THE 1981 ECONOMIC REPORT OF THE PRESIDENT

1046

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FIRST SESSION

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THE 1981 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 22, 1981

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

The committee met, pursuant to notice, at 2:03 p.m., in room 2322, Rayburn House Office Building, Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss and Mitchell; and Senators Jepsen, Abdnor, and Mattingly.

Also present: James K. Galbraith, executive director; Bruce R. Bartlett, deputy director; Richard F. Kaufman, assistant director-general counsel; Charles H. Bradford, assistant director; and Lloyd C. Atkinson, William R. Buechner, Mark R. Policinski, Timothy P. Roth, and George R. Tyler, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good afternoon. The Joint Economic Committee will be in order.

In his inaugural speech, President Reagan emphasized the need for immediate action to deal with "an economic affliction of great proportions" confronting the U.S. economy. We are faced with an economic affliction of great proportions and we do need to take immediate action to bring a rampant inflation under control, to reverse a decade-long decline in productivity growth, to reduce our vulnerability to disruptive changes in the world supply and price of oil, to find meaningful jobs at decent pay for the millions of disadvantaged Americans who have been left out of the economic mainstream, and to repair our ailing cities.

Of course, these and countless other problems plaguing the U.S. economy are not new. Indeed, most have been with us for years despite our best-intentioned policy efforts to solve them. But maybe there is a silver lining in this cloud of past failures; maybe our best-intentioned policy efforts were inadequate because they were wrong. This is what President Reagan has been telling the American people for the past several months, and apparently the American people have agreed.

We do need an infusion of new ideas to grapple with the vast array of economic problems that have been so stubbornly resistant to past policy initiatives. Along with a great many other Members of Congress, Democrats and Republicans alike, I welcome the opportunity to consider the innovative approaches being put forward by the new Reagan team. But if some news accounts of the Reagan program and the President's general approach to our problems are accurate, then either our economic problems will not be solved or, if some are solved, the solution will bring a whole new set of economic ills in its train.

To illustrate what I mean, first, I see that a major evil of the present economy, high interest rates, are likely under the Reagan program to be driven even higher than would otherwise be the case. Granted that a part of the excessive interest rates in the recent past is due to inflation premiums. Granted, we do need monetary restraint as part of a comprehensive policy to reduce inflation. Still, present monetary policies, concurred in by the Carter administration, are apparently not tight enough—and interest rates thus not high enough—for the Reagan administration.

The Federal Reserve's method of selecting monetary targets, already too rigid and inflexible in my judgment, is apparently considered too flexible and loose by the new administration. Indeed, President Reagan has already received from OMB Director David Stockman a memorandum urging that the Federal Reserve be given a new charter requiring inflexible adherence to an arbitrary money-growth rule whatever the economic conditions.

On the other hand, the Federal Reserve's refusal, acquiesced in by the Carter administration, to clamp down hard on purely speculative and financial transactions is not likely to come in for criticism from the new administration.

Moreover, the tax cuts which—if press reports are accurate—will soon be presented to the Congress will widen the budget deficit, increase Treasury borrowing, and thus drive interest rates even higher.

I am also concerned that the administration will do too little to promote investment, jobs, and productivity growth. In order to reverse our productivity slump, we need to increase sharply the share of our national output devoted to investment. The administration is apparently relying almost exclusively on tax and regulatory measures to stimulate increased investment.

Some reforms in these areas are needed, but we clearly need other measures as well. In particular, we desperately need measures to revive our cities and towns as attractive sites for investment, which can be done by improving infrastructure, and measures to improve the education and skill levels of our labor force have not yet been addressed in the emerging Reagan program. Moreover, if the administration decides to go with a full program of tax reduction, we are likely to witness a sharp increase in inflation as well, an outcome that would not be conducive to the required high rates of capital formation.

Finally, I am concerned about the income distribution consequences of hugh tax cuts proportionately benefiting the well-to-do; increased defense spending and increased interest rates; and the huge cuts in our social welfare programs that would be necessary to bring tax receipts into line with expenditures.

In my judgment, this would be most unfortunate, since it would redistribute income from the bottom four quintiles of income receivers to the top. Quite apart from questions of equity, it should be remembered that one of the reasons we got into the Great Depression 50 years ago was that we allowed Government policy to skew the incomes of workers and farmers so that they were no longer capable of purchasing what the economy could produce. God forbid that we should start down that path again.

This is the first day of hearings devoted to our annual review of the economy.

Tomorrow, we will hold our monthly hearing on the Consumer Price Index, and hear from a panel of experts on the outlook for inflation. Next week, we will examine three areas of critical importance for the economic policy of the Nation.

On Tuesday, we will hear a panel of experts on "A Comprehensive Strategy for Investment."

On Wednesday, we will investigate "The Income Distribution Effects of Federal Policies."

On Thursday, we will look into the design of policies to achieve "Regional Balance."

Our witnesses today are: Barry Bosworth, Brookings Institution, former Director of the Council on Wage and Price Stability; Alan Greenspan, Townsend-Greenspan, Inc., former Chairman, Council of Economic Advisers; William Nordhaus, professor of economics, Yale University, former Member of the Council of Economic Advisers; and Richard Rahn, vice president and chief economist, U.S. Chamber of Commerce.

We are most grateful, gentlemen, for your excellent help and your willingness to help kick off our 1981 hearings.

Before hearing from each one of you and then giving us an opportunity to ask you questions, I would like to call upon Vice Chairman Jepsen for such statement as he may care to make.

Opening Statement of Senator Jepsen, Vice Chairman

Senator Jepsen. Thank you, Mr. Chairman. The path of the U.S. economy during 1980 provides a textbook example of how not to conduct economic policy. With inflation raging at more than 18 percent during January, February, and March, the Federal Reserve responded by slamming the brakes on the money supply. Then, with the prime rate climbing to 20 percent, with gross national product declining at a 9-percent annual rate, and an election looming, money supply growth exploded at a 16.9-percent rate between May and August, and a 12.9-percent rate during the following 3 months. The net result is that money growth and interest rates have been more volatile than they have been in over two decades.

As for fiscal policy, in his January 1980 Economic Report, President Carter said that to have recommended a tax cut would have been a signal that "we were not serious in our fight against inflation." The same January 1980 Economic Report forecasted a fiscal 1980 budget surplus of $16 billion. By August, the administration was proposing a tax cut, and the budget was rushing toward a $60 billion deficit.

And through it all, businessmen, consumers, and the financial markets struggled to determine what it was that policymakers were trying to do. It is small wonder that, partly because of these uncertainties, retail sales are slipping, new orders for manufactured durables are increasing at a slower rate, and inventories are being pruned.

This is the first in a series of hearings intended to assess the state of the economy, to determine where the economy is headed, and to establish the appropriate policy response. If the experience of 1980 teaches us anything, it is that "fine tuning" and stop-go economic policies are not simply anachronisms; they are the source of many of the Nation's economic problems.

None of this comes as news to the new administration. President Reagan and his advisers are well aware of the need to emphasize policy stability; to encourage rather than discourage saving, investment, work effort, and individual initiative. We look forward to working with the administration in its efforts to restrain monetary growth, cut taxes, reduce the regulatory burden and, in general, to realize the growth potential of the American economy.

Thank you, Mr. Chairman. That concludes my opening statement.

Representative REUSS. Thank you, Senator Jepsen. And touché. Senator Mattingly.

Senator MATTINGLY. Not at this time.

Representative REUSS. I will ask, then, starting with Mr. Bosworth, that all of the witnesses make their statements, and we will withhold our questioning until you have done that.

Mr. Greenspan has an important engagement shortly before 4, and thus if we aren't able to complete our questioning of all witnesses before that time; I serve notice that I hope we can try to complete those questions that we have for Mr. Greenspan.

Mr. Bosworth.

STATEMENT OF BARRY P. BOSWORTH, SENIOR FELLOW, BROOKINGS INSTITUTION, WASHINGTON, D.C.

Mr. BOSWORTH. Thank you, Mr. Chairman. I have a prepared statement which has been made available to the committee.

Representative REUSS. All four excellent prepared statements of the witnesses have been received and will be included in the printed record; thus allowing the witnesses to summarize, if possible.

Mr. BOSWORTH. What I thought I might do in this opening period is try to keep my remarks as short as I can and try to summarize.

I would like to begin briefly, I guess, with what I regard as a summary of the current economic situation because I think that underlies any prescriptions about what policy ought to be, to deal with it. And I think it can be stated quite simply.

I think the U.S. economy, for somewhat different reasons, can most closely resemble that of Great Britain in the late 1950's and early 1960's in the sense that as we sit down as a group and try to talk about the economic outlook for the future, there is readily quick agreement; namely, that the future holds higher rates of inflation, continued declines in rates of growth of productivity, and declines in standards of living, and continued exposure of the U.S. economy to shocks originating in foreign markets that lie beyond our control.

I think today, we have an inflation rate that is an underlying rate of wage and price increases in the domestic economy of about 10 percent a year and that the real question for the inflation in the future is: When is the next oil shock going to occur or the next disruption of grain markets that will drive it to an even higher level?

The second major problem, I think, that we have to face up to has been reflected in people's statements in recent years where they say that something has got to be done about inflation because they can't keep up any more. But that is not inflation because inflation is just a proportionate increase in all wages and all prices.

Instead, that statement reflects the fact that prices have been rising much faster than wages, and people's standard of living has been declining in the United States in the last couple of years, and in particular in the last decade. Real factory earnings of American factory workers, adjusted for inflation, are lower today than they were in 1969.

The fundamental problem that lies behind that is the sharp deterioration in productivity growth in the United States, that the rate of growth of productivity that was running in the neighborhood of 3 percent a year from the end of World War II up to the midsixties, fell off to about 2 percent annually in the next 10 years. The last 5 years, it has averaged less than 1 percent; in the last 3 years, it has been negative, meaning that Americans actually produce less today per hour of work than they did a couple of years ago.

There is near unanimity that the problems are serious. Yet, when we turn to the subject of what to do about them, all of the alternative policies look so painful, seem to imply such major conflicts with interest groups, that the temptation to adjourn the meetings and say, "Let's come back next year at this time and hope somehow the situation has gotten better," seems overwhelming. And I think basically, U.S. economic policy has now been for quite a period of time in a state of adjournment.

If there is one major theme that does divide current prescriptions for policy, I think it is one of gradualism versus a more immediate severe or shock-type treatment to the economy. Gradualism is reflected in the argument that the current problems reached their present level of severity over many years and will take a program stretched over many years to correct them.

I will admit I think I am not a fan of gradualist measures. I think such forecasts of gains in the far future are too often a means of avoiding any action. We cannot forecast with sufficient accuracy the future shocks to the economy to deliver with credibility on a commitment to gradually reduce inflation, for example.

If the effort to achieve such a goal is made with a long-drawn-out period of fiscal and monetary restraint, the result is more likely to be continued stagflation as slow demand growth inhibits capital formation and intensifies the pressures of various economic groups to seek protection of their interest through political action.

In the current debate over alternative policies, my own preference would be to combine a wide range of the measures rather than choosing one and to do it in a more extreme measure than is normally advocated. But I think the problems can basically be summarized as this:

We must deal simultaneously with economic policy by first, trying to find a means of breaking the momentum of inflation that has been allowed to build up for over a decade and is currently running about 10 percent a year, only loosely related to the movement of aggregated demand and supply and has tremendous inertia.

And second, trying to devise policies to prevent future shocks to the economy such as oil market disruptions, grain crop failures, et cetera, that threaten to exacerbate that momentum process and raise it to even higher levels.

Third would be the problem of productivity growth and the contribution it has made to the declines in standards of living.

I have seen no credible explanation for the productivity slowdown. Certainly, we can identify some of the factors throughout. Our capital formation is an important part of the story, but there is more to it. Thus far, the focus of the policy discussion has been on increasing capital formation, regulatory reform, and promoting research and development, not necessarily because those are the most important factors in determining productivity growth, but they seem to be the areas where at least Government policy can have some influence.

There does, indeed, seem to be a general agreement that policy should try to attempt to increase the amount of the Nation's production that is directed into capital formation. And I would take that as being the third major objective of policy—find a way to redirect the Nation's resources into a higher rate of capital formation.

Overall, economic policy faces a tremendous task in the 1980's. We must find a means to break the momentum of an inflation rate now running over 10 percent. We must find a means to shift an amount of current output away from consumption and into capital formation while simultaneously accommodating much expanded demands on resources for defense spending.

And we have to develop new policies to insure us against the potential disruptions in world markets. We must do all this while we improve on a dismal record of providing jobs for new entrants to the work force.

In each of these areas, there are policies that can achieve the objective. The difficulty is that policies to achieve one objective conflict with goals in other areas, and it is extremely difficult to devise a coordinated program.

One example of the conflicts is provided by the use of fiscal and monetary policy to reduce inflation. While such policies will work, they also create very high costs in terms of unemployment. On the basis of experience in past recessions, a reduction of one percentage point in the inflation rate will require an additional 1 million people unemployed for at least 2 years.

Starting with a 10-percent inflation rate, I think that is extremely costly in terms of unemployment.

At the same time, we have a professed objective of increasing capital formation. Yet, firms will not build new plants when their current capacity is idle. Tax policy may be important in the investment decision, but first the firm must foresee a market for the product it produces.

The conflicts can also be illustrated in the current debate over budget policy. Given an objective of shifting more resources into defense and capital formation, there are three major alternatives for fiscal policy:

(1) Increase taxes and thereby reduce private consumption.

(2) Cut government social programs. This will reduce consumption of a different group from that affected by higher taxes.

(3) Expand economic growth so that no reduction in other areas is necessary. This seems to be the approach promoted by those who would like to reduce taxes immediately.

I would like to address this third approach in some detail because it seems to have generated a strange realinement of political and economic groups on both sides of the issue. It is, after all, the same policy prescription favored by the economic advisers to President Kennedy in the early 1960's.

In fact, the similarities are even stronger than most realize. Both the Kennedy advisers and the supply-side advocates of today anticipated a large rise in aggregate demand and supply, productivity growth, as a consequence of tax cuts. Thus, we must ask what has changed to precipitate such a flip-flop on this issue. I think there are two basic differences.

First, the 1960's program did not have the anticipated effect on productivity growth both because investment did not respond as much as expected to the tax stimulus and, second, there was less than anticipated impact of the investment on productivity growth.

Thus, we have learned something since the 1960's which is that we have a very incomplete understanding of the factors responsible for raising productivity and that it is extremely difficult to design policies that will have a significant impact in the near future.

Increased tax incentives for capital formation will help, but it would be very risky to bet that the acceleration of supply growth will be equal to and coincident with the rise in demand.

Second, and I think more important, the 1960's program was initiated at a zero rate of inflation. As a result, the Federal Reserve was willing to support the fiscal stimulus with an accommodative and expansionary monetary policy. That is not the situation in 1981. Inflation is running at over 10 percent, and the Fed has made it abundantly clear that it will not finance an expansion at current rates of inflation.

Without the support of the Fed, an increase in the deficit is far more likely to result in higher interest rates and a squeezing of capital formation to accommodate a higher rate of consumption. The monetary authorities might be willing to support an economic expansion if the administration had a credible anti-inflation policy as an alternative to tight credit. But such a policy does not exist nor is there any indication that it is forthcoming.

The tax cuts could be offset by expenditure reductions. But current policy seems to exempt defense and payments to current recipients of social security, and the Government cannot default on its interest payments. Four major categories—defense, social security, medicare, and interest—account for 65 percent of the Federal budget, and they account for over 80 percent of the proposed increase by the previous administration for 1982.

I think it very hard to achieve significant reductions when those categories are exempted from consideration. I believe that the fundamental difficulty in developing a comprehensive economic policy is the problem of inflation. As long as our policy is predicated on fiscal and monetary restraint to fight inflation, unemployment will remain at high levels, weak economic growth will retard capital formation, and the lack of real income growth forces a choice between increasing tax burdens and drastically cutting back social programs.

At present, the monetary authorities have made clear their unwillingness to finance an economic expansion. Continued efforts to achieve expansion through larger budget deficits can only result in ever higher rates of interest, credit restraints, and a deteriorating outlook for capital formation.

Thank you.

[The prepared statement of Mr. Bosworth follows:]

PREPARED STATEMENT OF BARRY P. BOSWORTH [1]

I would like to begin today by outlining my interpretation of the current economic situation since it is critical to any discussion of the appropriate economic policy.

With a continuation of current policies the economic outlook for the United States for several years to come is likely to be: continuation of double-digit rates of inflation, high unemployment, stagnant or declining real incomes and further exposure to the uncertainties of economic events in world markets such as petroleum and grains that are beyond our direct control. For somewhat different reasons the United States is beginning to resemble the economy of Great Britain during the 1950's and 60's as it exhibits serious signs of gradual but steady deterioration. It is not a problem that has come upon us suddenly and it is unlikely to evolve into a crisis. Nor is the economy currently quite as weak as some would have us believe. Rather it is the trends that are so disturbing in what they portent for the future.

The United States enjoyed near price stability as recently as 15–20 years ago. It emerged from the 1970 recession with an inflation rate of 3–4 percent, it came out of the 1974–75 recession with a rate of domestic inflation of 6–7 percent. It has now experienced its third recession in 10 years and is poised for a recovery with an initial inflation rate of double digit rates. As we look to the future we have a built-in momentum of domestic wage and price increases over 10 percent with the only question being—when will the next oil price shock or food crisis drive it even higher?

We have experienced a similar upward trend in unemployment and now try to convince ourselves that 8 million unemployed really don't want jobs.

In the period from the end of World War II to the late 1960's productivity growth expanded at a steady rate of 3 percent annually. In the next half decade it averaged less than 2 percent, declined to less than 1 percent in the last half of the 1970's, and in recent years it has actually been negative. This is reflected in the fact that the average factory worker's earnings (after adjusting for inflation) are lower today than at the end of the 1960's.

There is near unanimity that the problems are serious. Yet, when we turn to the subject of what to do about them, all of the alternative policies are so unattractive that the temptation to adjourn the meetings, agree to meet next year, and hope that the situation will somehow correct itself seems overwhelming. In fact, if there is one constant element of our policies over the last decade it is that we have underestimated the magnitude of the problem, proposed policies that were too weak, and when they failed actually worsened the problems by reducing the publics' belief that government was capable of solving them.

This is one major theme that divides current prescriptions for policy: gradualism versus a more immediate severe type of action. Gradualism is reflected in the argument that the current problems reached their present level of severity over many years and it will take a program stretched over many years to correct them. I will admit that I am not a fan of gradualist measures. I think such forecasts of gains in the far future are too often a means of avoiding any action. We can not forecast with sufficient accuracy the future shocks to the economy to deliver with credibility on a commitment to gradually reduce inflation, for example. If the effort to achieve such a goal is made with a long drawn-out period of fiscal and monetary restraint, the result is more likely to be continued stagflation as slow demand growth inhibits capital formation and intensifies the pressure of various economic groups to seek protection of their interest through political action. In the current debate over alternative policies my own preference would be to combine a wide range of the measures rather than choosing one.

INFLATION

I do not believe that the current inflation can be characterized by excess aggregate demand. In fact, I know of few markets where one could argue that either

[1] The views expressed are my own and do not necessarily reflect those of Brookings staff members or the officers and trustees of the Brookings Institution.

prices or wages are going up because of excess demand pressures. Nor do I believe that government fiscal and monetary policies can be criticized for trying to create too many jobs. It is, I think, better understood as a two-part process. First, there is an underlying momentum of industrial wage and price increases that has built up over many years. It is best viewed as a defensive reaction of individuals trying to protect themselves against what they regard as the inflationary demands of others. Every worker wants at least a 10 percent wage increase to match past price increases, the wage increase that he sees everyone getting, and perhaps a little more to carry over until the next time he negotiates his wage. Similarly, firms see their price increases as simply the passthrough of higher wages and other costs. This process has tremendous inertia and is only loosely related to current conditions of demand and supply. Most persons have come to realize that they do not gain from this repetitive cycle of wage and price increases, but no one dares get off the merry-go-round because they have no confidence that others will do the same.

Second, this process has been exacerbated during the 1970's by a series of shocks that heightened the inflation directly but also raised that underlying momentum process to even higher plateaus. On occasion excessively stimulative demand policies have been an important shock, but we have also learned that the list must be expanded to include disruptions in major markets such as food and energy that initiate catch-up demands to restore lost real incomes in the economy at large.

I see the anti-inflation policy problem as: (1) finding a means of breaking a momentum of inflation that has been allowed to build-up for over a decade, and (2) devising policies to prevent future shocks and disruptions or at least dampen their impact on the economy at large.

PRODUCTIVITY

I have seen no credible complete explanation for the productivity slowdown. Certainly we can identify some of the factors and while capital formation is an important part of the story there is more to it. Thus far, the focus of the policy discussion has been an increasing capital formation, regulatory reform, and promoting research and development. There does, indeed, seem to be a general agreement that policy should attempt to increase the amount of the nation's production that is directed into capital investment. In addition to its contribution to productivity growth I would add a second argument for additional capital investment: the need to expand industrial capacity. In earlier decades we became accustomed to thinking of the United States as a capital-rich, labor-scarce economy. Most of our economic analysis, for example, used the unemployment rate as a proxy measure for overall resource utilization. Yet, the large acceleration of labor force growth during the 1970's was not matched by a similar expansion of the capital stock. One reason that unemployment is so high today is that we lack the industrial capacity in many of our most basic industries. Efforts in 1978 to reduce unemployment to 6 percent initiated significant shortages and upward pressures on material prices.

Overall, economic policy faces a tremendous task in the 1980's. We must find a means to break the momentum of an inflation rate now running above 10 percent. We must find a means to shift a significant amount of current output away from consumption and into capital formation (while simultaneously accommodating much expanded demands on resources for defense spending). We have to develop new policies to insure us against the potential disruption in world markets for food and energy. And we must do all this while we improve on a dismal record for providing jobs for new entrants to the workforce.

In each of these areas there are policies that can achieve the objective. The difficulty is that policies to achieve one objective conflict with goals in other areas and it is extremely difficult to devise a coordinated program.

One example of the conflicts is provided by the use of fiscal and monetary policy to reduce inflation. While such policies will work they also create very high costs in terms of unemployment. On the basis of experience in past recessions a reduction of one percentage point in the inflation rate will require an additional one million unemployed for at least two years. If we had a goal of reducing inflation to half its current rate, unemployment would need to be in the neighborhood of 12 million for 3-4 years. At the same time we have a professed objective of increasing capital formation. Yet, firms will not build new plants when their current capacity is idle. Tax policy may be important in the investment decision, but first the firm must foresee a market for the product it produces.

The conflicts are also evident in the current debate over budget policy. Given an objective of shifting more resources into defense and capital formation, there are three major alternatives for fiscal policy:

(1) Increase taxes and reduce private consumption. (To some extent this will automatically occur with the current tax system and continued inflation.)

(2) Cut government social programs. (This will reduce consumption of a different group from that affected by higher taxes.)

(3) Expand economic growth so that no reduction in other areas is necessary. (This is currently the approach promoted by those who would like to reduce taxes immediately.)

I would like to address this third approach in some detail because it seems to have generated a strange realignment of political and economic groups on both sides of the issue. It is, after all, the same policy prescription favored by the economic advisors to President Kennedy in the early 1900's. In fact, the similarities are even stronger than most realize. Both the Kennedy advisors and the supply-side advocates of today anticipated a large rise in aggregate demand and supply (productivity growth) as a consequence of tax cuts. Thus, we must ask what has changed to precipitate such a flip-flop on this issue. I think there are two basic differences.

First, the 1960's program did not have the anticipated effect on productivity growth both because investment did not respond as much as expected to the tax stimulus and there was less than anticipated impact of the investment on productivity growth. We have learned that we have a very incomplete understanding of the factors responsible for raising productivity and that it is extremely difficult to design policies that will have a significant impact in the near future. Increased tax incentives for capital formation will help, but it would be very risky to bet that the acceleration of supply growth will be equal to and coincident with the rise in demand.

Second, and more important, the 1960's program was initiated at a zero rate of inflation. As a result, the Federal Reserve was willing to support the fiscal stimulus with an accommodative and expansionary monetary policy. That is not the situation in 1981. Inflation is running at over 10 percent and the Fed has made it abundantly clear that it will not finance an expansion at current rates of inflation. Without the support of the Fed, an increase in the deficit is far more likely to result in higher interest rates and a squeezing of capital formation to accommodate higher rate of consumption. The monetary authorities might be willing to support an economic expansion if the administration had a credible anti-inflation policy as an alternative to tight credit. But such a program does not exist nor is there any indication that it is forthcoming.

Perhaps the tax cuts could be offset by expenditure reductions. But current policy seems to exempt defense and payments to current recipients of social security, and the government cannot default on its interest payments. Four major categories—defense, social security, medicare, and interest—account for 65 percent of the Federal Budget and they account for over 80 percent of the proposed increase by the previous administration for 1982.

I believe that the fundamental difficulty in developing a comprehensive economic policy is the problem of inflation. As long as our policy is predicated on fiscal and monetary restraint to fight inflation, unemployment will remain at high levels, weak economic growth will retard capital formation, and the lack of real income growth forces a choice between increasing tax burdens and drastically cutting back social programs.

At present, the monetary authorities have made clear their unwillingness to finance an economic expansion while inflation continues at a rate above 10 percent. Continued efforts to achieve expansion through larger budget deficits can only result in ever higher rates of interest, credit restraint, and a deteriorating outlook for capital formation.

As an alternative I would favor a sharp shift in the mix of policy towards more fiscal restraint and less reliance on monetary restraint, and an overall demand policy that holds unemployment within the range of 6–7 percent. Within this stable aggregate demand framework that avoids shortages, I continue to believe that a short but severe episode of controls is a less costly means of breaking the momentum of the inflation. I see the shift in the policy mix as responsive to the need to stimulate capital formation, and a combination of modest demand restraint and controls as responsive to the inflation problems.

