postal savings system in which people put their money so they jiggle this thing so it pays a little more interest than the banks and then the postal savings system invests in nothing but these bonds. So they have really hooked up a system here where they can finance this deficit without upsetting the financial market as a whole. On long term interest rates, there, I think they're just smarter than we are. They do not use the interest rate as a means of allocating capital. They allocate capital by the government telling the banks what to do. It's just a different world and I don't think we would do it.

Senator D'AMATO. All right. But it's something that's bothered me in terms of when we get into these comparisons and we look at Japan in terms of seeing their industrial base and seeing what their interest rates are, et cetera.

Talking about interest rates, just one further question. There are many, including maybe this Senator, who have a deep concern with respect to the international monetary crisis that we now face. I wonder, as Congress is now called upon to consider an infusion of $8.2 billion into the IMF, whether or not we are throwing good money after bad; whether we are putting off the inevitable; whether we really think, for example, that Poland and Yugoslavia and some of the other countries will ever be able to pay back the tens of billions of dollars, and Third World nations, who do not have the resources of an Argentina or a Brazil or Mexico or Venezuela.

So that being the case, I'm wondering if you would comment with respect to what effect do you see this uncertainty playing on the banking community vis-a-vis its relationship to interest rates that we are now paying? Is there any? Are our long-term rates in this unstable condition as a result of this international crisis that we're facing?

Mr. ECKSTEIN. First, I agree with your initial statement that it is throwing good money after bad, but you had better throw it anyway. And the reason is that the uncertainty created by the world debt problem is considerable and certainly one of the factors keeping interest rates as high as they are, but that's nothing compared to what you would have in a world financial system if in fact you did not have the IMF to backstop this pyramid of debt which is excessive.

However we work our way out of this world debt problem it's complicated but it can be done. In the space of 3 or 10 years, depending on the assumptions you make, you can bring the obligations back to a level where they can pay the interest at least and we've got to do that and it's going to come out of the hides of the American taxpayer. I don't think that's fully understood yet. It isn't any $8 billion. It's going to be a lot more before it's over but you can't let the financial markets collapse. That's playing on the 1930's and we are not going to do that.

Senator D'Amato. Mr. Greenspan.

Mr. Greenspan. That is a very serious problem in the sense that we have allowed ourselves in the international banking system to create the aggregate level of debt relative to book capital which, I mentioned earlier, is far too excessive. We have arrived at a point because of this in which the normal increase in external lending, so to speak, of the international banking community is now dropping very rapidly.

For a long period of time the net new lending of the Eurocurrency system was running at rates in excess of 20 percent per annum. Clearly it financed the huge gaps that existed between the current account surpluses largely but not wholly of the OPEC nations and the non-oil developing nations' deficits. We have seen this tremendous flow of bank and international credit which in a sense acted as a bridge to enable the existence of large current account surpluses to exist concurrently with these large current account deficits.

Eventually, it ends up in balance sheets and the balance sheets have now gotten dramatically out of whack, both for the borrowers and the lenders. This is not a situation which is easily resolved, because its immediate impact is to create a massive decline in the rate of net new financing. That means that the normal financing for investment and for trade is probably now at a stage where it might well be declining. The data suggests that the increase in the Euromarkets over the last 2 or 3 months is zero. If there is a significant decline in the oil price, which a lot of us expect, it may act to create a pulling down of the supply of capital. In other words, to the extent that some of the OPEC countries reduce their deposits in the Eurocurrency system to finance their decline in surpluses or emergence of deficits, we're going to find some strains on the international banking system. Clearly the decline in oil prices will reduce the demand for funds so that we have both a decline in capacity and a decline in demand. The aggregate amount of borrowing is going to be declining over the next couple years.

Now in that sort of context we are not quite clear exactly where the dangers of financial rupture occur, and I agree with Otto Eckstein, that the IMF financing is not going to help very much. They are small amounts. What they probably should be used for is to keep the system going while some more deep-seated solutions to this problem emerge. More debt is not going to solve an excessive debt problem. Something different has got to happen.

Senator D'Amato. Congressman Hamilton, thank you very much. It's always a great pleasure to hear Mr. Eckstein and my good friend, Alan Greenspan.