At the same time additional measures would be needed in other areas. For example, a significant tax cut limited to improving investment incentives, a rebuilding of the grain reserve to levels of the late 1960's and an effective program to deal with disruptions of energy supplies are all critical elements if we are not to repeat the experience of the 1960's.

I am optimistic that the current economic problems can be solved in that the American public seems aware of the difficulties and willing to accept the short-term sacrifices that are necessary. But a successful program must be of sufficient magnitude to be convincing that it can succeed and it must involve an even-handed sharing of the burden. A policy of demand restraint alone is not sufficient to accomplish either of those two objectives.

Representative REUSS. Thank you, Mr. Bosworth. Mr. Greenspan.

STATEMENT OF ALAN GREENSPAN, TOWNSEND-GREENSPAN & CO., INC., NEW YORK, N.Y.

Mr. GREENSPAN. Thank you, Mr. Chairman.

There are a number of questions you and your colleagues have raised which I would like to address in the questioning of me subsequent to my statement.

Despite the persistence of near record high interest rates, the economy continues to edge ahead. The 5-percent annual real growth rate of the GNP during the fourth quarter was surprisingly strong and is not about to be matched in the current quarter. Housing starts and sales, of course, have been under pressure, as mortgage interest rates moved to 14–15 percent. Passenger car sales are best described as poor, if not worse, as high prices coupled with the rise of short-term financing costs appear to be pricing a goodly number of even the more fuel efficient models out of the market.

And yet, looking at the economy in aggregate, evidence of a broad, across the board weakening, is absent. Payroll employment continued to rise in December as did industrial production. Moreover, weekly data suggest that in early January both continued to edge above their December averages.

Part of this continued general strength in the economy, however, is more apparent than real. It reflects the fact that we generally tend to assess economic trends by adjusting for seasonal variations. But there are occasions, such as now when this can obscure rather than clarify underlying trends. As we adjust our numbers by seasonal factors determined largely by recurrent weather patterns, we often fail to recognize that the economy itself runs seasonally unadjusted.

Housing starts, for example, on past behavior normally fall by 50 percent between the summer peak in May–June and the winter low in January. Mortgage borrowing capacity and interest rates, however, are not similarly affected by the weather. But when both weather and financial constraints depress housing starts and sales at the same time in the winter months, the seasonal adjustment factors cannot distinguish between the two causes for the decline in activity.

Thus, they may now confuse the effects of financial constraints with the normal winter lull. Hence, it is difficult to read the impact of mortgage credit restraint fully in the seasonally adjusted starts figures. This impact, however, is likely to become dramatically apparent if mortgage interest rates do not fall significantly in early spring.

In that case, which now seems likely, it will be very difficult for the usual seasonal spring upturn in housing to take place. Typically, housing starts double for seasonal reasons alone from January, the seasonal low, to May–June, the seasonal high. This means that the seasonal adjustment factors will begin to pull down the unadjusted numbers over that period. This will surface the underlying weakness in housing starts and sales, and the financial constraints will finally begin to grip the seasonally adjusted starts and sales figures. To a somewhat lesser extent, similar trends will show up in those other areas of the economy which typically show a spring upturn as the weather clears in the Snow Belt. The normal seasonal pattern in industrial production, for example, produces a rise of 6 percent from December to June.

But when we move beyond the problems of measurement and statistics, it is clear that the bottom line remains the same. The economy is caught in the grip of inflation, and the emergence of near full inflation premiums in the long end of the bond market and as a consequence in the mortgage market threatens to lock the economy into a stop-start state.

The result in the end will be, to use a term out of the past, an underemployment equilibrium. Equilibrium, however, is perhaps the wrong term to apply to the current state of economic distortion. It is very difficult to view the current unstable state of the economy as some form of balance. In fact, a time bomb is ticking away in the financial system. It will eventually blow up if we do not defuse successfully to underlying inflationary pressure in our economy and, thereby, rid ourselves of the high inflation premiums embodied in nominal interest rates.

Unlike many other nations in this hemisphere and elsewhere, the United States cannot for any length of time successfully function above or even at current levels of interest rates. Other countries have been able to at some significant cost to create a financial system which can function at exceptionally high rates of inflation. The United States cannot. We have developed a very complex financial infrastructure based upon the assumption that for the American economy, inflation, when it occurs, is temporary and reflective of extraordinary circumstances, such as war or postwar economic distortions. Up until very recently, the markets assumed that a noninflationary environment was always just beyond the horizon.

Consequently, even during the 1973–74 period price explosion, long-term U.S. Government bond yields rarely exceeded 8½ percent. This implied a long-term inflation forecast of 6 percent or less. In fact, with double-digit inflation in 1974, the forecast of a 6-percent rate of inflation over a 15–20 year period meant that the market expected an early return to previous inflation levels and a rate of price increase perhaps quite below 6 percent in the outlying years. Inflation, so to speak, was never perceived to be a normal state of the American economy.

As a consequence, a huge thrift institution industry evolved, especially after World War II, based largely on the premise of an essentially noninflationary environment in which long-term lending, especially for mortgages, coupled with short-term funding could be profitable most, if not all, of the time. With deposit insurance, assets in savings and loan associations, mutual savings banks, and credit unions grew at a dramatic pace. By the third quarter of 1980, aggregate assets had reached $850 billion. But the maturity of these assets, at about 7 to 12 years on average, exceeded that of liabilities by 5 to 10 years. This gap in maturity structure reflects the historic noninflationary environment.

Because a goodly chunk of mortgage loans were made many years ago at much lower rates, the average portfolio yield of mortgages in savings and loans associations today approximates 9 percent, approximately half current short-term market yields. At this rate of return, S. & L.'s are extraordinarily exposed. While most of their liabilities consist of relatively short-term high interest cost instruments, there is still well over $100 billion, or approximately 21 percent of liabilities, in conventional passbook accounts at a legal ceiling of 5¼ percent.

Needless to say, the S. & L.'s are under strong pressure, and were it not for very heavy purchases of mortgages by federally sponsored mortgage pools in the secondary market and heavy direct lending by the Federal Home Loan banks to the S. & L.'s, it would be difficult to imagine these institutions continuing to function. Obviously, in the short run, they can sell off some of their nonmortgage assets to meet the interest payment costs of their liabilities. But obviously, this cannot go on for very long under the existing interest rate structure. At some point, when interest income will no longer consistently meet interest cost requirements, the whole thrift institution system will undergo a massive crisis.

The concern, perhaps, is not that thrift institutions will at that point cave in, but that the Federal Home Loan banks in conjunction with the Federal Reserve would feel obligated to bail out this major segment of our financial system. Such a bailout implies large borrowings by the Federal Home Loan banks, which if accommodated by the Federal Reserve would surely mean major new acceleration of inflation. We could move from the mere 10-percent base rate of inflation; which most of us estimate for today, to twice that. Life insurance companies are also in danger of a major acceleration of loans on outstanding policies at well below market cost of funds if short-term interest rates, especially for money market funds, continue at approximately twice the rate at which most individual policy loan contracts are written.

Obviously, were there a magic wand which could be waved to convert all long-term mortgage portfolios of thrift institutions into variable rate mortgages tied to, say, 1-year Treasury bill rates, then the prospective huge negative cash flow of the thrift institutions could be readily eliminated. But legislation which would abrogate millions of outstanding mortgage contracts to refinance them at higher interest rates seems unlikely in the extreme, is probably unconstitutional, and surely inappropriate.

If once we eliminate living with high interest rates and inflation as a viable option, we must look at the ways and means of eliminating them. In the short run, it appears very difficult to lower significantly the underlying rate of inflation. While this would be desirable, it is not immediately necessary. What is essential is that we put in place a series of policies which are perceived by the financial community and the public at large to bring inflation rates down over time, i.e., not necessarily in 1981 or even 1982, but in 1983 and thereafter.

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If a policy is implemented that succeeds in doing this, inflation premiums in the long end of the bond market will fall since they reflect the average inflation forecast over the life of a debt instrument. Thus, we need to address immediately the market's long-term inflation perception. Accordingly, we must first ask how did we get to a point where after many generations of modest or negligible long-term inflation expectations, the markets finally turned around.

The current extraordinarily high inflation premiums in the financial markets are unique in American history. From today's perspective, it may be difficult to realize that the price level in the year 1940 was actually lower than it was in the year 1800, implying a long-term negative inflation rate.

Even after World War II and the Korean episodes, price inflation simmered down very rapidly. There even seemed to be a major defusing of inflationary pressures in 1976–77. But thereafter, markets began to get skeptical of our ability to reign in inflation over the longer run and inflation premiums began to edge up in 1979 until they exploded in the early weeks of 1980.

It was President Carter's January 1980 budget message which apparently triggered the final explosion. That budget revised fiscal 1984 expenditures upward by $165 billion from estimates made only a year earlier. From this, the markets concluded finally that the Federal budget was now truly out of control. In effect, for the first time in American history, the financial community based its investment strategy on the expectation that inflation had become a deep-seated, long-term problem.

It is this expectation that must be reversed. Doing so has got to be the first priority of the Reagan administration's new economic policy. For if they succeed, thereby bringing down long-term interest rates and through arbitrage short-term interest rates as well, risk premiums for long-term capital investment would also decline. Consequently, what economists call the hurdle rate of return—the minimum required rate of return on a prospective capital investment—will move lower. This in turn will trigger a significant expansion in new capital investment, improve productivity, and reinforce the movement toward a steady decline in the rate of inflation.

Such an economic policy will obviously be difficult to implement. Mere economic rhetoric will achieve nothing. The financial community is going to insist on seeing basic changes from which they can extrapolate a significantly lower rate of growth in Federal outlays over the longer run and a marked decline in the aggregate amount of credit requirements directly and indirectly engendered by Federal Government policy.

Although the markets may not insist on seeing an actual decline in the current rate of inflation before altering their view of inflation over the long run, they will surely require changes in actual budget authorities and entitlement programs that will bring about a significantly lower level of Federal borrowing than is implied in today's statutes. Reduced pressures on the capital markets will foster a less inflationary, therefore, a more stable monetary policy.

The problem of reducing Federal borrowing requirements and inflation expectations is doubly compounded in current circumstances: We must not only reduce budget deficits and off-budget financings, but we also must cut tax rates to prevent the tax burden from rising inordinately, as it would under existing law, and we must restore a more appropriate level of defense outlays, which has been allowed to become dangerously deficient.

As a consequence, the focus of economic policy in the weeks immediately ahead must be on extraordinary changes and retrenchment in nondefense outlays and budget authorities. Our problems are essentially political not economic. For as best we can judge, the inflation which clearly has been corrosive to economic growth and structure has not yet arrived at a point where the damage to the American economy is irreversible. In fact, with the exception of a few weakened industries, removal of the inflationary bias from the American economy will find it far more resilient than I think many of us are willing to credit. We do have an emergency in this country, but it is not a general economic emergency; it is a fiscal emergency. We have allowed our political processes to unleash destructive fiscal forces. If we can correct them, as indeed we must, the rewards in terms of economic stability and growth and, in turn, in restoration of growth in the American standard of living, will be huge relative to cost. Thank you.

Representative REUSS. Thank you, Mr. Greenspan.

Mr. Nordhaus.

STATEMENT OF WILLIAM NORDHAUS, PROFESSOR OF ECONOMICS, YALE UNIVERSITY, NEW HAVEN, CONN.

Mr. NORDHAUS. Thank you, Mr. Chairman.

I did not receive any written instructions about what this hearing was about, but in the best tradition of economics, I made a forecast. And all I can do is hope the forecast is better than some of our profession's more recent blunders.

My prepared statement today will focus on four issues: First, a very brief statement on the economic outlook; second, some thoughts about appropriate policy responses; third, the question of the appropriate mix of monetary and fiscal policy; and finally, some discussion of possible innovations in macroeconomic policy.

On the question of economic outlook, there does not appear to be a great deal of difference of opinion on the outlook over the next couple of years. Most forecasts see a continued period of high inflation and poor economic growth.

For 1981, we will probably see output growing between zero and 2 percent over the four quarters. Inflation as measured by broad-based indexes like the GNP deflator or the consumption deflator should be in the 10- to 12-percent range.

The proposals for 1982 depends, of course. on economic policy. Given the stated views of the Federal Reserve and the incoming administration, the best guess at this time is that the economy will grow rapidly from late 1981 through 1982. But unless one of the new economic remedies proves to be a miracle drug, we will see a continuation of the high inflation and interest rates as well as the volatile financial markets that have characterized the last year and a half.

Given this economic output, what is the appropriate economic response of economic policy? At first, I will assume we are confined to using the usual macroeconomic instruments. At a later point, I will turn to the question of what innovations might be possible.

I share the widely held consensus that reducing inflation should be one of the constraints on economic policy over the coming decade. Inflation is increasingly becoming built into our institutions. When it gets fully built in, it will be highly costly to reduce inflation, more so than it is right now.

I think an ambitious, but realistic target would be to try to construct policies to reduce inflation to around 5 percent annually by the mid-eighties.

If we are to bring about this reduction, we will need some combination of the following three factors, as well as lots of good luck:

First, considerable economic slack would be necessary if we are to attain a reasonable inflationary objective such as the one he mentioned.

The second factor is that very great attention should be paid to the price-raising effects of Government actions.

Third, an effective incomes policy.

To be a bit more specific, what combination of these three factors would be a reasonable economic strategy to follow over the next few years? I would stress the following elements:

(1) The central question is the one of the level of economic activity as a whole. If we are to engender a gradual reduction of inflation, it will require, unfortunately, a period of sustained economic slack. It will require perhaps a half-dozen years with unemployment rates in the neighborhood of 7 percent.

(2) Very great attention should be paid to the price-raising effects of Government actions. We continue to see Government engaged in actions which exacerbate our inflation problem—the rise in social security taxes and the minimum wage hike on January 1 of this year are just the latest examples. Any serious anti-inflation program must take great care to avoid such price-raising measures.

Regulatory reform is probably the one area where reducing inflation can come with low costs, and the Reagan administration's effort, as they have been outlined so far, should have bipartisan support.

(3) Finally, if we are to reduce inflation efficiently, we should have a well-structured and tough wage and price program. The 1978 guideline program has clearly outlived its usefulness. I will return to some thoughts about its replacement in a minute.

From what can now be discerned about the Reagan economic program, of these three central planks in an anti-inflation program, only one seems to be in their policy proposals. And that is the second one to reduce price-raising effects of Government actions.

Obviously, much remains to be spelled out, and we are all waiting to see it. But I think it is a fair guess that if they follow the strategy that has been outlined in, for example, the September 8 speech or in the Stockman-Kemp manifesto, we will not see any major difference from the outcome of policies proposed by former President Carter.

We will probably see about the same inflation experience and perhaps somewhat more economic growth.

Let me, third, turn to the question of appropriate stance for monetary and fiscal policies. If the propositions I mentioned a few minutes ago are accepted, this has important implications for monetary and fiscal policy. It first means that we must accept a relatively high degree of slack in our economy in the coming years. Monetary and fiscal policy should in this view target a utilization of resources and we are likely to witness another half decade of stagnation without resolution of our underlying economic problems.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Nordhaus follows:]

PREPARED STATEMENT OF WILLIAM NORDHAUS

Prognostication and commentary on the economic outlook reminds me of a second-grade television soap opera. The story has been told countless times. We know who dunit. And the recommendations of the major players are pretty predictable.

True, we have a new actor who has just taken the lead role—and he might play some of the old lines in new ways. But there is unlikely to be any major surprise in the denouement.

My prepared remarks today will focus on four issues: the economic outlook; appropriate policy responses; the monetary fiscal mix; and possible innovations in macroeconomic policy.

I. There does not appear to be much disagreement about the economic outlook. The coming year should be one of continued high inflation and poor economic growth. We will probably see real output growth of 0 to 2 percent over the four quarters of 1981. Inflation, as measured by broad-based indices like the GNP deflator or the construction deflator, should be in the 10 to 12 percent range.

The prognosis for 1982 depends, of course, on economic policy. Given the stated views of the Federal Reserve and of the incoming Administration, the best guess at this time is that the economy will grow rapidly from late 1981 through 1982. But—unless one of the new economic remedies proves to be a wonder drug—we will see a continuation of the low productivity growth, high inflation, and high interest rates as well as the volatile financial markets that have characterized the last year-and-a-half.

II. What is the appropriate response of economic policy to the outlook? A prudent answer should assume that we use the usual macroeconomic policy instruments; in the last section I will ask how policy might be different if we use new policy tools.

I share the widely held consensus that reducing inflation should be one of the constraints on economic policy over the next decade. Inflation is increasingly becoming built into our institutions; when it gets fully built in it will be highly costly to reduce inflation.

An ambitious but realistic target would design policies to reduce inflation to around 5 percent by the mid 1980s.

If we are to bring about this reduction we will need some combination of the following three factors (as well as lots of good luck): (1) Considerable economic slack; (2) Restraint in government regulatory and price-raising measures; and (3) An effective incomes policy.

What combination of these three factors would be a reasonable economic strategy to follow over the next few years? I would stress the following elements:

1. The central question is the one of the level of economic activity. If we are to engender a gradual reduction of inflation it will require a period of sustained economic slack—perhaps a half-dozen years with unemployment rates in the neighborhood of 7 percent.

2. Very great attention should be paid to the price-raising effects of government actions. We continue to see government engaged in actions which exacerbate our inflation problem—the rise in social security taxes and the minimum wage hike being the latest examples. Any serious anti-inflation program must take great care to avoid such price-raising measures.

Regulatory reform is probably the one area where reducing inflation can come with low costs, and the Reagan Administration's effort should have bipartisan support.

3. Finally, if we are to reduce inflation efficiently, we should have a well-structured and tough wage and price program. The 1978 guideline program has clearly outlived its usefulness. I return to some thoughts about a replacement in the last section.

From what can now be discerned about the Reagan economic program, only the second of these three planks in an anti-inflation program are central to their proposals. While much remains to be spelled out, it seems a fair guess that over the next couple of years the Reagan economic program will probably show somewhat more economic growth, and about the same inflation rate, as the outcome of policies proposed by President Carter.

III. Returning to the main theme, what is the appropriate stance for monetary and fiscal policies? If the propositions of the last section are accepted, this implies that we must accept a relatively high degree of slack in the coming years. Monetary and fiscal policy should target a utilization of resources which corresponds to an unemployment rate of approximately 7 percent. (There is no implication that we can HIT this target; rather we should aim for a band of outcomes with this rate in the center.)

Given that as an overall target for economic activity, what is the appropriate MIX of policies?

It is clear that monetary and fiscal policies should be coordinated to aim at a commonly-agreed upon target.

It is generally agreed that the mix of policy should aim to raise the share of business investment and oil-conserving investments at the expense of consumption and government expenditures on goods and services.

To attain this shift in the mix of output, we need (i) tax cuts which are targetted to encourage business and oil-conserving investments and (ii) monetary policies which lower the cost of capital and the volatility of financial markets.

Monetary policymakers should stop trying to bury their heads in the sand. They cannot set sensible policies except in the context of the general state of the economy and the stance of fiscal policy. I regard the monetarist experiment since October 1979 as a minor disaster: it has probably worsened our economic performance because of the heightened instability in financial markets.

I would urge the Federal Reserve to work more closely with the Congress and Administration in setting overall economic targets and designing the monetary-fiscal mix to attain these targets. This would require abandoning mechanical monetary targets and using instead targets for real GNP, inflation, and unemployment.

The specific tax measures which would be best designed to encourage business investment are reform of the investment tax credit (particularly its extension to structures) as well as accelerated depreciation which insulates the value of depreciation allowances from inflation (such as the Auerbach-Jorgenson first-year depreciation plan).

Tax cuts to promote saving (such as a further reduction in capital gains taxes) are probably ineffective ways to use the revenues.

IV. Are there any innovations that might make reducing inflation less costly and socially disruptive? Two major new ideas have been put forth recently: supply side theories and proposals for tax based incomes policies.

Supply side theories take many forms. The latest incarnation, in starkest form, states tax reductions will have a marked impact on potential output (i.e. real GNP at a benchmark unemployment rate); and that the resulting productivity growth will therefore reduce costs of production and lower inflation substantially.

There has been no comprehensive study of these views, but two recent pieces of analysis cast doubt on the supply side panacea:

1. Data Resources Inc. performed supply side simulations in their macroeconomic model to test these propositions. According to the DRI model, if the demand effects are sterilized (i.e. if policy holds the unemployment rate at a given level) the effect of large personal tax cuts on productivity and inflation by the mid-1980s is extremely small—a Kemp-Roth size cut would reduce inflation by approximately one-tenth of a percentage point by the mid-1980s.

2. In the Economic Report of the outgoing Council of Economic Advisers, there is a careful review of the evidence on the likely impacts of Kemp-Roth type tax cuts. The Council concludes, in my view appropriately, that a 10 percent reduction in tax rates on indiivduals would have a negligible effect on productivity and inflation.

It should be noted that if the demand effects of Kemp-Roth tax cuts are not sterilized—that is if the tax cuts push the economy to levels of utilization higher than the targets—even these modest anti-inflation impacts of supply-side policies are likely to be swamped by the inflationary effects of tighter markets.

The other important innovation is tax-based incomes policies (or TIPS's). TIP would use fiscal carrots or sticks to induce workers to moderate their wage and price behavior.

I am much more sympathetic to TIP as a new anti-inflation tool. While untested, it does have considerable promise as an alternative to economic slack—and one whose costs are likely to be much much lower.

There are many proposals for TIP that should be carefully studied. My preferred version runs as follows:

To begin with there must be an overall structure of wage and price guidelines. These would constitute wage rate increase guidelines for groups of workers, and profit margin guidelines for firms.

The wage TIP would reinforce the guideline in two ways: groups of workers that stay within the guideline would receive an unconditional tax credit; while any portion of a firm's wages that were over the guideline would be disallowed as a deduction for corporate income tax purpose.

The price TIP is much more difficult to design—and it might be best to omit it all together. One suggestion would be that any firm that is within both the waste and price guideline would receive a refundable corporate tax credit of, say, 2 percent.

I have no allusion that a TIP would be enormously effective or easy to administer. But it might well allow us to hit our medium run inflation objective at considerable lower cost in unemployed resources.

V. In summary, the outlook continues to be grim for the U.S. economy. By well-designed wage-price guidelines reinforced by a wage-price-TIP we can speed the transition to a more favorable balance of unemployment and inflation. If, on the other hand, we lean heavily on the Kemp-Roth approach we are likely to worsen the medium run outlook.

Given the tentative pronouncements of economic policy by the Reagan Administration (particularly his September 8 speech and the Stockman-Kemp manifesto), we are likely to witness few TIP's and large supply side tax cuts.

Perhaps the views I have outlined are far off the mark. Maybe the U.S. economy will have as large a dose of good luck in the next four years as it has had bad luck in the last four. More likely, however, is that we will witness another half decade of stagnation without resolution of the underlying economic problems.

Representative Reuss. Thank you, Mr. Nordhaus.

Finally, Mr. Rahn.

STATEMENT OF RICHARD W. RAHN, VICE PRESIDENT AND CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES, WASHINGTON, D.C.

Mr. Rahn. Thank you, Mr. Chairman.

I will summarize my statement.

The U.S. economy has just completed a decade characterized by economic instability, accelerating inflation, deterioration in our standard of living, little growth in productivity, and erosion of our international competitive position. A reversal of these trends will require a new direction in economic policy.

Specifically, we recommend that Congress: (1) Take immediate steps to reduce Federal spending; (2) enact substantial tax cuts for businesses and individuals; (3) provide relief from excessive business regulation; and (4) encourage the Federal Reserve to adopt, as its primary objective, policies conducive to an environment of economic stability.

Over the past few years, the Joint Economic Committee has been at the forefront in having a clear understanding of the nature of our economic problems and the solutions that are needed to solve them. Others are now following your lead, including the electorate who voted overwhelmingly in favor of policies that had early and thoughtful consideration by members of this committee.

As we begin a new Congress, a new administration, and a new decade, there is emerging a growing consensus in favor of these policies. We are hopeful that this constructive bipartisan concern will continue.

At the moment, we are approaching an economic recovery following 2 years of stagnant or negative real economic growth and several years of accelerating inflation. We expect that the present quarter will see a modest decline in economic activity, confirming our summer forecast of a double-dip recession, and that positive growth will resume in the spring.

Given the present state of our economy, the time is especially ripe for a bold and comprehensive approach; the Federal budget is bloated, and its growth is nearly beyond the grasp of effective control; economic activity is again showing signs of deterioration and excess productive capacity is pervasive; real expenditures on productive plant and equipment declined last year after 4 years of increase; and wage earners, who on the average have experienced a decline of 15 percent in real spendable earnings since 1972, will see their individual income and social insurance taxes rise by a staggering $64 billion in fiscal 1981 and $77 billion in fiscal 1982.

The attainment of economic stability and the reduction of uncertainty are critical components of any coordinated set of economic growth policies. Without this stability, the impact of the other, more narrowly focused policies is likely to be less effective. A strong and growing economy requires a dynamic business sector that invests and plans for its future.

But we can only do this if business has a sense of what the future might hold. When economic policies change abruptly from restraint to expansion and back again, and when the outcomes of these policies lead to periods of recession followed by periods of accelerating inflation and sharply rising interest rates, the rational businessman is wise to be cautious and defensive.

In this environment, risk-taking, innovation and investment are discouraged, and the effect of this attitude is sluggish growth and lagging productivity.

To meet the objective of stability, it is imperative that the Federal Reserve refrain from attempts to influence and control short-run economic events and, instead, strive to maintain a steady rate of moderate monetary growth consistent with the goals of price stability and properly functioning credit markets.

We cannot expect our economic condition to improve unless Congress takes immediate steps to begin the reduction of the massive tax disincentives on work, saving, and investment. For far too long, we have ignored a fundamental tenet of taxation—that the tax system ought not to interfere with the productive economy any more than absolutely necessary to raise the requisite tax revenue.

Our current tax system discourages productive activity far more than is necessary and as a result diminishes rather than increases potential Government revenues.