Representative Hamilton. Gentlemen, we had a bank fail yesterday. I don't know whether it was opened this morning or not. Are we going to see—do we have grave risks of—large bank failures ahead of us in the next few months or years?

Mr. ECKSTEIN. It depends on how we go about it.

Representative HAMILTON. What are the conditions that influence it? What do you mean, "how we go about it?"

Mr. ECKSTEIN. The domestic bankruptcies in industry have been small, although there are some companies out there in peril. I think we can handle those bankruptcies. The Federal Reserve seems to be pretty skillful in rushing in with extra money when needed. Obviously there are banks we haven't heard of yet who have made bad energy loans and things of that sort, but I don't think that's where the big question lies.

The big question lies in the foreign loans because they are so enormous and not just the small ones but some not so little.

Representative HAMILTON. I don't know much about the bank failure yesterday, but didn't I read that the bank had gotten into foreign loans pretty heavily? Or was it strictly domestic?

Mr. ECKSTEIN. Well, there were questions about loans to the officers. There were questions about loans to the Tennessee Fair.

Representative HAMILTON. In any event, you don't see the problem of bank failures as a grave one except insofar as it is related to the international funding problems?

Mr. ECKSTEIN. We seem to have the ability in the Federal Reserve, the FDIC, and the SLIC and the Treasury to cope with it. They have been very skillful so far. The problem does not seem to be snowballing.

Representative HAMILTON. Do you agree, Mr. Greenspan, that we do have a capacity to deal with it?

Mr. GREENSPAN. The problem is we do, and I'm not certain whether that's good or bad; I'll explain. There is almost no chance that I can see that a series of sequential bank failures will mushroom in this country or for that matter even in international financial markets. It's very simple for the central bank to insert reserves into any institution and take care of the problem.

The difficulty is that when it does, it is, in effect, creating excessive bank reserves. While I'm not concerned about the potential problems of massive sequential bankruptcies, I am concerned that the potential solution may create problems; namely, an inadvertent major expansion of bank reserves as a consequence of bailing out large financial institutions. That could have significant adverse inflationary implications.

Representative HAMILTON. It's putting more money into the system; is that right?

Mr. GREENSPAN. Yes; there's no way to resolve this problem without doing that and that has adverse consequences of its own.

Representative HAMILTON. A few minutes ago in your comments about indexation you favored it, Mr. Greenspan; and you opposed it, Mr. Eckstein. At least you endorsed it, except I think you said we can't afford it. You're talking, of course, on the revenue side. How about the spending side, Mr. Greenspan? Do you endorse indexation of the spending of the entitlement programs?

Mr. GREENSPAN. I prefer that we didn't have it. There was an ad hoc procedure of the Congress to continuously make adjustments to programs. Some of it was successful; some of it was not. It seemed at the time a far more rational procedure was to index everything.

Representative HAMILTON. Does it bother you that you favor indexation on the revenue side and driving the tax rates down?

Mr. GREENSPAN. No, sir, our system creates a significant bias toward an increase in expenditures relative to revenues. We need some institutional procedure which addresses that problem. Were we to index the tax side that would probably keep the level of real receipts relative to real incomes relatively constant. I would think under those conditions it would act as some form of general revenue ceiling under which the Congress could proceed as it so chose to make adjustments in various benefit programs.

Representative HAMILTON. As a practical matter, the Congress isn't going to come along and knock out indexation on the entitlement side, it seems to me, even though your position is, of course, a legitimate and reasonable one.

Mr. GREENSPAN. I agree with that fully, Congressman. That's the reason I hesitated in answering.

Representative HAMILTON. So, the real problem, it seems to me, is not whether you knock them out, but how you get control on indexation on the spending side, which I think all of us acknowledge is really driving budget expenditures up. Do you have any suggestions for us at this point? How do you control indexation on the spending side? I recognize that you don't like it anyway, but how do you control it if you can't knock it out?