The chamber continues to recommend that Congress move promptly to reduce taxes. At least half of this needed tax relief should promote capital formation. Our main priority remains passage of "10-5-3," the Capital Cost Recovery Act.

In addition, tax changes to encourage more saving and investment by individuals must be adopted. Moreover, Congress and the administration should make it clear that investment-oriented tax relief will take effect January 1, 1981, so as to avoid delaying the saving and investment needed to increase productivity and create jobs.

The exact tax measures that the new administration will propose are not yet known, and we look forward to the opportunity at a later time to comment on them specifically. However, I would like to comment on the first order recommendations of President Reagan's Tax Policy Task Force. These consist of:

1. An immediate improvement in capital cost consumption allowances, as proposed in the Capital Cost Recovery Act, also known as "10-5-3."

2. An across-the-board reduction in marginal tax rates as proposed in the Roth-Kemp bill.

3. A reduction in the maximum capital gains rate to 20 percent.

Such a tax package would increase both the demand and supply of labor, greatly increase needed savings and productive investment, and cause a boom in venture capital that is desperately needed to revitalize America. These tax changes would substantially lower the rate of unemployment and increase the rate of productivity growth, thereby increasing real per capita income to all Americans. The necessity for tax relief is widely known and recognized, so I will not dwell on it now.

But as with any needed change, there are always a few who are opposed. Those who argue against tax cuts say we cannot afford tax reduction now because it would be inflationary. They argue that tax rate reductions will cause an increase in the deficit, which would be monetized by the Federal Reserve and, hence, would be inflationary.

The argument is fallacious on several counts:

First, the antitax cutters confuse tax rates with tax revenues. We know both from experience and casual observation that reductions in marginal tax rates stimulate economic activity, broaden the tax base, and discourage individuals from participating in tax shelters and the underground economy.

These tax revenue "feedback" effects have always been substantial and are much greater than estimated before the fact. Our most recent similar experience, the Kennedy tax cuts of 1965, which were of comparable magnitude to the proposed package given today's economy, led to much higher revenues than had been forecast.

Second, the demand for Government services, particularly transfer payments such as unemployment compensation, food stamps, welfare, et cetera, always increases dramatically during periods of economic decline, and their growth rate diminishes during periods of economic growth. Tax cuts, by stimulating economic growth, will cause Government spending to be less rather than greater than it would be in the absence of such cuts.

Given these two beneficial effects which result from supply-oriented tax cuts, revenue feedbacks, and a lower level of Government spending, tax cuts would not necessarily result in a greater deficit, even though short-run revenues might be less.

Perhaps the most difficult task facing the new administration and new Congress is the need to control Federal spending.

The U.S. Chamber believes that substantial tax cuts can and should be made beginning this year. And these cuts can be accomplished without sacrificing the central services or diminishing the well-being of those with legitimate needs who depend upon one or more of the Government's many benefit programs.

Finally, we should begin now to reassess our whole approach to regulating the productive sector of the economy. The regulatory impediments that now constrict our economy impose significant costs on business and consumers alike. Of greater significance, they have often led to interminable delays, postponements, and outright cancellation of new factories, real estate development, and energy-producing investments that are needed to support our future economic growth and increase our Nation's productivity.

If we can make substantial progress in these four areas over the next year, I believe the American economy will be well-prepared to meet the challenges that confront it and to embark on a path of sustained growth with rising standards of living. But if we fail to act now, the delay will lead to greater weakness and make progress all that much more difficult to achieve in the future.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Rahn, together with an attachment, follows:]

Prepared Statement of Richard W. Rahn

I am Richard W. Rahn, Vice President and Chief Economist of the Chamber of Commerce of the United States, on whose behalf I am appearing today. The Chamber of Commerce of the United States is the world's largest business federation. On behalf of our more than 103,000 business, trade association and local chamber members, we welcome this opportunity to present our views on the many serious economic issues that confront our Nation.

Summary

The U.S. economy has just completed a decade characterized by economic instability, accelerating inflation, deterioration in our standard of living, little growth in productivity, and erosion of our international competitive position. A reversal of these trends will require a new direction in economic policy.

Specifically, we recommend that Congress (1) take immediate steps to reduce federal spending, (2) enact substantial tax cuts for businesses and individuals, (3) provide relief from excessive business regulation, and (4) encourage the Federal reserve to adopt as its primary objective, policies conducive to an environment of economic stability.

If we can make substantive progress in these four areas over the next year, I believe that the American economy will be well prepared to meet the challenges that confront it and to embark on a path of sustained growth with rising standards of living.

The Need for a New Direction

There is little need for me to review these issues in any great detail before this committee. Over the past few years, the Joint Economic Committee has been at the forefront in having a clear understanding of the nature of our economic problems and the solutions that are needed to solve them. Others are now following your lead, including the electorate who voted overwhelmingly in favor of policies that had early and thoughtful consideration by members of this committee. As we begin a new Congress, a new Administration and a new decade, there is emerging a growing consensus in favor of these policies.

Because I believe we stand at a critical point in our economic history, where the challenges to our economic well-being are nearly as great as they were fifty years ago, the advent of this consensus could not have been more timely. We have just completed a decade characterized by economic instability, accelerating inflation, deterioration in our standard of living, little growth in productivity, and a decline in our international competitiveness. While we have recognized and attempted to deal with these problems in the past, the policies that we have implemented have often been either ineffective or have contributed to a worsening of other problems.

A continuation of this pattern would have had repercussions beyond the many immediate hardships it created: persistent failure could diminish our confidence and will make the hard choices and take the risks necessary to move our economy back to the path of stable economic growth.

As we review the current state of the economy and consider alternative solutions to our problems, we should look beyond the immediate objective of merely promoting and sustaining a short-run economic recovery to the longer run objective of better harnessing our collective skills, enterprise and initiative to reverse our meager productivity experience and assure that the decade of the 1980's will be one in which we achieve rapid and sustained advances in our standard of living.

At the moment, we are approaching an economic recovery following two years of stagnant or negative real economic growth and several years of accelerating inflation. We expect that the present quarter will see a modest decline in economic activity, confirming our summer forecast of a double-dip recession, and that positive growth will resume in the spring. While we expect the recovery to last through 1983, it will not be particularly robust. In the absence of a new policy direction, unacceptable levels of basic inflation will persist and the long-term outlook is still uncertain.

The policies that should be adopted now are those that would encourage real economic growth in an environment of price stability by reducing the many impediments that now stand in the way of production and productive capital formation, or add substantially to costs. Specifically, I recommend that Congress immediately take effective steps to reduce Federal spending, enact substantial tax cuts for business and individuals, provide relief from excessive business regulation and encourage the Federal Reserve to adopt, as its primary objective, policies conducive to an environment of economic stability.

Given the present state of our economy, the time is especially ripe for a bold and comprehensive approach such as this: the Federal budget is bloated and its growth is nearly beyond the grasp of effective control; economic activity is again showing signs of deterioration and excess productive capacity is pervasive; real expenditures on productive plant and equipment declined last year after four years of increase; and wage earners, who on average have experienced a decline of 15 percent in real spendable earnings since 1972, will see their individual income and social insurance taxes rise by a staggering $64 billion in fiscal year 1981 and $77 billion in fiscal year 1982.

RECOMMENDED POLICIES TO PROMOTE ECONOMIC GROWTH AND A RISING STANDARD OF LIVING

The goal of economic policy, as proposed by the U.S. Chamber's "Let's Rebuild, America" program, is to increase real per capital income. These policies have, as their primary focus, the creation of an economic environment that would take full advantage of the energy, enterprise and creativity of the American people.

Achieve economic stability.—The attainment of economic stability and the reduction of uncertainty are critical components of any coordinated set of economic growth policies. Without this stability, the impact of the other, more narrowly focused policies is likely to be less effective. A strong and growing economy requires a dynamic business sector that invests and plans for its future. But it can do this only if it has some sense of what the future might hold. When economic policies change abruptly from restraint to expansion and back again, and when the outcomes of these policies lead to periods of recession followed by periods of accelerating inflation and sharply rising interest rates, the rational businessman is wise to be cautious and defensive. In this environment, risk-taking, innovation and investment are discouraged, and the effect of this attitude is sluggish growth and lagging productivity.

To meet the objective of stability, it is imperative that the Federal Reserve refrain from attempts to influence and control short-run economic events and, instead, strive to maintain a steady rate of moderate monetary growth consistent with the goals of price stability and properly functioning credit markets. Too often in the past, monetary policy has been asked to bear a disproportionate share of the macroeconomic policy burden. When concern focused on unemployment and stagnant economic activity, as it did in the early 1970's, monetary growth was often increased to spur business. While some short-term stimulus may have occurred, such policies inevitably led to accelerating inflation, which, in turn, led to wage and price controls or guidelines and, finally, to severely restrictive monetary policies that created chaos in financial markets and sharp declines in economic output and employment. In large part, our present problem is a legacy of this pattern of stop-go stimulation and restraint.

The U.S. Chamber believes that the Fed's present monetary growth targets are appropriate and encourages the Congress and this committee to be supportive of such targets as the Fed endeavors to diminish the inflationary pressures that now pervade the economy.

Reduce the tax burden.—We cannot expect our economic condition to improve unless Congress takes immediate steps to begin the reduction of the massive tax disincentives on work, saving, and investment. For far too long, we have ignored a fundamental tenet of taxation—that the tax system ought not to interfere with the productive economy any more than absolutely necessary to raise the requisite tax revenue. Our current tax system discourages productive activity far more than is necessary and as a result diminishes rather than increases potential government revenues.

The Chamber continues to recommend that Congress move promptly to reduce taxes. At least half of this needed tax relief should promote capital formation. Our main priority remains passage of "10-5-3," the Capital Cost Recovery Act. In addition, tax changes to encourage more saving and investment by individuals must be adopted. Moreover, Congress and the Administration should make it clear that investment-oriented tax relief will take effect January 1, 1981, so as to avoid delaying the saving and investment needed to increase productivity and create jobs.

The exact tax measures that the new Administration will propose are not yet known, and we look forward to the opportunity at a later time to comment on them specifically. However, I would like to comment on the first order recommendations of President Reagan's Tax Policy Task Force. These consist of:

(1) An immediate improvement in capital cost consumption allowances, as proposed in the "Capital Cost Recovery Act," also known as 10-5-3 or the Jones-Conable bill;

(2) An across-the-board reduction in marginal tax rates as proposed in the Kemp-Roth bill; and

(3) A reduction in the maximum capital gains rate to 20 percent.

Such a tax package would increase both the demand and supply of labor, greatly increase needed savings and productive investment, and cause a boom in venture capital that is desperately needed to revitalize America. These tax changes would substantially lower the rate of unemployment and increase the rate of productivity growth, thereby increasing real per capita income to all Americans. The necessity for tax relief is widely known and recognized, so I will not dwell on it now.

But as with any needed change, there are always a number of nay sayers. Those who argue against tax cuts say "we cannot afford tax reduction now because it would be inflationary." They argue that tax rate reductions will cause as increase in the deficit, which will be monetized by the Federal Reserve—that is the Fed will print money to cover the deficit—and this will be inflationary.

The argument is fallacious on several counts. First, the anti-tax cutters confuse tax rates with tax revenues. We know both from experience and casual observation that reductions in marginal tax rates stimulate economic activity, broaden the tax base, and discourage individuals from participating in tax shelters and the underground economy. These tax revenue "feedback" effects have always been substantial, and are much greater than estimated before the fact. Our most recent similar experience, the Kennedy tax cuts of 1965, which were of comparable magnitude to the proposed package given today's economy, led to much higher revenues than had been forecast.

Second, the demand for government services, particularly transfer payments such as unemployment compensation, food stamps, welfare, etc.. always increases dramatically during periods of economic decline and their growth rate diminishes during periods of economic growth. Tax cuts, by stimulating economic growth, will cause government spending to be less rather than greater than it would be in the absence of such cuts.

Given these two beneficial effects which result from supply-oriented tax cuts—revenue feedbacks and a lower level of government spending—tax cuts would not necessarily result in a greater deficit, even though short-run revenues might be less.

Even if the deficit increases after a properly structured tax reduction, the higher deficit would not "crowd out" private borrowing if the tax cut caused the supply of saving to grow by more than the deficit. Moreover, if the Fed does not increase the money supply faster as a result of the higher deficit, the tax cut will clearly not be inflationary.

It is my belief that a properly structured tax cut package can increase the supply of saving and productive investment more than any likely real increase in the deficit resulting from lower tax rates.

The U.S. Chamber believes that tax relief to promote capital formation must be given the highest priority by Congress. We look forward to providing more specific recommendations after President Reagan has presented his proposals.

Limit the growth of Federal spending.—Perhaps the most difficult task facing the new administration and the new Congress will be the control of Federal spending. Over the last two decades, the federal government's share of our gross national product has steadily increased from around 18% in the early 1960's to a projected 23.3% in this fiscal year and the one to follow. Whether the budget growth is financed by taxes or borrowing, the effect on our economic performance is essentially the same: it is absorbing ever-increasing amounts from a weakened private sector, resources that could better be used by individuals and businesses to meet the competitive challenge that now confronts us.

The U.S. Chamber believes that substantial budget cuts can and should be made beginning this year, and that these cuts can be accomplished without sacrificing essential services or diminishing the well-being of those with legitimate needs who depend upon one or more of the government's many benefit programs. During 1980, organizations and groups such as the Congressional Budget Office, the Bi-Partisan Coalition for Fiscal Responsibility and the Washington State Research Council have prepared comprehensive analyses of the budget and offered detailed recommendations on where cost reductions can be achieved by eliminating waste, duplication, excessively generous transfer payments and unnecessary programs. The identified savings are substantial and range from $26.4 billion in FY 1981 to roughly $150 billion over the next five fiscal years.

At the present time, the U.S. Chamber is in the process of preparing a similar budget review that will identify needless and wasteful programs. Although the review is still underway, we have identified as one area in need of reform the automatic indexation of 33 percent of the budget's outlays. This mechanism now provides the beneficiaries of these programs with transfer payments that have risen at rates in excess of the gains achieved by wage earners. This problem was identified by President Carter in his last budget and should receive immediate congressional attention.

The U.S. Chamber recommends enactment of individual cuts in spending and the gradual, year by year, reductions in federal outlays from the present 23 percent share of GNP.

Reduce regulatory impediments to economic growth.—Finally, we should begin now to reassess our whole approach to regulating the productive sector of the economy. The regulatory impediments that now constrict our economy impose significant costs on businesses and consumers alike. Of greater significance, they have often led to interminable delays, postponements and outright cancellation of new factories, real estate development, and energy producing investments that are needed to support our future economic growth and increase our Nation's productivity.

To repair the competitive damage that has been inflicted on business by government regulations and to impose some reason on the regulatory process, the U.S. Chamber recommends that:

Congress make a thorough re-evaluation of all major laws under which regulations are promulgated, and rewrite them, as needed, so that they meet real needs, are confined to legitimate objectives, and are administered and enforced reasonably and realistically.

New legislation be enacted or present legislation amended requiring agencies to publish regulatory analyses of proposed rules, described economic costs and benefits and requiring the agencies to choose the last costly alternative or explain their failure to do so.

Efforts be made to require agencies to consider performance standards as alternatives to specific design standards in formulating industry-wide regulations.

Efforts be made to require periodic review and evaluation of federal regulatory programs to determine their value to our society and whether there is continued need for them.

CONCLUSION

If we can make substantive progress in these four areas over the next year, I believe that the American economy will be well-prepared to meet the challenges that confront it and to embark on a path of sustained growth with rising standards of living. But if we fail to act now, the delay will lead to greater weakness and make progress all that more difficult to achieve in the future.

Arnold Toynbee, the great British historian, argued that the success or failure of a civilization can be measured by the way it responds to challenges. In the late 1960's, J. J. Servan-Schreiber wrote a book entitled the "American Challenge." In it, he told his European audience that unless they adopt the techniques and spirit of the dynamic American business system, they would soon be overwhelmed by its economic might. Many took heed, and a mere dozen years later, it is we who are being challenged. It is a challenge whose power can be measured by the number of distressed businesses that dot our landscape. How we respond to this challenge will in large part determine the kind of future we have.

Attachment.

CONSUMER OPINION SURVEY, JANUARY 1981

Consumers are not very optimistic now, nor do they expect much improvement during the coming year, either in their personal financial situations or in the state of the economy.

The latest quarterly survey of consumers, conducted in December for the U.S. Chamber Survey Research Center by The Gallup Organization, found little change in consumer confidence between September and December, especially in three primary measures: the nearly one-half of consumers who say that now is a bad time to buy big consumer durables for their homes, the 53 percent majority who expect their incomes to rise less than prices, and the small but not significant increase in the proportion (to 64 percent in December) who are reluctant to buy on credit. (See Tables.)

Moreover, compared with a year earlier (December 1979) larger proportions of consumers say now is a bad time to buy big things for the home, to buy a car, and to buy a house.

The results are based on personal interviews with a nationwide sample of U.S. consumers.[1]

Consumers have limited expectations for the coming year. The consumer optimism that might be expected from having a new president has been counterbalanced by pessimism due to the worsening inflation and economic situation.

Respondents, asked about the prospects for changes in the economy under the new Reagan administration, expressed doubt that there would be much change. Only 25 percent think President Reagan will be successful in accomplishing all three of his stated objectives: to reduce government spending, cut taxes substantially, and balance the budget even though outlays for defense will increase. Ten percent volunteered that he will achieve two out of three of his objectives, but not the other. Fifty-one percent said simply that he would not be able to achieve these three objectives.

The generally pessimistic expectations for the economy and inflation may prove to be an advantage to the Reagan administration. A Gallup Poll conducted in late November, and released January 4, noted that "* * * since Americans do not expect any dramatic improvement in the nation's economic health, they may allow the new President a longer grace period than usual." The release continued:

* * * public expectations of the Reagan administration's likely impact on economic problems are in sharp contrast with the high hopes the public invested

[1] The current survey involved 1,549 face-to-face interviews with a representative sample of U.S. consumers, 18 years and older. It is very probable (95 chances out of 100) that survey findings are within three percentage points of the figures that would have been obtained if the whole adult population had been interviewed. All surveys had a minimum sample of at least 1,500.

four years ago in the Carter administration. In a survey conducted by The Garlup Organization for Newsweek in January 1977, firm majorities expressed the belief that the Carter Administration would reduce inflation (58 percent) and unemployment (69 percent). Carter lost much of his early high popularity when these economic expectations were not reached.

The November 1980 Gallup Poll found a majority of the public expecting an unemployment rate of 7 percent or more, and a double-digit inflation rate of 13 percent or more at the end of 1981. In other words, no real improvement in inflation and unemployment is expected during 1981.

In the current Chamber-Gallup survey, a majority of 71 percent think the average prime interest rate during 1981 will be the same as or higher than the 15 percent average in 1980.

Consumers see tax cuts and spending cuts as important to curbing inflation. The question was asked:

If he [Reagan] does achieve substantial tax cuts and reduce government spending, do you think that will succeed in reducing inflation, or not?

	Percent
Yes	53
No	33
Don't know	14
Total	100

These findings are especially interesting in view of the fact that in previous Chamber-Gallup surveys of consumers, widespread public support has been found for reducing both taxes and government spending, and for a balanced budget. In a Chamber-Gallup survey in December 1979, 56 percent of consumers favored a cut in federal income taxes at that time. A Gallup Poll in March of 1980 found that 67 percent of the public favored a Constitutional amendment to limit spending to no more than expected revenues, and 53 percent said a balanced budget would reduce inflation. In an August 1980 Chamber-Gallup survey, 54 percent favored a 10 percent rate reduction in federal income taxes, while 48 percent said the best alternative would be a cut in both taxes and spending.

In short, previous Chamber-Gallup surveys have found evidence that people do approve of President Reagan's objectives of reducing spending, cutting taxes, and balancing the budget. They feel some skepticism, a "show me" attitude, as to whether he will succeed. At the same time they think that if he achieves his objectives he will also curb inflation.

Consumers tend to see taxes as part of the problem of inflation, and this may explain in part their support for tax rate reduction. In the March 1980 Chamber-Gallup survey, 52 percent said that when taxes go up "that tends to increase inflation."

Notwithstanding their own views about taxes and Ronald Reagan's support for tax rate cuts, many consumers expect an increase in their total federal, state, and local tax burden over the next four years. The question was asked:

Looking ahead four years, and thinking of all the taxes you pay—to state and local governments as well as the federal government—do you think your total taxes four years from now are likely to be higher, lower, or about the same as they are now?

	Percent
Higher than now	64
Lower than now	8
Same as now	19
Don't know	9
Total	100

Consumers also were asked their views about how best to achieve economic growth and to reduce inflation. For achieving economic growth, consumers believe by a two-to-one margin (40 percent to 20 percent) that a substantial cut in personal taxes would be better than a substantial cut in business taxes. Fifteen percent say a cut in neither would be best, while another 15 percent volunteered that a cut in both would be the best way to achieve economic growth. Significantly, an earlier Chamber-Gallup survey (August 1980) asked whether it is more important to cut taxes paid by business in order to stimulate investment or more important to cut individual income taxes to increase consumer spending.

On this question, opinion was evenly divided at 38 percent each. The question asked in the current survey did not mention investment, and a smaller proportion favored business tax cuts. The difference in responses may be because same people do not perceive a connection between cutting business taxes and increasing business investment unless the two are linked in the question put to the respondent.

Similarly, from the standpoint of reducing inflation, 28 percent think a substantial cut in personal taxes would be better, while 22 percent say a cut in business taxes. Twenty-two percent favor a cut in neither, while 14 percent volunteered that a cut in both would be the better way to reduce inflation.

Respondents were asked what percentage of a tax cut they would save and what percentage they would spend, if taxes were cut by 10 percent in each of the next three years so that they would pay 30 percent less than now. On average, consumers expected to save 26 percent of the proceeds from such a tax cut. This, we may note, is a much higher proportion than people generally tend to save out of ordinary income.

On a similar question, if inflation were substantially reduced so that the consumer had more disposable income, on average people say they would save 30 percent of the increased amount left over at the end of each month.

What is especially important in these findings is the indication that both substantial tax cuts and a substantial reduction in the inflation rate would contribute to significant increases in savings and, by inference, in investment.

TABLE 1.—WHETHER NOW IS A GOOD OR BAD TIME FOR PEOPLE TO BUY

	Percent of all families					
	December 1977	December 1978	December 1979	June 1980	September 1980	December 1980
Cars:						
Good time	41	43	34	40	(1)	30
Good and bad	11	6	8	8	(1)	7
Bad time	33	40	50	53	(1)	57
Don't know	15	11	8	9	(1)	6
Total	100	100	100	100	(1)	100
Big things for the home: [2]						
Good time	51	52	38	38	33	34
Good and bad	16	13	15	12	13	13
Bad time	19	26	40	53	48	49
Don't know	14	9	7	7	6	4
Total	100	100	100	100	100	100
Houses:						
Good time	49	40	21	18	(1)	17
Good and bad	9	7	8	7	(1)	6
Bad time	31	45	67	69	(1)	74
Don't know	11	8	4	6	(1)	3
Total	100	100	100	100	(1)	100

[1] Not available.
[2] Like major appliances furniture or a TV set.

TABLE 2.—EXPECTED CHANGES IN CONSUMER INCOMES (NEXT 12 MONTHS)

[In percent]

	December 1979	March 1980	June 1980	September 1980	December 1980
Income will rise:					
Less than prices	58	58	55	53	53
Same as prices	29	27	31	30	33
More than prices	8	9	8	10	10
Don't know	5	6	6	7	4
Total	100	100	100	100	100

TABLE 3.—FEELINGS ABOUT BUYING ON CREDIT

[In percent]

	December 1979	March 1980	June 1980	September 1980	December 1980
O.K. to buy on credit	20	19	14	19	18
Middle position	6	6	4	4	4
Reluctant to take on new debt	60	52	61	61	64
Never OK to buy on credit	13	20	19	12	12
Don't know	1	3	2	4	2
Total	100	100	100	100	100

Representative REUSS. Thank you very much, Mr. Rahn. We will now inquire of Mr. Greenspan, under the 5-minute rule.

I was very much impressed by your presentation, perhaps because my concern for the present structure of high interest rates is echoed by your own. You added some excellent points, I thought, to your case that, in your phrase, the United States can't go on this way. I agree.

Here is my question: We have within the administration many who are saying that in 1980, the trouble with the Federal Reserve was that its monetary policy wasn't tight enough; it got too sloppy in its creation of the aggregates; and that it should settle down and lower its targets a bit and stick to them.

Second, we have the fact that the tax cuts—and there are a whole panoply of them that are being discussed—should, in the view of many of those in the administration, be put into effect immediately. And Congress then should pursue the question of spending cuts it wants to enact to reduce the initial increase in the deficit that occurs when you decrease revenues by a tax cut. And as you well know, this committee unanimously thinks that accelerated depreciation to encourage investment is needed.

But the initial effect of almost every tax cut you think of is to increase the deficit. This will mean that the Treasury has to borrow that much more. I would think the effect of that would be to increase existing interest rates, assuming that the Fed does not do what you and I would not want them to do—just monetize away the effect of that, because we know the end result.

So if you and I are right that the horrendously high structure of interest rates now is an impediment to the goals that we would like to see our country achieve, aren't some of the thoughts that are floating around now—maybe thoughts that are good in the abstract—leading in the opposite direction?

Mr. GREENSPAN. Well, Mr. Chairman, I am not here, obviously, to speak for the administration. It happens, though, I do agree with many of the positions that some of the members within that administration are currently taking. I do so largely because I think we have arrived at a point where we no longer have the luxury of structuring economic policy in some sequential fashion.

That is, should we cut spending first, and then look at taxes, or should we try to sequence monetary policy in a manner which is consistent with some preconceived fiscal policy?

I think that was a luxury we had a decade ago. We are now out of the game. We are at high risk and at what probably is a relatively narrow window of economic policy opportunities, so to speak, over the next 6 to 9 months to resolve this extraordinary deterioration that is occurring in the system.

As a consequence, I think that we do not have the choice, but to create a far more stable monetary policy. Whether one argues that growth rates in the monetary aggregates, however, defined, are excessive or not. I don't think anybody would disagree, including the people at the Fed that we had a highly unstable policy which requires considerable improvement.

I think that in part was to a substantial extent caused by extremely weak fiscal policy.

[At this point the stenographic reporter was unable to continue because of an equipment malfunction. The sequence of speakers missing follows after Mr. Greenspan finished:

[Senator Jepsen to Mr. Bosworth (taking his 5 minutes).

[Representative Mitchell said he always liked to learn something, then had a rapid interchange with: Mr. Rahn; Mr. Boswell; Mr. Rahn; Mr. Nordhaus; and Mr. Rahn (taking his 5 minutes).

[Senator Mattingly asked a question of Mr. Rahn then of Mr. Nordhaus. The stenographic reporter picked up during Mr. Nordhaus' response.]

Mr. NORDHAUS. * * * My personal reading of what is known about this is that the best place to spend our tax reductions is to support business investment directly. And the two important ones I mentioned in my testimony are accelerated depreciation and extension of the tax credit.

All the studies I have seen—we are still waiting for one of the miraculous supply-side models—indicate that tax cuts devoted to reducing individual tax rates will have a negligible effect on inflation and productivity. For that reason, I would not put my money there.

Senator MATTINGLY. National needs include increasing productivity, and the reality, you know, the reality is people. Businesses are people. And that is, I guess, what I am giving to you, which is, with your approach, what you do is continue to give the power to the Government rather than giving the power and the encouragement and hope back to the individual, which is Roth-Kemp, in cutting the marginal tax rates back.

That is part and parcel of 10–5–3, reducing the tax on savings, and many of the other things to encourage and create the optimism and restore the stability in the private sector.

I guess I am too new from the private sector. I am fresh out for 16 days from the private sector, having been there all my life. But the reality is that high interest rates have tripled business cost and have torn apart the home-building industry. If you are living by a paycheck every 2 weeks, you barely can make it, if you make it at all.

I think cutting the tax rates back is part and parcel of the solution to the problem.

Representative REUSS. We are addressing you first, Mr. Greenspan, because you do have a rendezvous——

Senator MATTINGLY. You do?

Mr. GREENSPAN. I wish.

Representative REUSS. Senator Mattingly referred to you as a supply-side economist. Are you now, or have you ever been, a supply-side economist?

Senator MATTINGLY. Just say yes, Alan. [Laughter.]

Mr. GREENSPAN. If there is a list, I am on it.

Representative REUSS. Thank you very much. As always, we have profited by your remarks. I am sorry you have to go.

Mr. GREENSPAN. I have got 15 minutes.

Senator JEPSEN. Stay as long as you can.

Representative REUSS. Feel free to go.

Senator MATTINGLY. It depends on your rendezvous.

Representative REUSS. Mr. Mitchell.

Representative MITCHELL. Mr. Greenspan, it is interesting that our discussions focus on a basic reality. What is real is that people are hurting—people are suffering—because of taxes, unemployment, and the general condition of the economy. Yet, more and more, I see a theme being played by the incoming administration that cures are long term. We are going to set into place an economic program that will cure some problems 40 years from now. It is a long-run solution. We shall succeed in addressing these problems only to the degree that the Congress follows the administration's request and only if we can educate the people we represent to have the sophistication that you gentlemen possess to consider the long run solution.

I am not at all sure that they do. They are going to face the realities of trade-offs in the budget next year. I think the sweep that took place in the Nation represents a kind of political personal reality that says: do something now, not 5 years from now. If that is true, I would anticipate enormous pressures being exerted on this Congress to take actions that obviously some of you gentlemen would not agree.

Am I right? What was your interpretation of the will of the electorate? Do you sense that they wanted something done for relief right now?

Mr. GREENSPAN. In all seriousness, that is the toughest question that has been posed to me in a long time.

Representative MITCHELL. It is tough, but we are all trying to analyze what people really wanted.

Mr. GREENSPAN. I think that is right. It is extremely difficult to determine what one reads from an election. And it is very difficult to avoid reading into it what you would like to read into it. Clearly, one has to agree that they wanted a change. And the question is: A change from what to what?

I think that probably beyond the issue that the electorate is saying to the Congress and to the executive branch that something is wrong, change it. I don't sense that there is anything implicit in the instructions that go along with that mandate.

Representative MITCHELL. It is not only change. But do it as fast as you can. Do it immediately.

Mr. GREENSPAN. I don't know one can infer that. I don't know by what means one would make that judgment. I think essentially, we are looking at representative government in its most effective sense; that the people are saying something is wrong, they need a change; we want to do something differently.

And it essentially is putting into place a somewhat different structure of the House of Representatives, a different Senate, and a different executive branch. And the presumption of that is that there will be changes and should be.

And what is essential for policy to address is how does one go about that in the context of trying to resolve the issue? I personally don't believe that what is confronting us can in fact be resolved in a very short period of time, nor does President Reagan.

There is a time frame. The electorate will give this Government, both the Congress and executive branch, a year, maybe two, to get it, not fully straightened out—I don't think it can be done—but to change the path. And I think there is implicit in the so-called mandate, to do it in a manner which is not overly disruptive.

As I read the particular policies which are in the process of being put together by the new Reagan administration's economic team, it is clear that they are truthfully aware of the fact that the size of the problem is very substantial; that it requires a long-term solution. But one cannot look only at the long term; you have to obviously look at what the short-term implications of what you are doing now are, and address that as well.

How they come out—how they trade off the long-term solution with short-term costs and amelioration of those costs as best one can do it—I cannot at this stage say. But they will be coming out with something within a relatively few weeks.

Representative MITCHELL. Thank you for your comment.

Representative REUSS. Mr. Bosworth, in your prepared statement, you advocate, in order to break the momentum of the inflation—and here, I quote you—"a short, but severe episode of controls."

Do you mean by that a general, across-the-board, wage-price freeze which would remain in effect for those intervening months while the President's program takes hold and becomes credible to the markets generally as an inflationary circuit breaker? Exactly what do you mean?

Mr. BOSWORTH. Well, I think there is no sentiment now in this Government, either by the administration or the Congress, to go for controls. I think, however, that it is an option that should be considered.

We have a double-digit rate of inflation today, and it is only going to go higher under current policy. You have two options if you really want to do anything about that inflation.

You can opt for fiscal and monetary restraint, and it will work to reduce inflation. But one must be clear about the costs. It will only work because, in the face of inflation, a refusal to expand the money supply implies that interest rates go up, investment goes down, production declines, and employment declines. And you throw some more people out of work.

If unemployment is high enough, people will quit asking for a wage increase. And if manufacturing capacity utilization is low enough, firms will slow their rate of price increase. That policy will reduce inflation, but everything tells you through the whole history of economic fluctuations that the costs are high.

The other option, again with very high cost, is wage and price controls combined with, but not as a substitute for, fiscal and monetary restraint. We have learned that controls alone are a disaster. That is the lesson of 1973.

But, so too, the unemployment costs of relying on fiscal and monetary restraint alone are unacceptably high. Therefore, some fiscal and monetary restraint combined with the wage price program, I think is the most effective way to break the momentum.

The choice, I think, is between a really long, drawn out period of slow economic growth and high unemployment or controls. I think, in the absence of such strong measures, the outlook of the United States is continued inflation and slow growth.

That is pessimistic, but I don't think the changing expectations emphasis of Mr. Greenspan is sufficient to sharply alter inflation.

I think the Reagan-type proposals for tax stimuli make a lot of sense in a world in which we are not constrained by inflation.

But such proposals for tax cuts ignore the fact that the Federal Reserve is not going to finance an economic expansion in the face of double-digit inflation. Thus, efforts to stimulate economic growth are thwarted by the problem of inflation.

I will admit that wage and price controls as a shock treatment for a 2- or 3-year period are extremely costly, very difficult to run. And in the past, the temptations to the Congress to say a high inflation is under control, we can now stimulate the economy, have proved to be overwhelming.

But if you will not say that the 1974 oil crises and food price explosion proves that controls won't work, I won't try to claim the 1951 program of Harry Truman shows they do. The Truman administration combined several measures, including controls, and including a very large and substantial move toward fiscal restraint, to get inflation under control.

The experience of other countries also points toward the use of a mix of several policies. You make inflation your No. 1 priority and have some fiscal and monetary restraint and a lot of other measures. In Germany, for example, it is illegal to have multi-year labor contracts, and cost-of-living indexation clauses are not allowable.

I am simply saying you have several policy tools, not simply wage and price controls alone. But the problem is severe enough to be willing to at least consider and discuss the possibility of some more extreme actions than is currently on the table.

Representative REUSS. My time is up. But with the indulgence of the minority, I would like to ask Mr. Greenspan before he departs to address himself to Mr. Bosworth's point.

Mr. GREENSPAN. First of all, I would not subscribe to the notion that what I am advocating is a gradualist approach. On the contrary, what I am trying to create by the type of economic change is a dramatic drop in inflation premiums embodied in long-term interest rates.

This, in my judgment, can occur in today's environment only by some extraordinary changes in the underlying statutes which control spending, borrowing, and a whole structure of guarantees.

This is a unique period in American history. We have never had inflation premiums at this level. And I do not sense that if we somehow can alter the perception of the marketplace out there, about the long-term possibilities of Federal borrowing, that we would. If we can lower perceived inflation premiums, we will have an immediate effect, up front, on long-term interest rates now.

What that would mean is that the type of restraint that you are talking about does not have the deflationary impacts on investment, because, if you create that type of long-term environment, I can see hurdle rates of return falling, and capital investment rising, not declining, in that particular context.

Second, there is a dispute about history with respect to the 1950–51 inflation. As I recall it, the price levels took off in June of 1950, and we did not impose any form of price ceiling until we got into 1951. It struck me, looking at individual commodity markets at the time, that we put price controls on after the inflation had run out of steam. And they usually work extraordinarily well under those conditions.

Finally, looking at the rate of inflation in today's environment, I just can't conceive of us creating anything which would resemble an effecttive wage-price control administrative mechanism, leaving aside the issue of the economics, the desirability, or its distortion effects. I don't see how in the world with prices moving the way they are, that we can move the paper around fast enough to effectuate a functioning control system.

It was a terrible problem during the 1971–73 period when price increases were half of what they are today. You couldn't move the papers around fast enough then. In other words, the distortions that occurred were too rapid to, in effect, try to ameliorate.

I would suspect if we were to endeavor to either institute a freeze or something resembling a mandatory wage and price control system, we would find within 6 months the mess that we would create would be so vast that the system would break down with very major costs to the economy and to the governmental processes themselves.

Senator MATTINGLY. Well said.

Representative REUSS. Thank you again, Mr. Greenspan.

Senator Jepsen.

Mr. GREENSPAN. Gentlemen, thank you.

Senator JEPSEN. Mr. Chairman, some statements made here earlier with regard to direct relationship to business profits during inflation were again an attempt to make profits appear as something being bad. Such statements are used to develop a stereotyped image, by some blanket emotional innuendo, that bad corporations are suspect. Because of all these statements and all this other adulterated bureaucratic nonsense that has been down here for a number of years, I want the record to show that corporate profits declined by approximately $14 billion between 1979 and 1980. That is taken from the economic report of the President.

I would also point out that the decline was taking place when we had reached our highest point of inflation. In fact, we came roaring into 1980 with the first quarter annual compound rate of inflation at 17 percent.

So to imply that profits are bad and corporations are bad for people is counter to everything that has existed in our 204-year history.

Mr. Nordhaus, you say we need economic slack, among other things, if we are to reduce inflation; is that correct?

Mr. NORDHAUS. That's correct.

Senator JEPSEN. Isn't it true that one way to reduce the rate of increase of prices is to increase the supply of goods and services?

Mr. NORDHAUS. Yes, there is no doubt. I mentioned three categories, three strategies, for reducing inflation. The second one was Government should take measures to essentially lower the costs of production.

There are lots of ways of doing that. One way is to increase productivity or to lower costs of production. And again, that can be attained by increasing supply.

Senator JEPSEN. Isn't it also true, then, that an increase in supply is generally accompanied by an increase in employment?

Mr. NORDHAUS. I don't quite see that association. Generally speaking, in macroeconomic terms, we associate an increase in employment with increase in the demand for goods and services. And when we talk about the supply side, we are talking about the capacity of the economy to produce.

Those are two things that we tend to distinguish.

Senator JEPSEN. Is it false that an increase in the supply is generally accompanied by an increase in employment?

Mr. NORDHAUS. As I say, I would make the distinction. I will be glad to answer the question, but I am rephrasing it.

Generally speaking, supply-side measures are ones that attempt to increase the capital stock, increase labor force participation rates, increase energy supply. Those by and of themselves have no direct affect on employment. That is to say, on the extent to which the labor force is actually employed.

So those are perpendicular kinds of concepts, if you like.

Senator JEPSEN. Since I rephrased it twice and you once, let me rephrase it a fourth time. Are you saying that employment did not increase with economic growth?

Mr. NORDHAUS. No. What most of the panel has been talking about when it mentions economic growth is the growth in real GNP.

Now, as for example, we had a very soggy year in 1980. We will probably have a poor year in 1981; 1977–78 were relatively good years in the sense of the growth of real GNP which was high.

To answer your question directly, it is clear when real GNP grows rapidly, I think that is what you meant by "growth," that employment expands rapidly, and that unemployment falls.

Mr. BOSWORTH. I think I might be able to clarify a little bit. If you mean by "supply" an increase in capacity, which I think is the sense of which bill was trying to use the term, unless you use that capacity, no, it doesn't increase employment.

If you mean by "supply," though, actually increasing production, utilizing the capacity, yes, it increases employment. But the relationship between an increase in output and employment are two: An increase in output will come from employing more people; and increase in output will also come from expanding productivity of the existing work force.

Some of the supply-side measures expand productivity, producing more with a given work force. That by itself, unless you have simultaneously raised demand so there is an increased demand for goods and services, actually reduces employment.

If you hold output constant, raise productivity, you provide less employment.

Senator MATTINGLY. They are not saying the same work force.

Mr. BOSWORTH. It would also enable you to use an expanded additional work force if you are short of capacity.

Senator JEPSEN. Basically, we are talking in general terms about the economy and getting our country moving again. And there seems to be some disagreement as to how to do that.

I have one final question, if I may, Mr. Chairman, for Mr. Bosworth.

In your prepared statement you say—and I quote: "investments did not respond as expected to the tax stimulus."

My question has to do with this: What was expected? Before you answer, let me point out some things. We have Department of Commerce data showing that after the 7-percent investment tax credit for installed equipment was enacted in 1962, net nonresidential investment increased 36 percent from $18.4 billion in 1962 to $25 billion in 1964.

And after the investment tax credit was legalized in 1964, net nonresidential investment increased from $25 to $44 billion in 1966. That is an increase of 76 percent.

Aren't these significant increases in investment?

Mr. BOSWORTH. Specifically what I refer to is that out of the 1962 investment tax credit and the corporate profits tax or the personal tax cut of 1964, we had hoped to be able to raise investments up to a level of about 12 percent of GNP. That was the anticipated result.

It fell short of that a little bit by rising from something under 10 percent up to about 11 percent.

Second, the economic projections prepared in the early 1960's of what it might be possible to do on the supply side projected an increase in the rate of growth of productivity to about—compared to a 3-point historical trend—5 percent by the end of the 1960's.

What was disappointing that the rate of growth of productivity ran in the 3 to 4 percent range in the first half of the sixties, then began to slow down for reasons that were not fully understood. We didn't get as much improvement in productivity as we had hoped for.

More recent work has again been more encouraging, I think, with respect to what capital formation can achieve.

I think all the people testifying there today, for example, are saying that this country needs to direct more resources into capital formation; to find a way to grow more rapidly on the supply side. These are all desirable things to try to do.

The question and difficulty is how to do it. The Nation must find a way to redirect some resources into capital formation and more defense at the same time. That means cutting back on activities someplace else.

How do you go about doing that?

If the policy is a tax cut that puts more income into the hands of consumers, consumption goes up, not down.

And if, most important, when taxes are cut to stimulate the economy the Fed will not accommodate the expansion of the demand, the result is simply to offset the final stimulus with a higher level of interest rates.

I am not saying you can't do what you want to do, but you have got to coordinate fiscal and monetary policy.

Another approach would be to scale back the tax measures, and target them more on capital formation. It is of a smaller magnitude, and the required cutbacks in expenditures are easier to achieve.

Senator JEPSEN. Thank you, Mr. Chairman. My time is up.

Mr. NORDHAUS. May I say I think I am a little thick, Senator, but it took me a while to get to the point here.

I think your last comment said that we are interested in getting ahead again. And I think I can perhaps restate what I was trying to say.

The supply-side cuts, whether targeted toward capital or labor, will probably increase the capacity of the economy to produce; it will increase the capital stock and number of people around willing to work.

In addition, however, they may increase the extent to which we utilize our labor and capital. That is to say, we will have a higher fraction of that capital humming along and a higher fraction of the workers employed.

The point I was trying to make is the following: To the extent that the policy increases our utilization rate of these resources, it is likely to exacerbate our inflation problem. And, therefore, this is the dilemma of the supply-side cuts, if you do something which increases these utilization rates, and lowers unemployment, and gets the country going again, you may exacerbate what is already a very serious inflation problem.

Representative REUSS. Senator Mattingly.

Senator MATTINGLY. Back to you, Mr. Bosworth. It always seems that if we are going to cut the tax rate, you wonder where we are going to get the money to compensate for it. You never seem to have thought about it in the past. If we increase the taxes, we really don't care where we get it from. It would just take more from the people. They don't, however, have any additional outlets.

Or else, we will just print more money and create more deficits.

In the dilemma you are talking about, it isn't that much of a dilemma. It is the reality of the situation. I think what we keep coming back to here is what type of tax rate cuts do you want to give back. And I think what it gets back to is just exactly what Mr. Rahn had said in his first comments.

Mr. RAHN. If I may make one quick comment——

Senator MATTINGLY. Yes.

Mr. RAHN. Basically, in response to some of Mr. Nordhaus' comments before, I think there is a lot of confusion about this notion of capacity and the notion that we are going to run up cost if we expand output. We must begin to also consider the "quality" of capacity.

Let's take the steel industry, for example. At present, the steel industry is operating well below capacity. But a lot of that underutilized capacity is high-cost, low-quality capacity. What we need to do is to improve the quality of our capital stock by putting in things like continuous casting equipment.

Right now, the steel industry doesn't have the money to do that. We need to do that through increased cash flow and better depreciation allowances.

The expansion capacity often enables you to lower the real cost in producing future products.

When we talk about the tax cuts again, what we are really talking about is a reduction in the planned increase. The fiscal year 1981 tax increase is about $86 billion, according to President Carter's last budget. None of us are talking about a real tax reduction. We are talking about ameliorating the tax increase and reducing these disincentives for work saving investments.

Senator MATTINGLY. And I would just like to throw out one general question and ask you all, I am a proponent of the "Free Enterprise Zone." If we keep talking about trying to create jobs and getting productivity going, as well as trying to encourage legislation in those areas of high unemployment we have now, will it work? Do you think that would encourage somebody to begin a new business or not?

Mr. BOSWORTH. Originally, programs such as "impact aid" and grants to cities were to be targeted. Yet, when it comes to the votes in the Congress, every city in every district has to be included as one of those depressed areas.

I think it is a mistake for the Federal Government to get into a game of trying to target geographically.

I think if you will focus more on the overall economic environment, business will move to those labor markets where there are lots of workers. And workers will move where there are jobs.

I don't know that the Federal Government can be very effective in trying to alter those decisions.

The past experience with such programs has not been encouraging because it becomes a program that every city qualifies for and every congressional district gets some money for. And there is no targeting.

Senator MATTINGLY. I think that is the initial thing that would probably be instituted as a test in some areas. It is not a game. The game is people, of trying to take people that are now unemployed and putting them into jobs. Why not test some areas of our country, Mr. Nordhaus, by cutting back his taxes to encourage him to start a business.

Say if one starts a business in a high unemployment area, to cut his business taxes back or social security taxes back, at least so you can encourage him to start that small business.

Mr. BOSWORTH. States have been offering such enticements for firms to move to their State from another for several decades. For example, they provide the financing of new plants and excuse the firm from various taxes.

And then, the other State says, "Oh, no, we can match that."

Do you really think it is productive to let geographical parts of the country compete against each other? And is there any difference because it is done by the Federal Government?

Senator MATTINGLY. I guess that gets back to what Mr. Greenspan was saying, what you said before, that you were negative about a lot of these things. That maybe is what the people spoke out against on November 4. The American public is tired of having people tell them they can't do this, or that this failed or that failed.

Mr. BOSWORTH. I will leave to you the question of what the people meant by that vote.

Senator MATTINGLY. It is pretty obvious what they meant. They couldn't stand what was going on, and that this idea of encouragement is strong, and the idea of hope is strong.

May I not expose a negativism, but rather say that let's go try this or let's give that incentive back. Let's give that hope and opportunity back to those individuals. And that is part and parcel of the cutting back the tax rates.

Yes, Mr. Nordhaus.

Mr. NORDHAUS. I think this is a good illustration of the budget constraint that Congress has to operate under. If you have x billion dollars you can return in tax cuts, general tax cuts are a better way to return it in terms of tax incentives, than tax cuts targeted to center cities or particular parts of center cities or counties or whatever. I think actually one of the nice things about these broad-scale or "supply side" tax cuts is they do away with these very finely tuned attempts to move people from here to there and move capital from here to there.

I think the experience we have learned from these programs shows a dilemma. Either you target them very narrowly, say, for a particular region, and then you get distortions within that region by people locating plants inefficiently in a given area.

Or if you don't do that, as Mr. Bosworth is saying, and the political forces make you spread those dollars around a lot, then they are too small for people even to notice.

So I would urge you to go back to Republican principles if you like and make those very general and with the least possible Federal interference in where the capital and labor of this economy are used.

Senator MATTINGLY. I think that, political forces probably don't bother me that much. I think that is probably one thing that Chairman Reuss and myself, and many others, probably heard in November; let's not worry about the political forces, but let's worry about creating more jobs. Let's get the inflation rate down, and let's have fundamental reform in the system. Let's not look disparagingly at everything that comes up, but let's try to institute some new policies and try some of the old ones that did work and get the show started now.

And I think what everybody is talking about, whether it is going to be 6 months or 9 months, I don't think it is important that the fundamental reform begin now. So that where I used to live, that when they hear the talk that comes from committees like this or anywhere else, the talk that restores some stability and reassurance to people's lives, especially the ones that have to go on Friday afternoon to the grocery store and gas station or buy clothes, whatever they have to do.

Mr. NORDHAUS. Senator, just one more comment. I think one thing that is sometimes overlooked in this is some kind of targeted programs like that almost always involve either a congressional or executive branch set of regulations about how those funds are going to be targeted.

This is a cause of concern because it leads to excessive Federal discretion and ultimately wasteful use of those resources.

Senator MATTINGLY. These are not Government funds used.

Mr. NORDHAUS. Where is it going to come from?

Senator MATTINGLY. We are cutting this social security tax back for those people he puts on the payroll that were unemployed before.

Mr. NORDHAUS. That is reduction in Federal——

Senator MATTINGLY. They didn't have a job before. There was no money. They were not a taxpayer before. The business that he starts wasn't a business before so he is just paying at a smaller rate going in now.

Mr. BOSWORTH. Why don't you look at a program run by the Department of Labor that offers similar tax incentives? It is called "WIN."

Senator MATTINGLY. I have already looked at some of the programs you promoted, all under the name wage and price stability.

Mr. BOSWORTH. That was under the previous administration.

Senator MATTINGLY. Okay.

Mr. RAHN. It is sort of interesting, but since Jack Kemp came up with the enterprise zone concept, I have noticed some criticism of it. Even at the chamber, we have been concerned what the geographical boundaries would be as well as a few of the problems Barry Bosworth has mentioned. It is apparent that the critics are not criticizing the notion of trying to reduce the disincentives to work in the inner-city and capital formation within the inner-city.

If this is the case, I wonder if the solution might not be to make the whole country an enterprise zone.

Senator MATTINGLY. That is a point well taken.

Representative REUSS. This week it is the South Bronx; tomorrow the world. [Laughter.]

I have a little question on monetary policy, about which Mr. Rahn and Mr. Nordhaus have somewhat different ideas.

First, Mr. Rahn says—and I quote.

The U.S. Chamber believes that the Fed's present monetary growth targets are appropriate and encourages the Congress and this committee to be supportive of such targets.

How does the Fed pick those targets? The current target—you can check me If I am wrong—for M2B which, I think, is 4 to 6½ percent.

But to ask an idiot question, why not 1 or 30 percent? How did they come to 4 to 6½ percent?

Mr. RAHN. I suppose that is why we agreed with their targets. It is a most difficult question. It involves a lot of judgment on their part as to what they think are the legitimate monetary and credit needs, while moderating inflationary pressures. In the past couple of years, our problem with the Fed has been the inconsistency in meeting the targets.

And as my associate has noted, the Fed's performance is analogous to the man who decides to go on a diet, and fasts for 6 months and then eats like a glutton for 6 months. The impact on his health of this is much different than had he consumed the same amount of food at a steady pace over 12 months.

I think the thing that we are most concerned with—at least I am personally—is that the monetary targets be made clear and well-known to the financial community.

As for the appropriate number, I can't tell you precisely what the appropriate number ought to be. There is also great debate as to what the correct measure of money ought to be. M1B seems to be probably as good as any.

But the thing I think is clear, however, is that we need greater stability and greater understanding of what the Fed will do.

Representative REUSS. If I could just add one thought to the excellent answer you gave to my question, Mr. Rahn. You have said, one, that the Fed's monetary targets are about right and should be adhered to.

Second, however, you said that it may be that the Fed isn't being sufficiently explanatory to all of us, particularly the markets, as to how it arrives at those targets. And you have said that it could do a better job of that.