Mr. GREENSPAN. Well, there's always a question of what index you use to drive the required change. In the Social Security Commission we examined this in great detail. Over the long run the various different measures that one uses to index are approximately the same. In other words, there's a tendency to presume that we misindexed in the last 4 or 5 years and that somehow it was just a plain mistake. If we had some great foresight we could have done it differently. That is the problem where prices exceeded the wage increases. Therefore, one should now recognize that there's been a terrible mistake and that one should now use wages instead of prices. I suspect that that would be precisely the wrong thing to do.

What might be useful, however, is more vehicles in which there are a series of various different indicators in which the legislation is written in a manner that it is either "a" or "b", the lesser. That would probably prevent the type of problem in which a specific index could conceivably inordinately create a rate of growth in benefits which would be a major budgetary problem.

Representative HAMILTON. Mr. Eckstein, do you have any thoughts on this problem?

Mr. ECKSTEIN. I think Mr. Greenspan gave the right answer. The anomaly of the last few years was that wage earners did take a cut in real living standards when OPEC raised prices.

Representative HAMILTON. Everybody wants a monetary policy that's going to support recovery without stimulating inflation. How do you translate that kind of monetary policy directly into targets for the monetary aggregates?

The Fed announces tomorrow, doesn't it, or very soon now, the way it is going to go. What kind of advice would you give the Fed?

Mr. ECKSTEIN. Well, as I mentioned earlier in the hearing, I don't believe 9.5 percent on M_2 is going to do it, which is probably what they will recommend. That assumes that inflation improves very dramatically and it retains the gains that it got lately which was a good major element of luck. The monetarists are putting pressure on the

Federal Reserve to lower the target a half point or a point a year. In the event we are very lucky on inflation, and who knows the inflation forecast? What if inflation is 3 percent for the next 3 years? Then, of course, 9.5 percent would be a lot, but that's not in our forecast. Our forecast is for inflation to go back up to around 5 percent.

So, I would say they should be extremely humble about the meaning of the aggregates in this period of very rapid change in the form in which people hold their deposits. There is a big fog around these aggregates which isn't going to go away for a year or two. So, they cannot mechanically run the deposits on the aggregates. It's just too uncertain a piece of information, but they can't ignore them. That would send a signal that they have given up on inflation. So, they've got to have targets.

I would like to see it go up to 10 or 10.5 as the target for M_2, and maybe M_3, which is a more comprehensive thing and may pick up some of these shifts within it, but I would also have them indicate—I think under the law—something like real interest rates—they have to indicate something, I believe. Presumably, they would like to see them come down at as fast a rate as they can, and I would like them to indicate that they have to look at other evidence. They do look at unemployment. They have to look at inflation. They have to look at the growth record of the last preceding year. The moment when you can run the policy on a simple one variable formula, if ever there was one, is gone.

Mr. GREENSPAN. Whatever occurs, the rate of monetary expansion is too high to be sustained. It's a question of bringing it down because even if one takes the set of criteria that Otto Eckstein outlines in which one focused on lower inflation, lower unemployment, greater growth, I don't think that the current rate of monetary expansion is consistent with that.

Now, I do acknowledge that there's a rate of growth which if one moves from where we are now, back, there probably could be short term disruptions. That's a tough dilemma which the Fed has. I don't think they know exactly how it is best achieved. I think there are two principles that have to underscore Fed policy; one is the clear recognition that the current rate of expansion in monetary aggregates is excessive, and has to be brought down, and that one cannot leave it to the indefinite future to do so. What we will end up doing is trading off a very short-term benefit which could easily create maybe 1 or 2 percentage points higher rate of growth, but at horrendous large negative effects 2 or 3 years into the future.

The Fed has a very tough problem. The best way we can all help them is to make it easier and bring the deficit down.

Representative HAMILTON. One reaction I had to your comments is this: When you get all of these factors out here for the Fed to look at, it seems to me you really don't have much of a standard at all. Is there a risk there? I don't want to be argumentative. I see merit to what you say, but if you're looking at the unemployment rate and everything else, you really don't have much of a standard.