Mr. RAHN. And how it is going to get to them. I also think that is important to know whether it is going to focus on the monetary base or interest rates or what have you. I think that is just as important, and having a consistent method of implementation, and to avoid switching from interest rates versus monetary base.

Representative REUSS. Thank you.

Now, turning to Mr. Nordhaus, the views in your prepared statement were somewhat different, Mr. Nordhaus. You advocate a Federal Reserve monetary policy that "would require abandoning mechanical monetary targets and using instead targets for real GNP, inflation and unemployment."

While I certainly agree with you that real GNP, inflation, and unemployment are the things we are interested in, I couldn't care less about money if we get good results on those three.

In fact, how do you operate a monetary policy if all you do is keep your eyes glued on the ultimate goals of GNP, inflation, and unemployment? Don't you have to have some intermediate goal? And isn't that goal something like the money supply or interest rates, if that is your stick and mine?

Mr. NORDHAUS. That is a term I am not familiar with.

Well, I think I am not sure what the question was, but perhaps it was, If you abandon mechanical monetary rules, where do you go from there? I think that is a good question because mechanical monetary rules should be seen as an act of symbolic politics rather than the way the show is really run.

You are telling people that is the way you run the show as a way of trying to persuade them to reduce their wage and price increases. I don't know that. You are the expert in the political science business. From an economic point of view, I have a little trouble understanding it.

In the first place, the actual technique that is used. of course, by the Federal Reserve in conducting monetary policy, the primary one, is the purchase and sale of assets. It has some other instruments as well. It is in fact extremely difficult for it to control the money supply.

It is widely misinterpreted to say that the Federal Reserve increased the money supply then decreased the money supply, then increased over the course of the time, is because in fact a lot of what happened was outside the control of the Fed.

It is by now well recognized among monetary specialists that anything except unborrowed reserves is in the short run, at least, uncontrollable. But to come to the question of what you would substitute, it seems to me the thing that is necessary is that the Federal Reserve, together with other major economic actors, the Congress and the President and the executive branch, should ask itself what should the stance of monetary policy and fiscal policy be, and should the targets be thus and so to combine both quantitative targets and interest rate targets?

The thing that disturbs me most is that the quantitative targets set by the Fed appear to bear no relation to what is actually happening in the short run or even in over a year's period to what is actually happening in the economy.

For example, they implicitly marked down their M1B, targets in 1980, but it was not because they thought that was consistent with an output or inflation target. It was because they always mark it down.

I am told that Chairman Arthur Burns used to like to reduce one of his limits every time he testified before Congress.

If that is true, then that seems to me very mechanical, and it is not a way of trying to organize your thinking about what monetary policy ought to be, coordinating with fiscal policy to reach the ends that I think many of us would agree upon.

Representative REUSS. All right. Thank you, Mr. Bosworth, Mr. Nordhaus, and Mr. Rahn. You have helped us a lot. And we are grateful.

We now stand in recess until 10 a.m. next Tuesday.

[Whereupon, at 4:20 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, January 27, 1981.]

THE 1981 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, JANUARY 27, 1981

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

The committee met, pursuant to recess, at 10:04 a.m., in room 6226, Dirksen Senate Office Building, Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representative Reuss and Senator Abdnor.

Also present: James K. Galbraith, executive director; Louis C. Krauthoff II, assistant director; Richard F. Kaufman, assistant director-general counsel; Charles H. Bradford, assistant director; and Kent H. Hughes, Deborah Matz, Mark R. Policinski, and Timothy P. Roth, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good morning.

The Joint Economic Committee will be in session for an inquiry into the need for a comprehensive investment strategy.

Last week we began our annual assessment of the American economy. We continue that effort this week with a close look at three often neglected aspects of the supply-side approach to our economic problems. Tomorrow we will explore the effects on income distribution of current and prospective policies to raise the rate of investment. Thursday we will attempt to assess the regional impact of such policies.

The thesis of today's hearing is that we do need a comprehensive strategy to raise our rate of investment. This can be done, not by picking supposed winners or by subsidizing alleged losers, but by creating an economic climate in which a higher rate of investment is possible in American cities and towns for American workers. The elements of such a strategy would include:

Some revisions of the Tax Code, including depreciation reform, and a rollback of recent social security tax rate increases which discourage employment.

Measures to encourage, coordinate, and rationalize investment in infrastructure, including railroads, highways, ports, water and sewer facilities, urban streets, and utilities; and to make available urban space in our worsening industrial wastelands of the right size and configuration for new investment.

Measures to improve the mobility, education, and training of our work force, so as to make American workers attractive competitors to those who can be hired overseas and to make them competitive at the higher wage rates which American workers, by virtue of their productivity, deserve.

We are particularly fortunate to have assembled an outstanding panel. Professor Etzioni will give us his views on a comprehensive investment strategy. He is currently at the Center for Policy Research of George Washington University. Mr. Charls Walker, former Deputy Secretary of the Treasury and now chairman of Charls Walker & Co., will focus on the role tax policy can play in stimulating investment in new plant and equipment. George Peterson, public finance director at the Urban Institute, will summarize the state of our industrial infrastructure.

Each has submitted a comprehensive prepared statement, which under the rule and without objection will be incorporated in full in the record.

I will now recognize Senator Abdnor for such statement that he may wish to make.

Opening Statement of Senator Abdnor

Senator Abdnor. Thank you, Mr. Chairman.

During the 1960's the net investment in plant and equipment in the United States increased at a 7.4-percent annual rate. Additions to the Nation's stock of plant and equipment fell to a 1.8-percent annual rate during the 1970's, which is less than one-fourth as fast as the 1960's. Worse still, since 1973, net investment has actually declined at the rate of 1.6 percent per year.

Contrast this with the acceleration of the growth rate of the Nation's labor force from 1.7 percent per year during the 1960's to 2.5 percent per year during the 1970's. Add to this the fact that, between 1963 and 1975, the percentage of highly skilled labor in the work force increased by only 1.3 percent per year, and it is no mystery why capital per worker has declined—and it is even smaller wonder that productivity growth has declined from a 2.9-percent annual rate during the 1960's to a meager 0.7-percent since 1973.

The growth of capital per worker has been slower since the mid-1960's in the United States than in any other developed country. In most cases, the same is true of the growth of the percentage of skilled workers in the labor force.

Japan is a notable example: Between 1963 and 1975 capital per worker increased 10.1 percent per year, while the percentage of skilled workers in the labor force rose 3.4 percent per year. The relatively poorer U.S. performance has not just eroded our international competitive position; it has resulted in a slowing of our economic growth rate, and it has chipped away at our standard of living.

Yes, it is time for a "comprehensive investment strategy," provided that means that it is time we came to grips with the root causes of our lagging investment performance; provided it means that it is time we implemented policies that reduce rather than increase uncertainties; that encourage rather than discourage individual initiative, and that increase rather than decrease real after-tax rates of return on investment in human and in physical capital.

Thank you.

Representative REUSS. Thank you, Senator.

We will now hear first from Mr. Etzioni.

STATEMENT OF AMITAI ETZIONI, PROFESSOR, GEORGE WASHINGTON UNIVERSITY, AND DIRECTOR, CENTER FOR POLICY RESEARCH, WASHINGTON, D.C.

Mr. ETZIONI. Thank you.

With your permission, I would like to deviate a bit from my prepared statement and make some brief comments.

I would like to congratulate you and your committee on holding the hearings, especially at this time. Those of us who are engaged professionally in policy research talk about windows in policymaking, periods in which policymaking is relatively open to new ideas and formualtions, after which the window kind of closes and policy is solidified. Obviously, we are in such a window period. And what we see is slightly distressing.

I apologize for being somewhat critical. This is supposed to be the period of honeymooning, in which everyone is supportive. But I am afraid the window will close before we ask the right questions.

Basically, if somebody would come up with a new economic theory and suggest that we submit it to a bunch of sophomores at Harvard, the kind of people on which we do experiments, you would run that theory before a human subject committee, demand that there be some evidence that it is safe and effective.

If you would want to market a new headache compound, you would have to go through animal studies and the FDA. But one can come with a new economic theory and subject 220 million Americans to it, often without the systematic examination. So I am particularly appreciative of this opportunity.

In my humble judgment, the theories which these days make the headlines just would not pass such an examination. Basically, they suggest a combination of pushing the accelerator with one foot and the brake with the other. And I don't know of any car which would move anyplace that particular way.

We have, on the one hand, the notion of restrictive monetarist policies to be pursued, with high interest rates, restriction on the supply of money. And we have the other side, the notion of supply-side tax cuts, which would stimulate the economy by providing new supplies of money, in effect injecting a stimulant.

One can argue about the logic and merits of each one of those positions. There is no complete evidence that restrictive policies work to contain inflation. In the last recession we got precious little relief from inflation. In fact, we came out with a higher rate of inflation than we entered in.

There is no evidence that supply-side tax cuts will do what they are supposed to do. The combination is the one that I just cannot follow.

A last point on that; we just did a new calculation of the role of hyper interest rates, as causes of inflation. It is usually presented as a cure to inflation. I would like to suggest that at the current rate it causes inflation more than it cures it.

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A single percentage point in interest rates, in fiscal year 1981, will increase Government outlays by $1.2 billion.

The additional expenses in debt services, already the third largest item in our national budget, the interest payments, is 4.2 billion for every interest point.

Now, if you follow the economic notion that roughly 3 percent above inflation rate to secure a real return for the lender and to discourage undue speculative borrowing, then you would suggest that if the inflation rate is currently roughly at 12 percent, and you want a 3-percent return above an interest rate of 15 percent. Actual interest rates are easily 5 percent higher. If you multiply that by the additional cost to Government—I didn't mention labor costs—and you see what an inflationary effect these current rates have.

By the way, I allowed here—to close on this point—a little margin, because the reason the CPI is at 12 percent is because of the interest rates.

As Alfred Kahn pointed out, if it wasn't for the run up of interest rates, the CPI would be at 8.7 and not at 12 percent.

So there are many ways to show that the restrictive policy will get us another recession and precious little relief from inflation. For the transition period, it is causing vast amounts of extra Government outlays and deficits.

Now, to come to the main point, in terms of long-run policy and not the short term, I believe the United States has been for a while now an underdeveloping country.

We had developed nations, we had developing nations, and I believe we and Britain qualify as kind of a new economic social category, "underdeveloping."

I don't think our economy is collapsing. But there has been erosion, slippage by most criteria if you talk about real income or GNP per capital investment, any of those indicators.

Now, the cure to that seems to be a rededication to development—in effect, to retrace some of the basic elements which go to a strong economy, looking at the infrastructure in the capital goods sectors and shoring those up again.

Now, if I could use an analog, if you build a new building project, you first spend some time on leveling the grounds and laying the water mains and running the electricity lines long before you build the first building. That is the infrastructure period.

And then comes the second period, in which you build the buildings themselves, the equivalent of the capital goods sector. You don't have a single apartment yet. Now, if you prepared the ground well and you have the building in place, now you are ready for consumer goods.

Now, if I had told that story in past years and stopped it, at this point, very few people would have raised a question. But what I omitted was any investment in maintenance. We are so optimistic—we used to be so optimistic that we just thought you put it up and it stands there, and then you milk it and that is all there is to it.

What happened is if you have that building up there and it has been standing there for a generation and you have plowed precious little back into maintaining the infrastructure in the building, the signs of strain show.

And the building was built in an era in which energy was cheap, and about the safest prediction we can make for the next 10 years is that energy will be expensive—I'm not just talking about oil—all sorts of energy.

That means that we not only have to go over all of the various elements which went into the first industrialization and shore them up where they have worn out, but we need to adapt them to the new technological environment to make them energy-efficient.

To just give one example, while we have obsolescent equipment in steel, textiles, rubber, our jets, by and large, are not obsolescent, but nevertheless need to be replaced because they are fuel-inefficient.

So the combination of deferred maintenance and the need to adapt to the new energy environment call for a major dedication to a period of economic growth, giving high priority to shoring up the infrastructure and the capital goods sector. This is something on which there is a growing consensus.

Let me turn to one more issue, American public policy. I think it is useful to arrange it on a continuum, from those who want to be completely nontargeted to those who want to be completely targeted, and the rest—in which I would find myself—who believe in semitargeted approaches.

At the nontargeted end, you find the philosophy that all we need to do is roll back Government. And if you cut the regulation and expenditures and dump the resources in the private sector, they will flow on their own good, where they would do the most economic benefit.

I believe there is too much Government. I believe there is too much regulation. I believe there is too much Government expenditure. But because of 30 years of excessive Government and because of the very prolonged neglect, that will not suffice to bring the resources where they are needed.

Indeed, experience shows that for every $100 available to the private sector, 96 percent is spent and 4 percent is saved, these days. So if you dump another $30 billion in there, or $60 billion, or whatever, experience would suggest—not maybe exactly the same proportions—but a very high proportion of those resources will be burned up in higher consumption, and therefore there would be more inflation and we would burn more gasoline.

So, in order to secure that some of those resources will go the infrastructure, into the capital goods sector, I think we need to rely not only on a nontargeted tax cut, we need to channel some of them to the capital recovery directions, incentives for savings and investment, incentives for R. & D., which are not in the present package.

And, in maybe 1982, I favor the Japanese idea, in which their first $5,000 of yield from investment for any family is tax-free. That is the most progressive way to go, because it will give some benefit to every family. Or, a somewhat less progressive way to proceed would be to allow any person who reinvests their dividends and interest within 30 days after they receive them in stocks or bonds, not to be taxed until they sell the stocks and bonds, and if they hold them at least a year, that they be taxed at reduced capital gains. That would encourage people to invest rather than spend their dividends and interest.

I chose my words carefully. I hope by saying "reinvest in stocks and bonds," that differs from the idea that we should simply cut taxes on capital gains, which would encourage people to invest in collectibles and residential housing. The question is if we should give more incentives to people to invest in these things which are not productive assets.

I would favor that whatever tax incentives are provided before, above, and beyond the general reduction; that we do as much as we can to guide toward productive efforts. The Capital Recovery Act will do that, depending on details. The "rollovers" would do it, depending on details. And tax incentives for additional R. & D. would be welcome.

There are other areas of economic policy which have not been mentioned sufficiently, and I would like to put them on the agenda.

One is we badly need systematic examination of our total credit policies. If you would just come from a faraway planet and you had never been to the United States and you go back and you report to your lunar tribes about the American credit system, you would say, "There is a secret central bank in this system, allocating credit according to some priorities. It wants us to create more liberal arts students, but not coal miners. It wants us to invest more in sewer systems, but not in venture capital. And it wants us to favor residential houses over productive capacity."

Why? Because preliminary examination of the terms of credit, taking everything into account, the level of interest you pay, the number of years you have to pay it back, the tax benefits, et cetera, you find that the system favors overconsumption. It favors basically consumer goods and college education and municipal government, and basically disfavors venture capital and other capital goods.

Obviously, if you are going into a decade of reindustrialization, we very much need to worry about collecting, not by turning to a central bank, but removing the interventions which tilt credit away from productive capacity.

Last is the school that wants to turn us into a Japan, Inc., which wants to create a central planning agency to "sunset," the losers. That assumes an analytic and political capacity which is quite incompatible with the American institutions.

Given more time, we could talk about what Japan really does. I don't believe Japan really is quite doing the things some of the recent statements suggest. Whatever they do or don't do, we cannot fit these institutions readily to our economy.

To give one example: Recently it has been suggested that we should make our executives more risk happy, the way they do it in Japan, by changing the curriculum in our business schools. What that disregards is several things.

First of all, in Japan an executive is almost never fired. He marries the corporation. Out of respect to this place, I will not use melodramatic terms such as "enslaving himself to the corporation." And no wonder he can take risks, because if he goes wrong, it doesn't really matter to his job. If we want our executives to take that level of risk, we would have to change the security of their employment.

Beyond that, in Japan they rely heavily on bonds and public capital. We rely more on the stock market, which is much less given to forgive errors of judgment. So we would have to change our capital structure.

Beyond that, our Comptroller of the Currency doesn't tolerate the kind of debt equity ratios you have in Japan. The debt may run up to eight or nine times of equity. A bank which would make loans like this in the United States would get a letter and a phone call quickly thereafter from the Treasury saying, "That's too risky."

I am making the point to suggest that you cannot pluck one item of a different culture and put it into America. If we, for instance, want executives to take more risks, we may have to do it the American way. That may entail very high bonuses, if they succeed, or some other mechanism.

Somebody suggested that our top executives tend to be old—and then they worry about their retirement—and we would be better off tying retirement payments to the success of the corporation after they retire.

But without going to any one of those schemes, I suggest industrial policy the way it is usually understood—which copies Japanese, sometimes French, sometimes West German experience and tries to transfer it to the United States—just will not work in our system.

The kinds of efforts you suggest in your opening statement of providing incentives in the tax system, providing a climate for investment, I believe they are the most compatible with the United States.

Thank you very much.

[The prepared statement of Mr. Etzioni follows:]

Prepared Statement of Amitai Etzioni

Reindustrialization: The Basic Thesis

My thesis is that for America to be able to sustain a high standard of living and set aside the resources needed for national security requires a decade or so of shoring up its productive capacity, of reindustrialization.

The American society has been underdeveloping. Decades of over-consumption and of under-investment in the nationwide economic machine have weakened America's productive capacity. The American industrial machine, with some important exceptions, is run, as it were, like the steel mills, with increases in labor settlements and dividend payouts that vastly exceed increases in productivity. Coupled with relatively low investment in new plants and equipment and in research and development, as well as other factors, this has resulted in an aging technology and an inability to compete with Japan and West Germany, which rebuilt their plants after World War II.

In the face of a deteriorating infrastructure and capital goods base, a continued high level of consumption leads to an acceleration in the rate at which these resources are used up, just as a university endowment is used up more rapidly once expenditures exceed the income. This was what happened during our period of mass consumption. Not enough was plowed back into the underlying sectors, the infrastructure and capital goods sectors, to maintain and update them. In that sense, consumption was "excessive."

The terms "reindustrialization," "industrial policy," "revitalization," and "supply side economics," are thrown around at a fast clip, sometimes as synonyms, sometimes as antonyms, and sometimes as both in the same breath. Under the heading "Re-industrialization's Poor Record," a British executive, R. H. Grierson, attacks "industrial revitalization" on the basis of Britain's and others' bad experience in lavishing support on lame duck industries, a typical failing of "industrial policy." Joel S. Hirschhorn of the Office of Technology Assessment believes that to "reindustrialize America" requires a "Marshall Plan," a "national industrial policy," and so it goes.

The quest for some measure of semantic order, for making definitions and sticking to them, is not a pedantic expression of an academician's need for tidiness; it is a matter of fixing labels long enough to tell what is in each bottle, and the differences among them. I turn to a modest classification shortly; but first I must account for the issue the terms attempt to capture.

At the core of the current important discussion of economic policy are competing conceptions of both what ails the economy and what prescriptions are called for. The advocates of all the varying positions despair, albeit to differing degrees, of the conventional econometric models, Keynesian theories, and policies based on them. All agree that something more is amiss in the American economy than an unduly high reading on some indicators (e.g., inflation, unemployment), poor productivity growth and low savings—that the problem is more severe than just one more downturn of the age-old business cycle, soon to swing up again. All concur that this is not merely or even mainly a demand-driven (or OPEC-caused) inflation, to be curbed if not cured by trading *x* points of employment for *y* points of inflation. All agree that the foundation of the American economy has weakened and needs shoring up. There is not a counter-culture, no-growth advocate in the whole lot.

The differences are best viewed as divergent conceptions concerning the proper relations between the policy and the economy, and where the levers for correctives are. The positions taken do not directly parallel those taken by public officials or the political parties or the conservative-liberal dichotomy. They may be arranged, for convenience of presentation, on a continuum from radical conservative to moderate-centrist to left liberal.

At the radical conservative end is the well-known position that what ails the economy is mainly an excessive level of politicization, reflected not merely in an unduly high proportion the GNP being used and allocated by the polity and excessive regulation of private decisions, but also in the revolution of entitlements, of attempts to deal with all social and many personal needs via the polity rather than the market. Daniel Bell and Irving Kristol have articulated this position, as has Milton Friedman.

The remedy which follows is to reduce the scope and intensity of the polity as much as possible, by releasing resources to the private sector, deregulating, and letting the market do its wondrous things. Arthur Laffer and Kemp-Roth are the most radical of the lot; they hold that the revenue lost via monumental tax cuts will be restored by the high tax yield of a more productive economy. Other radical conservatives, say Milton Friedman, are satisfied to cut back government expenditures and taxation drastically, without assuming a proportionate gain in the economy and tax revenues. Virtue is its own reward.

In terms of the record defining issue, where the leavers for change are, this approach is wholly non-targeted. It sees no need to direct, aim, or guide the public resources released to the private sector in any particular way. Indeed, freeing them to go wherever the market will take them is the kernel of the approach. This viewpoint is generally termed supply side economics, the approach which lets private demand work its way, and the private economy respond to it by increasing its capacity to supply what the demand seeks.

At the other end of the spectrum of positions is the notion that, far from being reduced, the polity's role should be intensified. Here the diagnosis is that, compared to other highly successful economies, especially West Germany and above all Japan, American institutions provide insufficient guidance and support for the private economy. The market, it is implied or openly stated, has shown its inability to invest enough in new plants and equipment, to innovate and compete. Executives have grown risk-shy and dividend-happy. Steel mills, auto plants, the textile and rubber industries are crumbling. Computers will soon face a government-orchestrated attack from Japan, while our industries' response will be divided.

According to this left-liberal view, correctives are to be found in emulation of "Japan, Inc.," and above all its MITI (Ministry of International Trade and Industry). In other words, the solution lies in government-guided collaborative efforts, in which business and labor pull together, with government bureaucrats and technologists serving as the task-masters and sources of analysis, tax incentives, capital, and informal if not outright protection. Recent attempts to turn around the U.S. auto and steel industries, following the suggestion of tripartite committees, are viewed as American dry-runs. Beyond this, the advocates of this highly targeted approach see the Department of Commerce transformed into a Department of Trade and Development (or some new agency, the Americanization of MITI) with a desk and a committee for each industry, from ball bearings to industrial diamonds. The trade desk would analyze the industry assigned to it, say, shoes; determine whether it is a winner or a loser, whether it has a promising future, in terms of productivity, export-ability, technology/innovations, labor intensiveness, and other good things in life.

The designated "winners" would be showered with government-provided subsidies, loans, loan guarantees, tax incentives, a measure of protection (as in a trigger price or import quotas), R & D write-offs, and what not. The losers would be buried. (Well, the term used is to "sunset" them.) The government might provide the workers with "trade adjustment assistance" to help move them from parts of the country where the losers congregate (Detroit, Pittsburgh) to where the winners roam (the Sunbelt, coal states). Retraining would also be provided.

This policy might be called "national planning," but as the term tends to raise fears of creeping socialism, most of its advocates avoid the label, at least as long as their defenses are up. Instead, the term "industrial policy" is in favor. It is quite appropriate, because the assumption is that the unit at which levers of policy are to take hold is not "the economy," or a major sector, but specific industries. Also, "industrial policy" is the label used for such detailed government planning and direction of corporate efforts in other countries.

Critics raise three major questions: (1) Do we have the analytic capacity to determine correctly who wil be a winner, who a loser? Does not our record suggest that we will misidentify industries and sink vast amounts of public resources in tomorrow's Edsels? (2) Will our policy, in which the government tends to be weak compared to business, labor and local communities, especially when these work together for their Chrysler, be able to channel resources to those who merit them by some rational analysis, rather than to those who have political clout? (3) Is the country—both voters and leaders—willing to accept more politicization, less reliance on the marketplace?

At the center of the continuum, between supply side economics on the right and industrial policy on the left, is the conception of reindustrialization, that what ails the country is over-consumption, public and private, and underinvestment, resulting in a weakened productive capacity.

Historically, industrialization is achieved in two main stages: First, an infrastructure is developed, in which nationwide transportation systems are set up (in the United States, it was canals and railroads); cheap power, neither animal nor human, is made available (the mining of coal and drilling of oil wells); technological innovators are advanced (the steam engine, for example; modern communications systems are evolved (e.g., the telegraph); legal and financial institutions are developed (national currency, banks, stock exchanges); and the labor force is prepared (the rise of vocational education, the acculturation of immigrants).

As the infrastructure develops, it becomes time for the second stage of industrialization, the capital goods sector, which builds heavy-duty machinery and plants (steel mills, etc.). These are not consumer goods, but the tools to be used to produce them. When these two stages are well advanced, a society can mass produce consumer goods and services.

Signs of deferred maintenance and lack of adaptation to the new environment of expensive energy can now be seen in most of the elements which make up the infrastructure and in the capital goods sector. There is urgent need, for example, for improvement in the means of transportation of commodities (railroads and bridges, for example); for energy development and conservation, without excessive commitment to any one path; for larger investment in R. & D., especially applied R. & D.; for improvement in the development of human capital, particularly in seeking to bring vocational training and actual jobs closer together. On the capital goods side, greater encouragement to investment is essential.

The suggested cure is semi-targeted: release resources to the private sector, but channel them to the infrastructure and capital goods sectors, away from either public or private consumption. For example, if we cut government revenues by $50 billion through across-the-board tax cuts, the funds released might well be used mainly to spur private demand for consumer goods and services (gasoline, for instance): little rejuvenation of productive capacity would occur. On the other hand, if the resources released are guided to the productive sectors of the economy—not to specific industries—reindustrialization may take place. Thus, if tax revenues are "lost" not just through tax cuts for individuals but in part by allowing accelerated depreciation for those who replace obsolete equipment, or who replace oil-based or energy-inefficient equipment with equipment which is energy-efficient or uses alternative energy resources, the released resources will revitalize, without determining which will benefit: steel or textiles, rubber or rails. The polity will set the context; the market will target.

Similarly, providing tax incentives for greater R. & D. expenditures spurs on all such efforts; it does not require any government trade desk or tripartite committee to decide which R. & D. project is desirable. And if workers are provided with productivity-based incentives, so they can share directly in renewed economic growth, Washington need not be involved in determining which group of workers is eligible; this is best done by the management and the workers within each corporation.

Reindustrialization thus stands between supply side economics and industrial policy; it is semi-targeted, and the context it seeks to advance is a stronger productive capacity.

Critics suggest that such reindustrialization will return the country to the nineteenth century and focus on "basic" rather than post-industrial high-technology industries. The prefix "re-" does point to a return, but it should not be taken too literally. A return to a strong infrastructure and capital goods sector does not require a return to the same mix of specific industries. Thus, communications satellites and data-phones could do the job of the Pony Express and the Morse telegraph, and slurry pipelines instead of barges might carry coal. The return implied is to higher investment and innovation in the productive sectors, not to anachronistic details.

On a second count, though, reindustrialization must plead guilty as charged: it does favor mitigating the criteria of "comparative advantage" with considerations of developmental economics, national security, and social responsiveness. Studies of developmental economics show that a measure of government-provided incentives and support, even short term import limitations, is often essential for developing a new industrial base; the same might hold for renewing one. National security requires us not to grow so dependent on imported coal, steel, and shipbuilding that we are unable to withstand interruptions or boycotts. Social considerations urge us not to export all blue-collar work to Third World countries; we have plenty of unskilled labor of our own. Moreover, social considerations, both ethical and practical, require that reindustrialization be carried out in a much more socially sensitive and responsive manner than America's first industrial development. The call for a national accord on our priorities for the next decade must cut both ways: the various social interest groups will have to moderate their demands, but at the same time, the business community will have to accept a wide sharing of the renewed wealth.

Representative REUSS. Thank you, Mr. Etzioni. Mr. Peterson.

STATEMENT OF GEORGE E. PETERSON, DIRECTOR, PUBLIC FINANCE PROGRAM, THE URBAN INSTITUTE, WASHINGTON, D.C.

Mr. PETERSON. You referred to this session as being the neglected aspects of industrial policy. I think the topic I have been assigned may be the most neglected item in shaping industry. That is the need to maintain and restore the country's public capital facilities.

Much of the Nation's private productive capacity has been made possible by the highway network, assurance of reliable water supplies, and well-functioning water systems. The United States owns and operates those by the local and state governments, and to bring this portion of the capital stock into the effort of industrial modernization will require a special collaborative effort between the private sector, the public sector, constituting both the Federal Government and thousands of State and local governments.

Senator Abdnor referred in his opening statement to the national concern about the stagnation of rates of private sector investment. I want to call your attention to the long-term trend, dating back no more than 15 years—a very substantial decline, greater than in the private sector, of gross investment by State and local governments.

The course of private, State, and local investment in recent years is illustrated on the chart in my prepared statement. I don't mean to minimize in any sense the proper concern over the magnitude of gross investment in private capital facilities, but I think if anything, investment in plants and equipment appears to have outrun our support capacity through investment in infrastructure.

If you look at the same investment trends from the perspective of State and local governments, one of the most constant economic features of our time since the mid-1960's has been the year-in, year-out decline in the share of State and local budgets that are used for capital purposes—either capital purposes or maintenance purposes. The capital share alone is down from about 28 percent in the mid-1960's to 15 percent of State and local budgets in the last 3 years. Spending for capital, spending for maintenance has gradually been displaced by spending for social programs.

That investment picture is still more sharply focused in the older parts of the country. Public capital outlays have shown the steepest declines in the Nation's oldest and largest cities. Maintenance expenditures have fallen off even more rapidly than capital outlays. Thus, those investment categories have been singled out for budget reductions when State and local governments have faced immediate budget crisis.

The slowdown in new investment in State and local capital facilities comes at a time when many parts of the Nation's infrastructure are beginning to show their age. Large parts of the sewer and water systems, especially in the older metropolitan areas, were installed in the mid-to-late 19th century and are approaching 100 years or more in age at this time. Those systems were designed for long periods of service, but they place a maximum of 100 years on the expected serviceable life.

The Nation's Interstate Highway System that of course was put in place far more recently is also nearing the end of the original pavement life. The most recent national transportation report shows very significant deterioration in the pavement of the interstate highways and singles that out as a No. 1 priority for future public capital investment in the highway system.

Unfortuantely, we don't know a great deal about the exact pattern with which capital depreciates with time, and that has led to speculation as to just how serious the deterioration that has occurred is. If we have to face accelerated capital depreciation as the capital plant reaches its maximum age, and that is coupled with the lag in the new growth, that would raise the possibility that the Nation is consuming its inherited stock of public capital at the expense of future productivity.

One project on which we have been engaged for some time now at the Urban Institute has been to undertake an assessment of the current capital stock condition of public facilities in selected urban areas. I have given an indication in my prepared statement of the kind of performance measures that we carried out for individual cities.

Let me just summarize our results by saying that to me the results were encouraging. We did not find any evidence of sudden deterioration in service levels, in cities or State water delivery sytems, sewer collection systems, even the streets and highways of older cities. Much of what has been published in the papers about the extent of water loss from aged water delivery systems appears to be unnecessarily alarmist. Careful comparisons of the extent of deterioration, as I said, I believe there is no sudden decay in those systems, and in most cases performance levels continue to be within acceptable levels.

That survey is encouraging on another score. We seem to be bound much less than we had anticipated to the age of our capital. Maintenance, not age, appears to be the crucial factor in today's capital condition—the ability to deliver services with public capital plants. The record of repair and maintenance in the last 10 years in each of these facilities was far more determinative of current capital stock performance than was the age of the facilities, the date of their original installation. There is ample time to address the country's investment gap.

What are the Federal policy choice that we face. In my estimation, renovation of the public infrastructure that supports private industrial activity is crucial to a national industrial strategy, but it does not require new Federal programs or major Federal departures. State and local governments are capable, I believe, within the framework of present Federal aid programs of performing the central support role. These activities—the provision of water and sewer services, the operation of roads and bridges—lie at the very core of State and local government responsibilities in any reasonable division of effort in the national comprehensive investment strategy. I believe that would entrust the principal responsibility for that investment on State and local governments themselves.

In gaging the Federal policy response, we should not under estimate the distance which Federal policy has come in just the last 2 or 3 years. As late as the mid-1970's, almost all Federal capital programs were targeted exclusively for new capital investment through the State and local sectors. Until 1976, Federal aid for highway construction was limited to building new roads. Since that date, the authority to use Federal highway moneys for resurfacing, restoration, and rehabilitation has led to a very considerable jump in the improvement to existing road networks in older metropolitan areas and throughout the country.

The Federal bridge program which was expanded in 1978 has led to a national assessment of bridge condition, bridge structures, and an immensely greater volume of information about bridge conditions than we had even 5 years ago. I think the force of information has proven more coercive than the appeal of Federal aid dollars in persuading local governments to assign a higher priority to bridge repairs and to maintenance of this crucial element in the capital stock.

In my prepared statement, I have given some indication of the response of State and local governments in repair activities for streets and highways to the shifting Federal program emphasis.

Is it realistic to think that State and local budgets, with all their own problems, can reshape their budget to finance capital renovation without additional Federal aid? I think the answer to that question is yes, and let me just conclude with three pieces of evidence that the State and local sectors are beginning to move in that direction, and if its efforts are focused, it can be counted upon to play a national role in investment strategy.

First is the significant reshaping of State and local capital budgets that has already occurred. If we are going to refocus these government energies, it will be necessary for them to begin with their own capital budgets. I think New York City stands as an encouraging example of the possibility of reshaping budgetary outlays. In the last 5 years ending in 1978, New York City had spent only about 30 percent of its capital budget on these basic infrastructure items—bridges, sewer and water systems, and mass transit. Its new capital plan, the one it is currently carrying out, reallocates its capital budget entirely to change that proportion from 30 to 70 percent of capital being spent for these renovations of basic plants.

That means diverting capital funds from education, from new schools, from parks, from public buildings, from a number of other facilities that have a great deal of political and popular appeal. It remains to be seen whether it is a politically feasible reallocation of capital resources.

New York's example is being pursued as well in Boston, Cincinnati, Cleveland, and many other older cities. That convinces me that there is sufficient flexibility within existing capital budgets if cities and States choose to emphasize industrial productivity to reallocate capital resources for that purpose.

Second, we have seen a very substantial trend toward the operation of basic facilities as independent authorities. If the sewer and water systems are to survive over the long run with intelligent, rational capital replacement and maintenance plans, they will need pricing independence; they will need pricing authority to recover the cost of capital replacement. That frequently means freeing the services from the constraints of the day-to-day politics.

Again, several of the old cities have spun off their sewer and water operations as quasi-independent authorities, given them far greater pricing authority than they have had in the past and have combined this with the preparation for the first time of a long-range capital plan for replacement of basic facilities.

And finally, State and local governments will have to embark on a collaborative planning effort with the private sector. Any breakthrough in capital planning as private industrial programs, I am convinced will occur at the local level, the regional level. Public capital investment needs are so specific to individual metropolitan regions that the State and local element in any comprehensive investment strategy seems fated to be with the local rather than Federal authority. And, therefore, the steps that Cleveland, Pittsburgh, and Chicago have taken to do their planning jointly with private sector, which has helped in defining major obstacles, major blocks, whether it lies in broken down bridges and the projection of bridge deterioration or in the inadequacy of waste water treatment facilities, that private and public collaboration is one of the most encouraging developments of the last 5 years in bringing the private sector into public capital planning.

Thank you.

[The prepared statement of Mr. Peterson follows:]

Prepared Statement of George E. Peterson

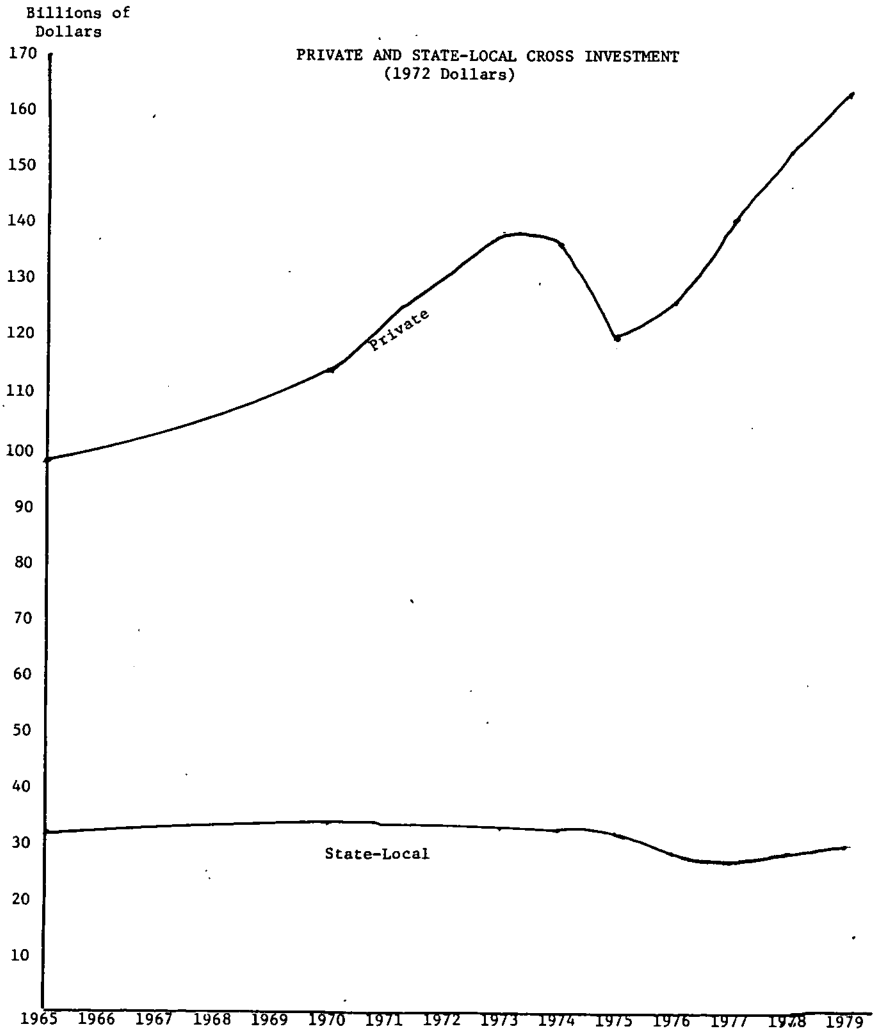
My name is George E. Peterson. I am Director of the Public Finance program of The Urban Institute.

I wish to call the Committee's attention to a neglected aspect of U.S. industrial policy—the need to maintain and restore the country's public capital facilities. Much of the nation's productive capacity has been possible by its road and highway network, by the assurance of reliable water supplies, and by the availability of well-functioning wastewater systems.

In the United States, these facilities are owned and operated principally by state and local governments. Their preservation and improvement, as part of a national effort at industrial modernization, therefore, calls for a special partnership between the private sector, the federal government, and thousands of state and local governments.

DECLINE IN CAPITAL INVESTMENT

A great deal of concern has been expressed about the stagnating rate of growth of private capital investment in the United States. For the last decade and a half, however, there has been an actual decline in real capital investment within the state and local sector. As the following figure shows, this decline stands in marked contrast to the course of private capital investment. If anything, investment in plant and equipment appears to have outrun investment in supporting public infrastructure.



Put in a different perspective, capital improvements have been gradually but steadily squeezed out of state and local government budgets. One of the most persistent recent trends, up to 1978 at least, has been the shrinking share of capital investment in state and local budgets. In the mid-1960's capital spending claimed some 28 percent of these governments' budgets; by 1977–79 the capital share had been cut almost in half, to an average of 15 percent of state and local spending. Spending for capital purposes has been gradually displaced by spending for social programs.

The investment picture is still more sharply focused in older parts of the country. Public capital outlays have shown an especially abrupt decline in the nation's largest and oldest cities. Maintenance expenditures there have fallen off even more steeply than capital outlays. Both budget categories have been singled out for spending cutbacks by governments faced with the prospect of budget deficits.

By itself, the downward trend in state and local capital spending need not be a signal for alarm. After all, the country for many years has experienced a fall off in public school enrollments and it is only natural (and prudent) that the building of new schools should be sharply reduced, as well. There are other categories of capital outlay that more closely support household consumption of public services than future productive capacity. There is no reason that budgetary retrenchment in the public sector should spare these parts of government activity.

Closer inspection, however, shows that the decline in capital spending has affected virtually all capital functions. The few areas that have not suffered—investment in wastewater treatment, for example—have had their expenditures spurred by federal grant incentives or federal program mandates unrelated to national industrial investment goals.

The slowdown in state and local capital replacement comes at a time when many parts of the nation's infrastructure are beginning to show their age. The central portions of most older metropolitan areas' water distribution systems and sewer collection systems were installed in the nineteenth century. Though these systems were designed for long service, they are now approaching or exceeding most estimates of their useful service lives. The nation's interstate highway system is of more recent vintage, but many segments are nearing the end of their initial pavement life. The 1980 National Transportation Report reveals significant pavement deterioration in the interstate highway system, raising the need for planned rehabilitation and repair if that network is to remain fully serviceable.

Unfortunately, we do not know a great deal about how different types of public capital deteriorate with age. At several points in recent years speculation has leaped ahead as to the investment backlog that would confront the nation if the water distribution systems of the Northeast and Midwest, say, were suddenly to fail as they reached their hundredth anniversary. An accelerated path of capital depreciation, due to the age of the nation's capital plant, coupled with laggard new gross investment, would raise the possibility that the nation is now consuming its inherited stock of public capital at the expense of future productivity.

CURRENT CAPITAL STOCK CONDITION

To shed some light on current capital stock condition, especially in older urban areas, The Urban Institute has completed an assessment of capital facilities' performance in selected urban areas.

On balance, the results of this survey are encouraging. There is no sign of sudden deterioration in service levels, no indication that the physical infrastructure put in place in the nineteenth century is about to "wear out." Indeed, some of the most often expressed fears are clearly alarmist. Although newspaper articles and testimony before Congressional committees have placed water loss from some old distribution systems at upwards of 50 percent of water entering the system, our survey found that once water "loss" was defined to exclude unmetered uses in public buildings, firefighting, street flushing, etc., loss rates almost never exceeded 15 percent. The evidence rebuts the assertion, for example, that Boston loses 50 or even 60 percent of its water through system leakage.

Our study also shows that capital stock condition generally bears only a modest relation to age. Far more important is the last decade's history of maintenance and capital repair. The performance of each such perishable elements as mass transit rolling stock, and much more emphatically sewer and water systems, responds sensitively to repair and upkeep. The absence of urgent performance problems, combined with the possibility of stretching useful lives through modest repaid and maintenance programs, suggests that even the oldest urban areas, with the poorest records of capital neglect, have time to set about a corrective policy.

Tables 1 and 2 illustrate the types of performance measurement that are possible for capital items, by comparing water loss rates in different cities. In this service area, and in others, performance levels show a good deal of variation between cities; and, on balance, newer cities, with more recently installed capital facilities, have discernibly fewer performance difficulties than older cities, or cities that have been laboring under budgetary stress. But the overall results reveal few examples of extreme infrastructure deterioration and little evidence of rapid growth in capital failure rates. There is, it would seem, ample time to address the country's public investment gap.

TABLE 1.—ESTIMATED WATER LEAKAGE, 1978

City	Percent of production
Cleveland	15
St. Louis	15
Pittsburgh	14
Tulsa	14
Philadelphia	12
Hartford	11
Kansas City	11
Buffalo	10
Baltimore	10
Cincinnati	10
Portland (Oregon)	8
Seattle	8
New Orleans	7
Des Moines	6
Tucson	6
Milwaukee	6
Atlanta	6
Dallas	5
Minneapolis	2
Charlotte	2
San Jose	1

Source: George E. Peterson et al. "The Future of America's Urban Capital Plant" (Washington D.C.: the Urban Institute, 1981).

TABLE 2.—ESTIMATED WATER LEAKAGE BY CITY GROUPING

City grouping	Percent of production
By economic distress index:	
Severely distressed	9.9
Moderately distressed	7.4
Not distressed	5.7
By age of housing:	
Old	11.3
Middle aged	7.4
Young	5.3
By region:	
Northeast	11.8
Midwest	8.3
South	7.0
West	5.8

Source: Table 1.

FEDERAL POLICY CHOICES

Does the country require a new federal policy to stimulate state and local capital investment? A number of such policies have been discussed in recent years. These range from a federal development bank that would guarantee or subsidize loans for public caiptal investment to new categorical aid programs which would help state and local governments pay for such tasks as modernizing aged water distribution systems.

Realism suggests that new aid commitments are not going to be established by the Congress. Moreover, new federal assistance is not essential to the job of capital renovation and upgrading. Such capital facilities as roads and bridges, sewer and water networks, and mass transit systems lie at the very core of local governments' service responsibilities. Any division of national effort in forgeing a comprehensive investment strategy should entrust principal responsibility for this type of investment to state and local governments themselves.

Federal policy can be used most effectively, within existing aid programs, to help make sure that investment resources are used for basic capital renovation, which also supports industrial revitalization. Already, federal aid programs have shifted their emphasis to promote preservation and improvement of existing capital facilities.

Until 1976, federal aid for "highway construction" was limited to building new roads. Since that date, the authority to use federal highway monies for "resurfacing, restoration and rehabilitation" (3 R) work has led to a jump in investments to improve existing road networks. This policy has been coupled with Federal Aid, Urban Systems to bolster spending on urban road improvements. Table 3 shows the surge in resurfacing and rehabilitation that began in 1978, as this redirection of federal support was translated into local capital improvements.

The Federal Bridge Program was expanded by the Surface Transportation Act of 1978 to include bridge rehabilitation as an eligible activity. The national program of bridge assessments required by this legislation—as much as the new federal aid dollars—has elevated bridge repairs in local spending priorities and led to widespread local action to upgrade bridges to meet the needs of modern commerce. In the next four years, a national highway policy designed to support private sector industrial productivity would shift resources to the repair and preservation of the oldest links in the nation's interstate highway system.

A comparable reexamination of national priorities in other federal capital assistance programs—including EPA wastewater grants—could reveal similar opportunities for shaping federal programs to a comprehensive investment strategy, without entering into new spending commitments.

TABLE 3.—ESTIMATED RESURFACING AND REHABILITATION IN 13 CITIES[1]

[In percent]

City	1973	1974	1975	1976	1977	1978
Atlanta	4.3	4.3	4.3	4.3	4.3	11.4
Baltimore	.3	.5	.5	.7	.8	2.0
Cincinnati	1.9	1.9	2.8	4.0	5.7	13.6
Cleveland	5.2	.7	2.8	.6	3.4	1.6
Columbia	2.7	2.6	2.3	16.8	5.1	12.2
Dallas	2.3	1.3	1.1	1.3	7.1	5.1
Hartford	4.1	4.1	4.7	3.8	3.8	3.8
New Orleans	.5	.5	.5	.5	2.0	4.4
New York	2.9	3.7	2.5	1.0	1.4	1.7
Portland	1.7	2.4	3.5	2.9	2.5	2.3
San Jose	1.0	1.0	1.2	.7	.8	.9
Seattle	1.8	1.6	6.0	4.8	.4	.0
St. Louis	5.5	.4	.4	4.2	7.2	5.4
Average	2.6	1.9	2.5	3.5	3.4	5.0

[1] Percent of city's responsibility paved streets resurfaced or rehabilitated.

Source: The Urban Institute.

STATE AND LOCAL POLICY CHOICES

Is it realistic to think that state and local budgets can be reshaped to finance the capital renovation that is needed without additional federal aid?

There are already signs that the 15-year decline in capital investment shares is beginning to be reversed, as governments concentrate their resources on basic service responsibilities. In addition to choosing to emphasize capital functions more heavily in their budgets. state and local governments can:

Shift their priorities within the capital budget. In the five years ending in 1978, New York City spent only 30 percent of its own capital resources on the five core functional areas of streets and bridges, sewer and water systems, and mass transit. In the next five years, it proposes to reverse its capital allocation, and commit 70 percent of its own resources to investment in these functions. This means diverting capital from education, parks, and public buildings—a plan whose political feasibility remains to be fully tested. But the proposed reshaping of capital priorities indicates the flexibility that many governments have if they desire to concentrate investment on basic capital responsibilities. Many other states and cities are in the midst of comparable adjustments in their capital budgets.

Guarantee the long run financing of capital replacement for key functions by setting up partially independent authorities that charge economic prices for services. Economic pricing includes a provision for capital depreciation, replacement, and maintenance. Our study demonstrates that sewer and water authorities with pricing independence have been able to adhere to more regular capital investment and maintenance plans. In recognition of this, several older cities, including Boston and Baltimore, have reorganized their sewer or water systems to be run more along the lines of private utilities. This practice has the further advantage of making it possible to finance major capital improvements through the issuance of revenue bonds.

Finally, state and local governments can plan the next generation of capital improvements in concert with the private sector. At present, city and state capital plans are drawn up with only the most general idea as to what capital bottlenecks impede private sector productivity. It may be known that a "posted" bridge, closed to truck traffic, adds greatly to the costs of certain factory locations, or that limited wastewater collection capacity makes it impossible to accept further business growth in certain areas; but the public and private sectors have rarely collaborated in designing multiyear capital plans that reflect business as well as citizen investment priorities.

This historical attitude toward capital planning may be changing. In metropolitan areas as diverse as Cleveland, Pittsburgh, and Chicago, the public and business sectors have joined, with local foundation support, to take a joint inventory of current capital stock condition and future capital investment needs. Although it is too early to know whether such efforts will ultimately succeed in making public investment more effective in reducing private industry costs, it seems certain that any capital planning breakthroughs will occur at the local level through public and private collaboration. Public capital investment needs are so specific to individual metropolitan regions that the state-local element in any comprehensive industrial policy seems fated to be the summation of individual city and regional plans, not the creation of a federal authority.

Representative Reuss. Thank you, Mr. Peterson. Mr. Walker.

STATEMENT OF CHARLS E. WALKER, CHAIRMAN, CHARLS E. WALKER ASSOCIATES, INC., WASHINGTON, D.C.

Mr. Walker. Thank you. I appreciate very much the invitation of this committee to present my personal views on the proper investment strategy to revitalize American industry. That revitalization depends heavily on dealing with the stagflation that plagues our economy now.

The appropriate strategy involves a comprehensive economic game plan that needs to be mounted at the earliest opportunity. I am quite pleased to note that the new administration is embarked upon that task. We have got to restore stable economic growth with stable prices and growing productivity, all as a basis for the sort of revitalization that you so properly envisage. It includes a topping-off in the rate of growth of Federal spending. It includes a stable monetary policy. It includes tax cuts, both from a macro- and microeconomic standpoint. It includes rationalization of our regulatory system with respect to business activities.

Not only is it pleasing to see that the administration is moving to get that sort of program to the Hill within a short period of time, but I think that Congress is disposed to consider that program expeditiously and carefully and to move it on ahead.

Having said that, and moving to tax policy which you particularly asked me to comment upon, I have not in my prepared statement offered a comprehensive tax policy program. Rather, I have picked out certain areas of tax policy that need special emphasis.

For example, in a macro sense, the question of the relationship between overall Federal tax receipts and expenditures culminating in the deficit—that needs special attention.

Second, emphasis is needed on the tax policy involved in the capital formation arena. Most people will agree that the U.S. tax system is biased in favor of consumption and against the saving and productive investment so vital to revitalization.

A third aspect of tax policy has to do with the differential impacts among industries and companies and also with respect to dealing with pressing public interest problems such as our energy problem.

Let us begin with the macroeconomic problem of the alleged inflationary impact of an across-the-board cut in individual income tax rates of the type that is proposed in the Kemp-Roth tax legislation.

As you know, the Kemp-Roth proposal would provide for a 10-percent cut in individual income taxes in each tax bracket, reducing marginal tax rates across the board over a 3-year period, 10 percent each year, for a total of 30 percent over the 3 years. Many people in the business community, particularly in the financial community both here and abroad, are very concerned about that sort of tax cut, arguing that it will be very inflationary.