Mr. ECKSTEIN. Well, in a way, it does smack of the standards of the past when they did look at everything and then through some magic came up with a number. I think at the moment, in some regards, they are in a better position than usual. If you look back over the postwar history, they have either been too easy or too tough. Now, there's a reason for that. In periods of ease the impact of financial change is rather slight and it's only when they jump on the brake that they have any effect. So, it's an all or nothing proposition. They're either throttling the economy by stepping on the brake or they have the opposite effect. Well, that was a period when real interest rates were zero. We are now in a situation with real interest rates at 6 or 8 percent. In that circumstance maybe the Fed has a more continuous effect. It also used to have a lot of regulations which enforce this stop-and-go kind of thing. So, there is a possibility if they keep the real interest rates in the 5- or 6-percent territory, where they're likely to stay anyway, that they will allow the kind of monetary expansion that is sustainable and the real danger is not that they will do too little but that they will panic over these monetary aggregates a year or two from now and bring the whole thing down again.

Representative HAMILTON. You gentlemen have been at it for a while and I'm going to wrap it up here. What does the phrase "industrial policy" mean to you and what do you think we ought to do about it so far as the U.S. Congress is concerned?

Mr. ECKSTEIN. Well, in the United States, unlike Japan, industrial policy does not mean a strategy of picking winners and subsidizing them and protecting them against foreign competition and developing foreign markets.

What it means in the United States really is to have an orderly structural change from the old to new industries, to soften the decline of the old industries and also to get smarter about dealing with the other countries. I mean every major competitor of ours just about has an industrial policy which is considerably aimed at exploiting the American market.

Representative HAMILTON. What do you mean "soften the decline of the old industries"?

Mr. ECKSTEIN. That we don't just abandon them and walk away from them without caring for the unemployed in those regions, that we hold them in some way. Some of that is protectionism, there's no way getting around it. Some of it may be retraining. Some may be a tougher stand. The idea of reciprocity is not the worst idea in the world—that if they get nasty to us that we be nasty back. There is a reinforcement of our difficulties by the abuse we suffer abroad.

Representative HAMILTON. Mr. Greenspan.

Mr. GREENSPAN. I never heard a definition of industrial policy so phrased. I think that's another policy.

Industrial policy means and probably has to mean some mechanism by which very explicit actions by the Federal Government endeavors to structure the growth in the American economy toward some and away from other industries. It's a wonderful thing in retrospect to know which are the winners and which are the losers and what you should do. It's always something that we know with 100 percent hindsight and do very poorly as a forecast. I would be very chary of what most people mean by industrial policy. I think it presupposes an ability to pick winners and losers, which we do not have.

Representative HAMILTON. Thank you very much, gentlemen.

The committee stands adjourned.

[Whereupon, at 12:05 p.m., the committee adjourned, subject to the call of the Chair.]

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

Statement of Fletcher L. Byrom, Chairman, Committee for Economic Development, and Retired Chairman, Koppers Co., Inc.

Mr. Chairman:

On behalf of the Committee for Economic Development (CED), I am pleased to submit this statement outlining the basic approach toward current fiscal policy issues that we believe is needed to restore sound noninflationary growth of our economy. While some of the cited specific applications of this approach are my own personal recommendations, the positions described here are generally in line with those that CED has supported in the past.

Fiscal Policy Issues

A central feature of CED's thinking ever since our organization was founded over forty years ago has been a focus on the long term. We believe it is essential that short-run fiscal, monetary and other economic policies be systematically and steadily geared to the nation's broad long-range economic goals. In my testimony before this Committee last year, I described four of the key goals as follows:

> "First, there is need for a progressive, year-by-year reduction in the inflation rate until essential price stability is achieved... There are strong reasons for believing that we are now witnessing more permanent progress toward bringing down the underlying inflation rate... But adequate progress toward the goal of reducing inflation cannot be taken for granted and fiscal and monetary policies... must be conducted on the assumption that inflationary risks remain great.
>
> "A second central policy aim is the achievement of healthy economic growth and high employment. Given the continuing inflationary threat, some moderation in the rate of long-term economic growth from what otherwise might have been desirable is probably

necessary. But demand restraint must not become so severe that it blocks out necessary incentives for capital formation and productivity growth.

"Third, public policies need to be redirected so that a significantly greater share of the growing real Gross National Product will be devoted to investment and saving. We need more investment not only in new plant and equipment but also in more rapid technological progress and innovation, in domestic energy production and conservation, in improved skill training and education, and in public infrastructure.

"Fourth, for reasons of both equity and humanity, national policy can and should give adequate weight to the concerns of those disadvantaged members of our society who have the greatest need."

In our view, these goals remain as relevant today as they were a year ago. It is encouraging that there is now a much wider public consensus that fiscal policy should be aimed at achieving these goals. More specifically, the fiscal program should contain the following ingredients:

1. The enormous and successively growing "outyear" budget deficits that are now in prospect in the absence of further policy actions must be sharply reduced to levels that are consistent with lower real interest rates and sound economic recovery. Most importantly, there needs to be a decisive reversal of the trend toward ever-rising budget deficits and a clear demonstration that expected future structural deficits will eventually be eliminated. Such action is vital for achieving each of the goals cited earlier: preventing a damaging resurgence of inflation as the economy recovers; insuring that economic expansion will not be aborted by unduly high levels of long-term interest rates propped up by expectations of enormous future budget

deficits; averting a "crowding out" of needed private capital investment that is likely to be inflicted on the most disadvantaged members of our society if these future deficits should lead to more inflation as well as to an abortive recovery.

2. The total cut in future deficits must be sufficiently credible to make a major dent in current inflationary expectations and bring about the kind of interest rate reduction that is needed for vigorous revival of capital investment. An appropriate goal might be to aim at a deficit-reduction path that would lead to elimination of the deficit or even a modest budget surplus when the economy returns to high employment with reasonable price stability. This is a more stringent requirement than that used in the President's budget, which projects a return to high employment (defined as 6-1/4 percent unemployment) by FY 1988 but still envisages a budget deficit of $117 billion, or 2.4 percent of GNP, for that year. On the other hand, if one accepts the more recent projections by the Congressional Budget Office (which point to significantly lower structural deficit levels than the President's budget), the total deficit-reduction task to be achieved until the indicated goal is reached appears more manageable, though still very formidable.

3. At the same time, care must be taken that the budget is not tightened so abruptly that it interferes with a healthy near-term recovery. A substantial part of the projected deficits for FY 1983 and 1984 reflects the effects of continued weakness of the

economy, as manifested in abnormally high rates of unemployment and abnormally low levels of capacity utilization. Attempts to reduce or eliminate the "cyclically-induced" portions of the deficit could well lead to a progressive weakening of the economy and actually add to the deficit problem.

4. To achieve the needed budget deficit reductions, a comprehensive approach is required that will spread the burden fairly. Means-tested and other programs targeted on the poor have already been cut very substantially and should not be viewed as a source of further major savings. The principal deficit reductions will have to come from nonmeans-tested entitlement programs and other domestic transfers and subsidies; defense spending; and revenue increases.

In the nondefense area, the largest share of budgetary savings should come from slowdowns in the growth of entitlement programs, particularly through limitations on automatic cost-of-living adjustments. In this connection, we support the compromise recommendations of the Greenspan Commission on Social Security. While our own preferred solution would have been for a more far-reaching approach, along the lines spelled out in our 1981 policy statement, Reforming Retirement Policies, we believe that the Greenspan Commission compromise is the only solution that now has a clear chance of adoption. Early action to put it in effect is urgently required in the interest both of the Social Security System and of reducing prospective budget deficits. At the same time, we continue to believe that timely action is also essential to deal with the longer-range problems of the Social Security System, particularly through a gradual increase in the normal Social Security retirement age to 68. This could be accomplished in small steps, by beginning now to increase the normal retirement age two months a year until the higher retirement age is reached by about the year 2000. In addition, we favor less than full cost-of-living adjustments for other entitlement programs as well (with appropriate exceptions for persons in the lowest income categories) together with forceful action to phase out various uneconomic subsidies that do not constitute part of the essential social safety net.