That argument presumably stems first of all from the indisputable fact that the Kemp-Roth tax cut will in the short run cause a very significant increase in the Federal deficit. On that score, the first approach of course is to move decisively to top off the rate of increase in Federal spending, thereby holding the deficit down.

As this distinguished committee well knows, over the next 5 years, even conservative estimates of revenue growth come to a total of about one-half trillion dollars or more. This is not a cumulative total. This is the annual rate of tax receipts, given the projections on economic growth and inflation over the next 5 years or so. Therefore, if we can do reasonably well in curbing the rate of increase in Federal spending, there will be more than sufficient revenues to take care of, or "pay for" a tax cut, as well as meet our defense spending needs and move ultimately to a balanced budget.

But beyond that, I think the criticism of Kemp-Roth stems from the view that this is a tax cut on individuals, and individuals are consumers; therefore, the proceeds of this tax cut, which will be very large—$32 billion or so the first year in static revenue terms—that this will be spent largely, if not wholly, on consumption. As a consequence, prices will go sky high; interest rates will go through the ceiling, and so on.

I think that case could be made for a tax cut of the type proposed by President Carter last year, which was largely in the form of a tax credit related to social security taxes paid. That sort of tax cut would have almost a dollar-for-dollar equal impact on the part of each taxpayer, because it is a credit coming off the bottom line of the tax return as opposed to a deduction coming off the top line.

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What we are talking about with respect to the Kemp-Roth proposal is an across-the-board percentage cut which is proportionate to the tax burden already being paid by taxpayers. In that case, then, we see that 60 percent of the tax reduction will go to middle-income taxpayers in the $15,000 to $50,000 family income range, simply because that group pays 60 percent of all Federal income taxes in this country.

When we examine that, I think we realize that what we are talking about are the real savers of this country. There are a lot of thrifty people in that group. These are the people who have the hundreds of billions of dollars in savings accounts, in commercial banks, in savings and loan associations, in credit unions, in like insurance contracts, in savings bonds, and so on.

To be sure, the rate of saving has dropped significantly in recent years. According to the revised figures, the rate of personal saving was above 8 percent in 1973 and dropped to somewhat over 5 percent in 1980. Nevertheless, I think the thrift instinct is still very strong, and by cutting taxes proportionate to the way people pay taxes, there will be a strong impact on saving. In fact, there will be a double impact from this sort of tax cut.

First, there will be an increase in the disposable income of those people who are so important in the saving process—the middle-income group.

Second, there will be a significant increase in the aftertax rate of return on savings.

For example, when you reach a $30,000 taxable income level, you are paying a marginal tax rate of 37 percent—37 cents out of each extra dollar that is earned—so that if you are putting your money in a savings account or buying stock and getting dividends, except for that small $200 to $400 deduction, you are being hit with a very, very high tax rate.

After the 3-year period under Kemp-Roth, this rate would be cut from 37 percent to 27 percent. You would be keeping, instead of 63 cents out of each extra dollar you get through saving, 73 cents. And that is a very significant increase in the after-tax rate of return.

A Gallup poll last summer asked the American people around the country: If you get a 10-percent cut in your Federal income tax rates, will you spend most of that or will you save most of that? Significantly, 41 percent of the respondents said, "We will probably spend most of it," but 40 percent, almost the same amount of respondents, said they would probably save most of it. So I think we can't overlook the fact that Kemp-Roth is a prosaving tax reduction as contrasted to a tax credit approach.

The probability that a significant part of the proceeds resulting from an across-the-board cut in marginal rates would be saved casts doubt on the thesis that strong extra spending on consumption would sharply boost consumer prices in the short run. Still, the deficit will be larger, and everybody knows that deficits cause inflation. That needs rather serious reexamination.

A lot of people know that deficits in West Germany and Japan, relative to gross national product, have been larger over the years than the deficits in this country. Nevertheless, those countries have had a lower rate of inflation than the United States. If deficits are the basic cause of inflation, how can that be true? Well, the answer is quite clear there. There is a much higher national savings rate in the private sector in Germany and Japan and because savings are higher in the private sector, they can offset high rates of dissaving in the public sector, as represented by the deficits.

Our deficits are very inflationary because we have a very low rate of saving in the private sector, insufficient to offset the rate of dissaving, or the deficits in the public sector—which is another way of getting to the basic point which we have known for many, many years: that deficits per se are not inflationary, not inherently inflationary, in a pure economic sense. It depends on the manner in which those deficits are financed. If deficits are financed out of genuine saving, then the inflationary impact, in effect, is nullified. But if it—as has been the case in this country over the past decade or so—is financed through excessive monetary growth, monetization of the deficit, that is what results in the basic inflationary problem.

So ultimately, the key is monetary policy. Monetary policy gets into trouble in part because of the nature of our political system, and in part because of our economic ideas. We get very concerned about interest rates going up, and there is insidious or subtle pressure on the Federal Reserve to monetize too much of any deficit.

It is true that if you have a very large Federal deficit, and the savings rate is low, as it is in this country, and monetary policy attempts to hold the rate of monetary expansion to an appropriate level, interest rates rise and credit markets tighten sharply. That is the downside risk. That is why it is so important to get your deficit under control.

To summarize the so-called inflationary impact of a large individual tax cut depends on several factors. If spending growth is restrained, the expansion in Federal revenues can "pay for" the tax cut. If the tax cut leads to more individual saving—as Kemp-Roth will, I believe, the reduction to some degree pays for itself. The saving, in effect, can finance the deficit, or at least part of the deficit.

In any event, monetary policy is the ultimate key, regardless of the size of the deficit or the increase in saving that the tax cut engenders. Maintenance of limited growth in the money supply can, in itself, assure price stability.

In the case of a very large deficit, however, the cost, in terms of rapidly rising interest rates and a credit market crunch, may be high. Incidentally, Congress could cut back somewhat on Kemp-Roth or any sort of across-the-board individual cut, and make that cut around 7½ percent. That would release 2½ percentage points of the planned amount, that could then be used for special savings incentives.

A number of effective savings proposals have been introduced. I mention only one in my prepared statement, and I think it needs special attention. That is the legislation introduced by Representatives Brown and Rousselot, and Senator Roth, which in effect would give you a "two-basket approach" to the taxation of the individual income.

So-called earned income, as you know, and so-called unearned income, or investment income, are the two types of income streams the tax code distinguishes between. Under current law, if, as a result of your salary income, you are in a 50-percent tax bracket, then your first dollar of interest or dividend income is taxed at 50 percent.

The Brown-Rousselot-Roth proposal would tax that first dollar of interest or dividend income at the current 14-percent level, up to a maximum of 50 percent, under that bill. That is a very powerful device to shift the bias in the tax code away from saving and investment.

I discuss in my prepared statement several other aspects of tax policy. Certainly, attention should be given to business tax cuts, and priority should be given to capital cost recovery.

Our system of capital cost recovery is woefully out of date. We are far behind many of our competitors abroad. We have not allowed sufficiently for the impact of inflation, or the interaction of inflation with the historical cost method of depreciation. We have a very complex system of depreciation, a system so complex that the vast majority of small businesses do not take advantage of allowable methods such as the asset depreciation range. ADR is simply too complicated for them to deal with.

At the same time, with over 120 so-called class lives in the ADR, you are subject to constant bickering and arguing between Internal Revenue agents and business people as to the appropriate life of particular assets. Consequently, simplification and liberalization of depreciation is a high priority. It is a high priority, first, because we need to increase the willingness of business to invest more—by increasing the after-tax rate of return on investment—and, second, we need to increase corporate cash flow to allow for more investment. There is a strong consensus in the business community and in the Congress that depreciation reform should be enacted, and at an early date. In 1979, Representatives Conable and Jones introduced their Capital Cost Recovery Act, the so-called 10–5–3 proposal, a measure which a few years earlier would have received great criticism as a tax cut for the business community. When the smoke cleared, over 312 Members of the House of Representatives had cosponsored that bill, and some 75 Members of the Senate had either cosponsored it or sponsored other legislation which included it.

There are other approaches to depreciation reform under discussion. Former President Carter presented one proposal last fall. The former Ways and Means chairman, Congressman Ullman, presented another. A third alternative is the one developed by Senator Bentsen and approved by the Senate Finance Committee last summer.

Without getting into the different approaches, or the pros and cons, let me say that the outlook here is very, very good that the administration will propose something in this area, and that Congress will move quickly to update and simplify our outdated depreciation approaches.

Will that give us a really good, efficient, equitable capital cost recovery system? Unfortunately, it will not, alone, of itself. This is because a number of companies and industries where the rate of profit for cyclical reasons, foreign competition, or other reasons, is just too low. That is, these companies and industries are unable to generate the taxable earnings that they must have to take investment tax credits. An efficient investment tax credit is the other important leg needed along with depreciation for an effective capital cost recovery system.

In recent years, airlines, railroads, many of the steel companies, automobile companies, natural resource companies, in paper and mining, have been finding it increasingly difficult to take the investment tax credits which Congress wanted them to get in order to promote a productive investment. The most recent figure I saw indicated these companies had earned some $12 billion of accumulated credits which they could take. They had met the letter of the law in terms of the investment Congress wanted them to make, but they were unable to get this tax incentive, and the extra cash flow that would be available from it, because their earnings have been simply too low. Some of these companies have seen their credits at the end of the carry-forward period, which is a 7-year period, just disappear into thin air.

One approach to that—and I think the best approach—would be to move entirely to a value-added tax system. However, a value-added tax system is not politically feasible at the present time, although it has been proposed in recent years by Senator Long and Representative Ullman. Also, the proposed VAT wouldn't eliminate the corporate tax; it would reduce it. As long as you have a corporate income tax, you have got the problem of generating the earnings to take the investment tax credit.

I think you are going to hear a great deal more in the months ahead about making the investment tax credit refundable. It is a controversial issue. With a refundable investment credit, a corporation making the eligible investment which did not have sufficient earnings to capture it, would receive a payment of that amount in cash, marketable Government securities, transferable warrants, or whatever it might be.

Opponents argue that that would tend to subsidize inefficient and failing businesses when they ought to go out of business. That argument is a little bit absurd when you are talking about the Nation's railroads, airlines, auto companies, steel companies, and copper companies. These are very important industries.

As a matter of fact, you can argue this is almost an automatic targeting of the type needed for industrial revitalization. I think you will hear more about it as we go along.

Finally, Federal tax policy is not contributing as it should to the solution to our energy problems. As you gentlemen know, Congress attempted in 1978 to establish a special additional 10-percent investment tax credit for investments in energy-efficient equipment. That provision has been a failure. It has been a failure partly because of the way that the law is drafted; it has been a failure because of the Treasury's lag in getting the regulations out; and finally, the regulations issued have not been helpful.

Legislation was introduced last year by Senator Wallop and legislation, I think, will be introduced shortly by Senator Wallop, Senator Kennedy, Representative Heftel, in the House, which would present a more workable and effective approach to encouraging needed investment.

The idea is based upon the assumption that conservation is the best, quickest, cleanest way to deal with big parts of our energy problem. The industrial sector has made a lot of progress in conserving energy. But the "easy" conservation is behind us, and future conservation will be very costly and capital-intensive.

Capital is short, and these needed projects can get moved out of the pecking order because of the shortage of capital funds. The investment credit could be a valuable device to promote greater efforts of industrial conservation and thus move toward a solution to our energy problem.

To sum it all up, the most gratifying thing now is the consensus that seems to have emerged. We see the problem. The problem is defined. I think the components of it are clearly identified. Actions are being developed by the Reagan administration to be sent to Congress shortly. I think the record of the 79th Congress on moving toward the revitalization, which you have pinpointed, is going to be very satisfactory indeed.

Thank you.

[The prepared statement of Mr. Walker follows:]

PREPARED STATEMENT OF CHARLS E. WALKER

My name is Charls E. Walker. I am chairman of Charls E. Walker Associates, Inc., a Washington-based consulting firm. I appreciate very much the invitation of this committee to present my personal views on the proper investment strategy to revitalize American industry.

You asked me, Mr. Chairman, to concentrate on tax policy as a part of that investment strategy. I am happy to do so, but let me emphasize first that the early mounting of a comprehensive overall economic program to stop inflation and foster stable growth in productivity and output is essential to the task at hand. To be sure, tax policy is a crucial part of such an overall policy, but budget restraint, stable monetary growth, and rationalization of government regulation of business all have indispensable roles to play. I am pleased to observe that the new Administration is busily at work devising such a policy, and also that Congress seems at this stage disposed to cooperate. Early submission and enactment of the spending, tax and regulatory legislation necessary to implement the fundamental economic game plan will do more than anything else to help revitalize American industry.

As part of that plan, tax policy has several aspects. First is an overall or macroeconomic sense and involves the flow of Federal revenues as related to expenditures. The difference in the two—the Federal surplus or deficit—is of course of great importance in the effort to meet our economic goals. The second aspect involves the bias of our tax code toward consumption and against saving and investment, and is therefore highly important to the capital formation process. Still a third aspect of tax policy relates to the impact among different industries and companies, along with its role in helping to meet national problems, such as in energy.

I shall touch on all three of these aspects in my statement.

The point I want to make with respect to the macroeconomic problem pertains directly to the alleged inflationary impact of an individual income tax cut—specifically, the Kemp-Roth proposal which would reduce rates in each tax bracket by 10 percent in each of the next three years. A variety of economic writers and even some members of the business community have expressed apprehension about this proposal. Many participants in financial markets both here and abroad are convinced that the reduction would balloon the Federal deficit and that, as a result, the inflation rate would soar and interest rates would go through the roof.

That the deficit will rise in the short run is indisputable. How much depends on how successful the Administration is in persuading Congress to cut back on the rate of growth of Federal spending. As you well know, projected increases in Federal revenues over the next five years come to a whopping half trillion dollars or more. This is not a cumulative figure; it is the annual total by 1986. There will therefore be plenty of revenues available to "pay for" Kemp-Roth and other tax initiatives if the rate of growth of Federal spending can be scaled back.

But this is not all of the story. Critics of Kemp-Roth also maintain that a tax cut on individuals is especially inflationary, presumably on the theory that since individuals are consumers, the extra disposable income will be spent on consumption. In the case of Kemp-Roth, however, a strong case can be made that a substantial portion of the additional disposable income will not be spent on consumption, but that it will be saved.

This is because of the structure of the Kemp-Roth tax cut. In contrast to the type of tax credit proposed last year by President Carter, which would affect most taxpayers about the same, the Kemp-Roth proposal would reduce taxes in proportion to the amount each taxpayer is now paying. As a result, about 60 percent of the cut would go to middle-income taxpayers with family incomes in the $15,000 to $50,000 range, for the simple reason that those families are now paying 60 percent of all Federal income taxes.

There are a lot of thrifty people in that group. These are the men and women who hold hundreds of billions of dollars of savings in banks, saving and loan associations, credit unions, saving bonds, and so on. Although many at the lower end of the scale are hard-pressed to make ends meet as prices rise, and the personal saving rate has therefore declined, the fact is that the thrift instinct is still strong.

The impact on saving of a Kemp-Roth type cut in tax rates would be twofold. First, the disposable income of many of the nation's thriftier individuals and families would be increased, thereby enlarging the pool of funds from which they can save. Second, and also highly important, the after-tax rate of return on each additional dollar saved would increase sharply, thereby giving a significant boost to the incentive to save. For example, a family of four with taxable income of just under $30,000 now pays a 37-percent marginal tax rate. Kemp-Roth would reduce that rate, after three years, to 27 percent. That would mean a significant increase in the marginal after-tax yield to the saver.

The disposition of the American people to save is indicated by the response to a Gallup poll last summer. When asked whether they would "spend most" or "save most" of the extra money resulting from a 10-percent tax cut in their income taxes, 41 percent of those interviewed said they would probably spend it and 40 percent said they would probably save it.

The probability that a significant part of the proceeds resulting from an across-the board cut in marginal tax rates would be saved casts doubt on the thesis that the strong extra spending on consumption would sharply boost consumer prices in the short run. Still, critics say, the deficit would be significantly enlarged, and everyone "knows" that big Federal deficits cause inflation. The answer to that charge is that a big deficit is not inherently inflationary. Witness the situation in both Japan and West Germany. In both countries deficits over the years have been larger relative to gross national product than in the United States, but the inflation rate has been much lower. Why? The answer lies in the higher rate of national saving in those countries relative to ours, a saving rate in the private sector sufficiently large to offset the very high rate of dissaving in the public sector.

Stated differently, whether or not a government deficit is inflationary depends on the manner in which the deficit is in effect financed. If it is financed, directly or indirectly, through excessive monetary creation, then inflation results. But if it is financed through genuine private sector saving, then average prices will remain stable.

Thus, the so-called inflationary impact of a large individual tax cut depends on several factors. If spending growth is restrained, the expansion in Federal revenues can "pay for" the tax cut. If the tax cut leads to more individual saving, the reduction in some degree "pays for itself," for the saving in effect finances the deficit. And in any event, monetary policy is the ultimate key. Regardless of the size of the deficit or the increase in saving that the tax cut engenders, maintenance of limited growth in the money supply can in itself assure price stability. In the case of a very large deficit, however, the costs in terms of rapidly rising interest rates and a credit market crunch may be high.

To the extent a Kemp-Roth type tax cut fosters individual saving, it will serve as an important complement to tax measures to promote business investment in new plant and equipment. The reason is that, for such investment to occur without causing economic overheating and excessive inflation, real resources must be pulled away from consumption. This transfer is, of course, facilitated by an increase in the personal saving rate.[1]

The other side of the equation is the necessity to increase the ability and willingness of businesses to make the new investment. In this respect, the existing tax system is part of the problem, and changes in it can be especially useful in stimulating capital formation.

The corporate income tax inhibits new investment. It reduces the after-tax return on new productive investment—thus reducing the willingness to invest; and it curtails the cash flow necessary to finance that investment—thus reducing

[1] A measure introduced by Representatives Brown and Rousselot, and by Senator Roth, would be an even more powerful stimulant to individual saving and investment and deserves serious consideration. This proposal would separate individual taxable income into two "baskets," one consisting of personal service ("earned") income, the other consisting of investment ("unearned") income. Each basket of income would be taxed at rates ranging from 14 percent in the lowest bracket to 50 percent at the top.

the ability to invest. Existing tax credits and accelerated depreciation are insufficient to offset the negative investment impact of these high tax rates.

The problem is further compounded by underdepreciation of real assets. Inflation, combined with high statutory tax rates, raises corporate tax burdens, primarily because the historic cost method of depreciation causes a significant overstatement of taxable earnings. As a result, the total effective tax rate on business sector capital income is far higher than it otherwise would be.

Even without this underdepreciation, however, the U.S. capital cost recovery system is badly deficient. Here, the process is much slower than among some of our important competitors around the world. In addition, the system is so complex that the vast majority of small businesses do not take advantage of accelerated depreciation permitted under law and regulation.

Clearly, reform of the U.S. capital cost recovery system is long overdue; it should be significantly simplified and liberalized. Such reform would afford significant dividends in terms of capital formation and at the least "cost" in terms of foregone revenues to the Federal Government. This is because a business would enjoy tax reduction for accelerated depreciation only if the requisite investment had been made in the first place.

Fortunately, there is today wide agreement that simplification and liberalization of the tax treatment of business depreciation stands in the highest order of priority among possible tax legislative actions. The strongest and broadest support has been provided for the Jones-Conable "Capital Cost Recovery Act," also known as "10-5-3." An alternative measure by Senator Bentsen which provided four class lives (2-4-7-10) for equipment and two (15-20) for structures was approved unanimously by the Senate Finance Committee last summer.

Legislation to simplify and speed capital cost recovery will help greatly to revitalize American industry and should be passed at the earliest possible date.

As important as it is, enactment of the Capital Cost Recovery Act will not alone provide this country with the most equitable and effective system of capital cost recovery. The reason is that the other strong leg for efficient capital cost recovery in the U.S. tax system—the widely acclaimed investment tax credit—is seriously deficient in an important respect. Utilization of the credits generated by eligible investment in equipment depends upon the presence of an adequate volume of taxable earnings against which the credits can be charged, and the fact is that a growing number of companies in important industries have in recent years been unable to generate such earnings. These industries include airlines, railroads, and steel, automobile, and natural resource companies.

Because of the low earnings in these companies, the most important investment incentive in the tax law is denied to a large number of firms whose ultimate survival and prosperity are crucial to the revitalization of American industry. Moreover, as long as these earnings are deficient, accelerated depreciation will not help the companies and indeed will, if utilized, make them worse off. This is because depreciation is a charge against earnings; the faster plant and equipment is written off, the lower the level of net profits against which investment tax credits can be taken.

The fundamental problem is, of course, inherent in efforts to use the income tax system for private sector incentives. Replacement of the income tax system with a consumption-based value added tax would obviate the problem; in effect, the cost of capital assets would be "expended" and recovery of the capital costs would be immediate. Although adoption of a value added tax has from time to time been discussed in this country, no such radical change in tax structure is likely to take place in the foreseeable future. Even if it did, the strong probability is that the corporate income tax would only be reduced, not eliminated. The capital cost recovery problem would still be with us.

As a result, the only reasonable solution to the capital cost recovery problem in those industries with low earnings is to make the investment tax credit refundable—i.e., companies which in effect earn the credits through eligible investment, but have insufficient earnings to apply them against, would receive the proceeds in the form of cash, marketable government securities, or some similar form.

The major argument against this approach is that it would reward inefficiency and help perpetuate companies which should, in our market system, go out of business. The answer to this charge is that while some of the companies involved may be "inefficient" in a global sense when compared to foreign firms operating with newer plant and often with government assistance, they are not necessarily inefficient in a domestic sense. Moreover, their industries are vital to our economy. In addition, proceeds from refundable credits are not likely to go very far in prolonging the life of a failing company.

As noted, the case for an early enactment of the Capital Cost Recovery Act is very strong. But if that passage is not accompanied by some type of refundability of the investment tax credit, our capital cost recovery system will continue to be inefficient and inequitable. Some of our most important industries will continue to find it difficult to modernize their machinery and equipment.

Finally, Federal tax policy is not contributing as it should to solution of the nation's energy problems. This is especially true with respect to efforts to foster industrial energy efficiency, an area of great promise in the drive to reduce this country's reliance on imported petroleum. Although industry has already achieved much, the easy types of conservation are behind us and future efforts will be more difficult and more capital intensive.

This issue is closely related to the nation's capital formation problem. Energy experts tell us that the efficient use of energy in industry is lagging greatly behind existing technology—that new machinery and equipment which are highly energy efficient are now available for use by industry, but that the investment in this machinery and equipment is at a much slower pace than desirable.

The reason is that the funds for investment in any type of business equipment are limited; not all desirable projects can be undertaken at once. Moreover, the competition among projects is severe, and those which would afford significant energy conservation may be lower in priority than others related to market goals or other factors that bear on management investment decisions.

Recognizing this problem, Congress enacted an additional 10 percent investment credit for investment in energy efficient equipment in 1978, but the statute was badly drawn, the regulations issued by Treasury have not been helpful, and new legislation is needed. A bill introduced by Senator Wallop and Rep. Heftel last year would have provided a workable and effective approach. I understand that these members, as well as Senators Boren and Kennedy, are planning to introduce similar legislation this year.

Enactment of some version of these proposals will help significantly in fostering the industrial conservation that is so important to solving our overall energy problem.

In conclusion, Mr. Chairman, there are a number of practical ways in which tax policy can promote the new saving and investment so necessary to help revitalize American industry. This is good news in itself, but equally gratifying is the fact that a strong and wide consensus exists on the need for tax policy changes for revitalization, and there is even substantial agreement on the types of measures that should be enacted into law.

In this respect, I am convinced that the record of the 97th Congress will be very constructive indeed.

Representative REUSS. Thank you, Mr. Walker. Mr. Peterson, there is much discussion now of the conflict between the so-called Sun Belt and the Cold Belt, with the thesis being advanced in some quarters—perhaps the President's agenda for the 1980's is one of them—that with respect to the Cold Belt's shrinking itself and seeing that growth go to the Sun Belt, the best policy is to let nature take its course, and not try to interfere with those factors which cause the displacement of investment, plants, manpower, to the South and West.

Do you agree with that view, or do you think conscious effort ought to be made to assist our older and colder areas, to wit, the Cold Belt, the Northeast, and Midwest?

Mr. PETERSON. First, I think there is no doubt whatsoever that the market forces will continue to be the predominant influence upon location decisions both for businesses and individuals. There is no possibility that the Federal Government or other governments can contradict the market influences wholly or in large degree.

So the question, then, is whether as the margin public section should be acting to cushion the impact of these market movements. As a general answer, I think yes, there is a role for cushioning. It is a relatively modest one. Some specifics would be, there are possibilities at the regional and State level, for planning.

As firms move away from individual areas, there is an excess supply of public facilities in several cases. These can be more rationally planned. The firms can be made aware of their availability. There are real reductions in economic costs from using the fixed capital. The real reductions in resource cost can be reflected in the nominal costs that firms face, so that there are a number of strategies of that sort than can pass on cost reductions from State and local planning.

At the Federal level, I think many of the tax incentives that were spoken of previously, including of course the refundable investment tax credit, would be especially appealing to firms in older parts of the country, to continue to enhance the investment profitability from carrying out capital investment in those regions of the country.

My own estimation is that most of the policy decisions will be made so as not to exacerbate the market, rather than having a corrective Federal policy that attempts to create artificially, competitveness for older regions of the country, to make sure that we do nothing through the adjustments that are going to be a major item on the next agenda—to do nothing to further exacerbate the regional differentials.

The historical record, I think, of the tax code and the public investment has been to inadvertently encourage regional differentials, and to speed up the pace of market adjustment.

Representative REUSS. How?

Mr. PETERSON. For example, an investment tax credit by itself, any other action that is taken to trim the after-tax cost of capital, that is going to have two effects: first, it increases the rate of growth investment for new capital formation, and it speeds up the rate of return, replacement of old capital.