Defense spending should be subject to the same intensive scrutiny that has been applied to nondefense programs. This should permit significant savings from projected increases, at least for the "out-years" starting in FY 1985, without weakening our basic defense posture. Better-honed strategies, plus improved procurement and pre-purchase planning, ought to enable us to get more for our money. There must be full recognition of the need to set clear priorities among defense programs and to ensure that the total program is consistent with viability of the economy. A strong economy is in itself a key ingredient of overall U.S. national security.

Many of CED's trustees share my belief that a cut of about $25 billion in projected FY 1985 defense spending would be feasible with this approach. The main emphasis, however, should not be on the precise budget outcome in FY 1984 or 1985 but on restraining the growth of defense spending over the next 5 to 10 years. In fact, near-term savings in personnel and maintenance costs might well prove counter-productive if they should lead to larger-than-projected expenses for these categories in subsequent years to preserve the required degree of defense readiness. What we need is an efficient, sustainable long-term program for strengthening our defenses, without peaks and valleys that are wasteful and also damaging to effective dealings with our allies and with the Soviet Union.

Congress needs to be resolute in driving for the maximum feasible combination of the kind of spending cuts I have outlined, and for this task it needs strong support from the Administration and from the public. Even such an effort, however, will probably not be enough to produce the total deficit reduction that is required. Therefore it seems inescapable that measures to increase revenues will have to be part of the deficit-reduction strategy. I regard such tax increases, however, as a last resort, justifiable only if Congress is in fact acting resolutely to curtail government expenditures along the lines outlined here.

If tax increases are enacted in this way, we believe national objectives would be best served if they are designed to fall primarily on consumption. Some increases in revenues over current projects can be expected if the Social Security compromise is adopted. Other revenue gains should be achievable through wider reliance on user charges and other structural changes in the tax system. As is discussed in more detail in the CED policy statement on Productivity Policy: Key to the Nation's Economic Future that we will publish in about a month, various structural changes of this kind are desirable, particularly those that encourage saving and productive investment rather than consumption.

Beyond this, however, the need to bring the deficit under control is likely to call for imposition of additional broad-based taxes once the recovery has become firmly established. To deal with this prospect, the Administration has prepared a contingency tax plan, (involving an excise tax on domestic and imported oil and a 1 percent income tax surcharge on individuals and corporations) that would take effect in FY 1986 under specified conditions. We recognize the possibility, however, that the specific contingency tax approach outlined in the budget may not mesh well with Congressional procedures and may not carry sufficient conviction with the financial markets to allow the needed near-term reduction in interest rates.

As at least a partial alternative, consideration should be given to a modified procedure under which future tax reductions currently scheduled to go into effect in FY 1984 and beyond would only become operative on the basis of explicit Congressional and Executive action, following careful analysis of the deficit outlook. For example, the existing law with respect to initiation of so-called "tax indexing" in FY 1985 might be changed to provide that such indexing would only begin if, prior to the start of FY 1985, Congress and the President made an affirmative decision that this would be appropriate in the light of the budgetary situation at the time.

5. Although forceful actions to reduce deficits will be of critical importance for the overall fiscal program, attainment of the national policy objectives I have outlined will also require that other aspects of the program are conducive to substantially increased investment in productive private plant and equipment. Moreover, adequate budget resources should be devoted to longer-term investment in public infrastructure and in human resources that is needed for sound economic growth. There is also a case for limited use of temporary job creation, training and retraining programs that are specifically geared to the groups hardest hit by continued high unemployment, including particularly youth, dislocated workers, and the long-term unemployed. While most of these programs would entail extra near-term budgetary costs, they need not add to the long-term deficit and inflation risk if they contain built-in features that will automatically lead to their termination when the economy has moved closer to full recovery. Detailed testimony on the issues involved in designing temporary as well as longer-term jobs and training programs was presented by Mr. Franklin A. Lindsay, Vice Chairman of CED, before the House Education and Labor Committee on February 23.

CED continues to be strongly in favor of a longer-run objective of gradually reducing the total share of GNP taken by taxes, in balance with a phased reduction in government spending as a share of GNP. The recommendations for tax increases in this letter are cited only very reluctantly since we are concerned that tax increases not become a mechanism through which Congress and the Executive avoid their responsibilities for curtailing excessive growth of government spending.

O