That is a main purpose, to replace old capital with new capital, and that is fine as far as the national productivity perspective is concerned. But at the same time, if you recognize, as I think we all have to recognize, that the country is out of equilibrium now, that if a capital plant were put in place today, it would not be located where it is; it would not be located as largely as it is in the Northeast and Midwest and older cities; that we are in an adjustment period; that each step we take to cheapen the cost of new capital also carries with it a further locational incentive to speed up that—to compress, to speed up the adjustment process, geographical equilibrium, and encourage the movement from older locations to newer ones.

And we can structure our tax incentives, as happened the last time around, with the investment tax credit, to make sure that we don't unduly accelerate this regional adjustment which is going to occur in any event, and inflict upon those who don't have the same mobility opportunities the cost of remaining behind.

As the chairman is especially aware, and as you have concluded in many of your other policy statements, the other aspect of cushioning is to make sure the mobility alternative is open across the board to our labor force and not presently—which is simply to the middle and upper portions of the labor force which have the migration alternatives.

The one thing we see as regional business movements occur, we are left behind with a pool of concentrated, higher unemployment rates among the low-skilled, low-mobility, low-income portions of the labor force, who can't afford to follow business and have no other possibilities of mobility.

So the twofold policy of making sure the Federal policy doesn't exacerbate market movements, in cushioning them over the lower labor force, would be my prescription.

Representative REUSS. In fact, doesn't one of the suggestions you made for Federal expenditure programs constitute a modest reinforcement of your position that we don't want to add, by governmental action, to the forces now making for Cold Belt to Sun Belt migration?

To wit, when you talked about Federal programs, you say, and I think you are right, that it is not realistic to expect Congress to create vast new infrastructure subsidization programs for older cities.

But you point out that a reorientation of existing Federal programs now going on would, if continued, help meet the problems of the older cities. For example, instead of building new highways, repair the highways and bridges that we have.

Instead of building a whole new water or sewage system, repair the leaks in the one you have got.

To the extent that existing Federal programs are reoriented in that direction—that is, in a way which one would hope would not be infuriating to the Sun Belt, this helps the Cold Belt quite a bit, does it not?

Mr. PETERSON. Yes.

Representative REUSS. Their plant is older. And I think your interesting figures showed they do have more leaks in the pipes than Phoenix does.

Mr. PETERSON. Yes. There is a fully rational national policy to recognize that capital is indeed scarce. And it is foolish to not preserve this several-hundred billion dollars worth of public capital we have in place; and to make it as useful and serviceable as possible.

One aspect of what I was talking about has no additional cost. It is simply relaxing the constraints upon local governments, for what purposes they can use current capital. Federal capital assistance.

There never was a purpose, in my estimation, to forbidding local governments to use their own judgment that repairs and replacement was more valuable to them than the construction of new capital.

Relaxation of that constraint simply allows those same capital resources to be delivered with more clout.

I do believe that, within a national strategy, which is going to encourage new capital formation in the private sector, encourage new capital investment across the board, that some modest targeting within existing Federal programs to make sure that we don't overlook the preservation of a century and a half's worth of public capital investment, would be appropriate.

And should not be unduly antagonistic for any region of the country.

Representative REUSS. Mr. Etzioni, in your testimony, you have, I believe, much the same view as Mr. Peterson, that stressing infrastructure is a sensible thing to do, rather than to try to pick specific winners, or avoid picking losers in specific industries.

Do you agree with Mr. Peterson's view that probably the most that realistically can be done about giving infrastructure, at the State and local level, a pat on the back, is by:

One, reorienting the Federal infrastructure programs so that they do help as much as possible.

And second, abetting the recent tendency of State and local government to change its course and to put a little more of its total funds into infrastructure investment; finding the money to do it by investing less in schools, parks, and public buildings?

Mr. ETZIONI. I very much agree with you.

Representative REUSS. Does that two-point program of Mr. Peterson's satisfy you? Or does it leave some hunger in your soul?

Mr. ETZIONI. The exception—it is basically an advisable approach, starting from the point that, if you are going to be short on capital for at least the next 10 years, in view of our great needs— if you just start from that national need. Because if you have this discussion between the Frost Belt and the Sun Belt, you need some basis on which you can talk to each other.

The one thing we share, as a Nation, is a great shortage of capital. And if you start from that assumption, it leads you to concern, leaving $100 billion worth of capital behind and moving elsewhere to build all that again.

Again, I would also support the point that we should not just leave the poor behind. Assistance geared at helping people to relocate in the lower income brackets, rather than just staying in place. It would help in that direction.

The only point of difference I would like to flag is the term "infrastructure" covers two rather different things:

One in infrastructure directly related to productive capacity. The other is infrastructure which increases consumption and is, in effect, a consumption item itself.

Unfortunately, many of the systems we are talking about in our older cities are only indirectly related to productivity and production. And, in many cases, they are more closely related to consumption.

My No. 1 concern is limited resources. You give first priority to productive capacity. For example, I would put resources in railroads long before I would invest in rapid transit systems. Because they are more directly tied to national security—coal, grain—as against just getting people downtown quicker, et cetera.

Representative REUSS. Mr. Walker, you said that Kemp-Roth and other bills would not be inflationary.

Address yourself, if you would, to another criticism that is made of the Kemp-Roth family of tax reductions—higher interest rates by producing in the near term an increased budget deficit—particularly when accompanied by increased military spending, and by the fact that most of the Kemp-Roth adherents don't say: "Wait until these revenue gaps are matched by equivalent dollar-sized cuts in expenditures. Do it now." There is a school of thought which says this can be very dangerous. You increase the deficit in the near future from its projected figures. Since the Federal Reserve is not made up of mad inflationists, and since President Reagan, if he interferes with them at all, is going to interfere on the basis of creating less new money, being more conservative, that being so, we have nothing to fear of the Fed monetizing this new debt. They will insist that it be met out of what there is.

Won't this produce even higher interest rates in the near term—and the near term is one that interests us all—which will be well nigh disastrous? And certainly is this not going to make capital investment—which we all believe is needed—less attractive?

How do you meet that?

Mr. WALKER. Let me make two points.

The first is a general point concerning why we shouldn't wait for tax cuts. The second point concerns interest rates.

I think Prof. Paul McCracken put it well in an article for the Wall Street Journal, on August 18, 1980. He made the case that we cannot continue to follow the counsel of many years that said we must wait and balance the budget before we start cutting taxes.

Professor McCracken pointed out that in 1981 over 1980, based on revised revenue, estimated from the "Midsession Review of the 1981 Budget," we would see an increase in Federal revenues, without any new legislation, of about $86 billion.

That increase reflected the windfall profit tax, social security tax increases, and taxflation, as people moved into higher brackets.

On top of that, he pointed out, it was estimated there would be about a $30-billion increase in revenues at State and local government levels for a $115-billion increase in total tax payments, by American individuals and businesses, to tax collectors at the Federal, State, and local level.

Then Professor McCracken looked at national income. National income, not national product, that includes depreciation—you don't pay taxes out of depreciation, you pay taxes out of income—and national income—your income, my income, General Motors income, the total—was expected, according to the Carter administration estimates, to rise about $210 billion in 1981 over 1980.

As Professor McCracken suggested, the Nation's "fiscal plan", calls for a marginal tax rate of 55 cents on the dollar.

He also said we are never going to reach a balanced budget under this sort of marginal tax rate. We will recover weakly and then fall back. That is a big cause of the stagflation we have.

So the case against waiting and cutting taxes, I think, is very, very strong. We have got to move down this path of spending restraint and tax cuts together.

Representative REUSS. If I could interrupt at that point—and I am waiting for your second point.

On this point of yours and McCracken's—that we will recover it all back, and we must do something to get rid of this fiscal gap—I make two points:

One, we haven't recovered at all. In fact, we have a $60-billion deficit.

Second, aren't you and McCracken echoing the budgetary outlook of the Keynesian Democrats of the 1960's and 1970's, which finally caused them to be ejected from office, in being so blythe about the budget deficit?

Mr. WALKER. I don't want to say that I am blythe.

Representative REUSS. You might be right.

Mr. WALKER. I am much more relaxed than my friends in the financial community and my friends in the business community.

I am not one that says that Keynes is all bad, and supply side is all good, and supply side—we're just talking about classical economics. We have finally come full circle, to get back where we started. It took us 40 years into the wilderness, but we are now moving back in the right direction.

The basic cut that John F. Kennedy proposed in 1960 was really a supply side cut. When you cut the top marginal tax rate on individuals from 90 to 70 percent, you are really doing something on the supply side stand.

And the cut in business taxes and the introduction of the investment tax credit was good supply side economics, rather than being blythe with respect to the deficit or rather than saying that you are going to get some extreme version of the Laffer curve which it will pay for itself very quickly. No, I don't believe that.

But I believe that a supply side cut will pay for itself sufficiently, partly through the revenue feedback, but, much more importantly, through generating the savings that are necessary to finance this Federal deficit.

Incidentally, we need to examine more carefully not just the deficit but the Federal Government's total borrowing requirements, on budget and off budget.

I think there is a great deal in the Keynesian analysis that is very useful, at least as it was applied in earlier days.

I am not relaxed. I am concerned and I do think there is risk involved. But, I do not think the risk is as high as some people in the business and financial community think.

This is very important and gets to my second point. The impact of expectations is crucial to this whole concern. The financial market people are up-tight because they relate inflation to the size of the deficit, and don't get as far as they should into the analysis we are talking about here.

So, even if the proposals the administration sends to Congress in mid-February are very solid from a supply side standpoint, if the financial markets take a look at that and say: "Oh, my goodness, this is going to cause trouble," it can cause interest rates to go up very rapidly, and there could be a credit market crunch, regardless of what the Federal Reserve does.

But let's look at the other side of this. A great deal of this is communication, and that throws the job squarely on the backs of the President and his Secretary of Treasury, the Director of the Office of Management and Budget, and head of the Council of Economic Advisers.

And I think they are off to a pretty good start on this score.

The financial markets put a great deal of emphasis on control of spending, and a great deal of emphasis on the inability of Congress to grapple with this because political forces are so strong.

They argue topping off the rate of increase in spending is simply impossible from a political standpoint.

But let us suppose that what the administration sends up is not only carefully thought out from an economic standpoint, but the spending cuts—where you cut back, to get the rate of growth of spending in line—are sufficiently across-the-board—I don't mean a certain percent in every function, or every department—but you are reaching out and catching almost every special interest of single-issue group.

Suppose that they do that in such a way that, working with the leaders on the Hill, such as yourself, they were able to come to an overall vote, sometime during the next 100 days. Suppose it is so postured as a vote of: "Are you for or against balancing the budget? Are you for or against getting inflation under control?"

And let's suppose that that vote is a positive vote, and that we do start to reach these goals on spending restraints. As we all well know, the interests rates that we have in credit markets now, particularly in the long-term sector, reflect a large inflationary premium, probably in the range of 10 percent, or so.

If this tactic is successful, suppose that in a little more time, we see that Congress is really following through on this spending restraint.

So participants in financial markets may wake up one morning and say: "You know, I think they're going to do it." If this tactic is successful, I think that over the next 5 years the inflation rate may be cut in half. If those expectations capture the day, then the interest rates that you see will be moving in that direction, instead of the other direction, because inflationary premiums, in effect, would be cut in half.

That, admittedly, is the good side of this story. I won't say it is just a best case scenario. I say it is a reasonable scenario.

The outcome depends upon how well the administration does its job in putting these spending cuts together, along with game plan for getting each House of Congress to act on that, as a group, instead of singling them out so the single-interest groups can hone in, with all of their potency.

Representative REUSS. Let me be recorded very clearly. I think that would be a great thing for the Nation if that happened. I certainly would do everything I can to bring it about.

Here I stress what you said about the spending cuts, that they affect every special interest group and thus make it possible to develop a national interest. I think that is the way to do it. I would want to help.

If that isn't what happens, however, aren't we then going to get into quite an interest rate bind if we vote large revenue losses by tax cuts without having done the spending stringency that you so well sketched just now and if the Federal Reserve sticks to its guns and does not simply monetize the resultant debt?

It seems to me the answer is yes, we could. That is a risk you are willing to take.

Mr. WALKER. If the Federal Reserve stuck to its guns, I think ultimately we would get back to shore. But in the meantime I could contemplate some very, very serious repercussions, as you would, too, on the international scene, the dollar, gold, things of that type.

As you perhaps know, I was a member of an economic policy committee for Governor Reagan during the transition, which was headed by former Treasury Secretary George Shultz and included Alan Greenspan, Arthur Burns, Paul McCracken, and others. And we said, "At the centerpiece of this policy is the spending cut."

Some supply people would say it isn't all that important. It is that crucial in the light of expectations and attitudes in financial markets. And if they don't pull off this spending side, the whole game plan is in danger of falling apart.

I can sit back and contemplate what might happen if it doesn't work. I am saying that we've got to make it work.

Representative REUSS. Let me turn to another point of your argument, the point which suggested that receivers of the tax cuts will de-part from their traditional savings-spending patterns. Their traditional savings-spending patterns are scary, aren't they?

We spend 95 percent and save 5 percent. Isn't that about what it is?

Mr. WALKER. That's not quite fair. We are not cutting taxes on all consumers in an equal way. If you took the Carter credit, you could expect that sort of thing.

Representative REUSS. I didn't mean to suggest it is going to be the same way. Isn't 95 and 5 about the overall savings-spending——

Mr. WALKER. In recent years it was 93–7.

Representative REUSS. One of the lowest on the face of the globe.

And you have already expressed your belief as to the amount that is returned to taxpayers by a tax reduction. Their saving rate would be vastly greater than the 5 percent, or whatever it has been overall.

Mr. WALKER. Yes.

Representative REUSS. One of the reasons for that is since a large part of the benefits of Kemp-Roth and similar bills go to more affluent people and since they already are eating 2,800 calories a day and have a reasonably nice house and three neckties, they aren't going to feel the same impulse to spend as if you gave an equivalent bonanza, a la Upton Sinclair. That's the point, isn't it, which is fair enough and I will not quibble over it.

Let me ask you: Are there not other ways that we should inquire into for expanding savings? For example, the budget document shows that about $8 billion a year of tax expenditures goes to the allowable interest deduction on consumer purchases. About $20 billion goes to the interest deduction on homes.

You mentioned the Federal Republic of Germany as a country that has done well on encouraging saving, in the last 15 years particularly, and they have. You are aware of the fact, of course, that they repealed those tax deductions in their system, so that they weren't giving a tax incentive to consumers, of consumer goods in the one case and housing in the other case, to spend rather than save.

Would you examine those areas in your attempt to get more savings?

Mr. WALKER. I would examine them rather gingerly at the margin.

Mr. Stockman had a quote in today's New York Times. This is a paraphrase: Political capital has a short shelf life; it doesn't last very long. And he was taking it from LBJ.

Mr. Reagan has got to expand political capital to get the sort of spending cuts we are talking about. How much of that political capital I would use right now to take on the home building industry, the savings and loans, the savings banks, et cetera—I don't think I would spend very much at this stage of the game.

By saying I would approach it gingerly at the margin, I might raise the issue of interest deductions on vacation homes and things of that type. But I would not put that way up front because of the political capital argument, even though it needs reexamining—no question about it.

Representative REUSS. So much for the $20 billion on the home mortgage interest reduction.

What about the $8 billion on consumer borrowings? The Germans say, "Forget it. If you give people an incentive to spend, they won't save." What does Walker say?

Mr. WALKER. I say, first of all, that if we can get our overall ducks in order with respect to spending and tax policy in general, I think we can deal with this problem without moving too far into sacred cow areas at this stage of the game.

You can pull out, I guess, a lot of specifics of the type, the interest on consumer spending, and this and that. And at the same time we have other goals in our system. One of the goals is to provide as much housing for people as possible.

I just wouldn't at this stage of the game, Mr. Chairman, go too far into those sorts of areas. I don't think the game is worth the candle right now.

Representative REUSS. I could scarce forebear to cheer a moment ago when you suggested heroic action by Reagan, Stockman, and company on budget cutting, in view of the special interest, and let the chips fall where they may.

How do you distinguish your heroic performance on that from your rather cautious performance on tax expenditures?

Mr. WALKER. Maybe it is knowing when to be heroic. I would think it more important right now, the parliamentary problem you would have in getting tax legislation into a reconciliation spending bill.

We are dealing with two different things. We are dealing with different committees in the Congress. Time is of the essence. I wish they had their proposal up here. I wish they had it up here—I wish it had come upon the afternoon of January 20. So the longer we wait—it is a political capital thing again—the longer we wait, the more difficult it is going to be.

If you had time to get together a comprehensive bill dealing with the spending and the so-called tax expenditures. I think it would have a great deal of merit. I don't think we have time.

Representative REUSS. Thank you.

One question of Mr. Etzioni: You, in your prepared statement, took the view that the United States probably lacks the analytical capacity to predict industrial winners for special rewards. What do you say to the fact that in agriculture, the Department of Agriculture has for years conducted the major research and development role, rather than the individual farmer? It is the Department of Agriculture that has developed new seeds, new pesticides, new insecticides, new agricultural methods, new marketing methods.

That was the Government, after all. There are differences, of course, but how would you answer somebody who urged you to retreat from your position based on the Department of Agriculture's experience?

Mr. ETZIONI. There is no problem with public support of research and development. Indeed, in the other parts of the economy, this is one of the most nationalized industries we have. A very high proportion of our total are in the budget. And nonagricultural area is publicly supported.

That, though, is not the same as to suggest that a committee or Department of Commerce or the U.S. Trade and Development Agency could determine what would be the comparative advantage of an industry say 10 years hence. It requires a completely different kind of analysis.

With shoes, they were a losing industry. Since they have turned halfway, they are half losers, half winners. I don't know of anybody who predicted that. If you go back in the records, ours and others, to predict 10 years hence, you see how poor it is.

In order to predict where shoes will be in the 1990's—because you don't have to predict for next week, you have to predict into the longer future—you have to know what the Mexicans, Italians, Japanese are going to do, et cetera, with their shoes and what they are going to do in other industries. In order to know the comparative advantage, you have to know what ball bearings, industrial diamonds are going to do, et cetera.

The record shows that when we try to do that, the worst kinds of answers come out.

Mr. Chairman, if you allow me, may I make a footnote on another question of a moment ago about the Kemp-Roth?

First of all, I think the record will show that Mr. Walker, after carefully supporting the Kemp-Roth idea, closed on a support for some accommodation in a direction that—for instance, he suggested 7½, 2½, which would secure for saving investment and not give it all to automatic arrangement.

That should not be lost in his general support for the Kemp-Roth position. It indicates an understanding that it is highly risky to assume that a question can be relied on for anything.

Those of us who professionally study those things know that if you ask people about saving as a virtue, they will say, "Sure, sure, sure." It doesn't mean that they put another penny into the bank.

Similarly, I think he is quite correct in saying that the tax cut, as suggested, which goes more to richer than to poorer people, will yield a higher saving rate than one which is progressive. It doesn't mean it will yield a high savings rate. Indeed, precisely because of expectations, we had a very long, high rate of inflation.

And until people think inflation is coming down, it would be unduly stupid—I don't think there is a high correlation between being investmentwise stupid and being rich—to pump the money into savings accounts.

And so, I congratulate his closing note on not relying too heavily on that notion that there are people who will save a lot more than they did. And this is exactly where Congress comes in.

I heard him in another presentation on December 10, pointing out that the President proposes and the Congress disposes. Here is the opportunity. The President feels obligated to come up with a 10–10—only three 10's, the 10–10–10. Congress has an opportunity to help him get off that notion by doing something for saving investment.

And last, the one thing is the expectations business. There are interesting phenomena, and it deserves more attention. Whenever the equations of econometrics don't work, there is the magic voice which can plug in, known as expectations. It makes the wrong proposition whole again. So if people are supposed to buy less as prices rise and, indeed, they buy more, the answer is they expect more inflation. Anything can be made whole again.

I would like to say something about expectations. People will not be swayed by announcements of efforts to cut spending. The notion that this is a magical thing—President Carter tried it last March, and as you recall, he tried to balance the budget at that time—again, because it was believed that it would have a great magic effect on the people out there. People look at the prices. The headlines fly by them.

And so, if you want to convince the people out there that they—they will look at the prices in the supermarket and unless those are coming down, I don't think we should rely that heavily on what efforts to balance the budget—as much as they are called for—it is expectation.

Mr. WALKER. I agree very much with what he said.

I want to add one point further. As to Kemp-Roth, my support for Kemp-Roth, or a cut of that type—across the board, cutting marginal rates—stems almost as much from social and political reasons as economic reasons.

We put together this Federal income tax system many years ago. Much of it was constructed during the Great Depression, when social and economic theories and attitudes were much different from now.

The Keynesian ideas really came along to support the views that had already developed, that we were consuming too little and that saving and investment didn't matter all that much. So the tax system we constructed was an anticapital formation.

On the individual side, there was a lot of feeling about soaking the rich and redistributing wealth through the tax system, and so on. We have today a tax system we set up in the 1930's. And as we shaped it further in World War II with a system of very high marginal tax rates, which is now clobbering at the middle class of the country.

This is hitting the most important group in the country from a social and political standpoint. This is the group that is so vital to economic stability and political stability. As you well know, some of the reasons why developing nations have not been able to develop any faster is because of the absence of the middle class.

In Germany, when the great inflation in the 1920's, in effect, wiped out the middle class, it paved the way for the coming of Hitler's national socialism. I think the care and feeding of the middle class in this country is awfully important.

As a consequence, the social and political case for something along the lines of Kemp-Roth is a compelling factor.

However, if you scale down the rate cuts somewhat and put savings incentives in there, you are still dealing with the same middle class that I am talking about, so I can compromise on that very, very easily.

Representative REUSS. Under Kemp-Roth, how much of the benefits of that go to people under and over $30,000 a year? $30,000 a year is when this 37-percent bracket that you talk of begins to bite, is it not? Isn't that what you get?

Mr. WALKER. $29,900 taxable income is where you hit the 37-percent rate. I would have to get that for the record. The latest figures compiled by the Tax Foundation show the top half of your taxpaying families were paying over 90 percent of all Federal income taxes, and surprisingly, that break comes around $13,000 a year. I think the Kemp-Roth still would be the biggest portion of it, would be, certainly, below $40,000, and maybe below $30,000.

Around 60 percent would fall in that $15,000 to $50,000 range, and there I am talking about family income, I think more than taxable income.

Representative REUSS. I wish you would put into the record the amount of Kemp-Roth benefits that go to those with incomes of more than $30,000, and less.

What about the amount going to those with incomes of $50,000 a year or more? How much of Kemp-Roth proceeds go to them?

Mr. WALKER. I would have to get that for you, sir. It shouldn't be a very large figure.

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

CHARLS E. WALKER ASSOCIATES, INC.,
Washington, D.C., January 30, 1981.

Hon. HENRY S. REUSS,
Chairman, Joint Economic Committee,
Dirksen Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: When I appeared before the Joint Economic Committee on January 27, 1981, you asked me to submit additional information on the income distribution of the Kemp-Roth tax cut.

Attached are estimates prepared by the Joint Committee on Taxation that address your question. The JCT estimates show that 50.6 percent of the Kemp-Roth tax cut would go to those with $30,000 of income or less. In addition the JCT calculations indicate those earning $30,000 or less pay 47.7 percent of taxes paid so that the Kemp-Roth cut is roughly proportional. This ratio, the percent of taxes cut to the percent of taxes paid, also applies to those with incomes of $30,000 or more. In other words, the Kemp-Roth plan would reduce taxes in proportion to taxes paid across income categories, a proposal which seems eminently fair.

Again, thank you for the opportunity to appear before your Committee.

Sincerely,

Charls E. Walker.

Enclosures.

TABLE 1.—DISTRIBUTION OF KEMP-ROTH TAX RATE REDUCTION

	Percent of taxes paid	Percent of tax cut
Expanded income class:		
0 to $30.000	47.7	50.6
Over $30,000	52.2	49.5
Over $50,000	28.4	25.5

Source: Joint Committee on Taxation, from testimony of Hon. Jack Kemp on tax rate reduction before the Senate Finance Committee, July 29, 1980.

TABLE 2.—DISTRIBUTION OF KEMP-ROTH TAX-RATE REDUCTION

	Percent of taxes paid	Percent of tax cut
Expanded income class:		
$0 to $5,000	0.2	0.3
$5,000 to $10,000	3.6	4.4
$10,000 to $15,000	8.1	8.8
$15,000 to $20,000	11.3	11.9
$20 000 to $30,000	24.5	25.2
$30,000 to $50,000	23.8	24.0
$50,000 to $100,000	14.5	14.5
$100,000 to $200,000	6.6	6.0
$200,000-plus	7.3	5.0

Source: Joint Committee on Taxation; testimony of Hon. Jack Kemp on tax rate reduction before the Senate Finance Committee, July 29, 1980.

Representative REUSS. I think you will find people over $30,000 get just about half of the Kemp-Roth proceeds, and people over $50,000 get just about one-quarter of the Kemp-Roth proceeds, which makes me wonder about these little middle-class figures you're talking about. These people with $50,000 a year or more——

Mr. WALKER. I am defining——

Representative REUSS. They are approaching affluence.

Mr. WALKER. I am defining middle class not as a statistician. I think median income is at $20,000 a year, and I am defining middle class in its own image. If you talk to some people who are making family incomes of $30,000, $40,000 to $50,000 a year, they think of themselves as middle class. The fundamental point is——

Representative REUSS. I wouldn't object to your designation of the $20,000 to $50,000 group as middle class, maybe with some subgradations.

But I think it is important to be aware of the diminution of the revenues that is involved in taking care, not of this middle class, but of those who are in income brackets above the $20,000 to $50,000. As I say, if my figures are right, it amounts to almost one-quarter of the total revenue losses of Kemp-Roth.

Mr. WALKER. You have to recognize two things there. First of all, the higher the income bracket, the more money for the buck on the savings side you will get.

Second, and you didn't make this charge, I know, but I get concerned about people that say that this is not the fair way to cut taxes. What is fairer than to cut taxes in proportion to the way you are paying them already? That seems to me the equitable way, unless you are consciously going to try to use a tax system primarily for redistribution of income, welfare purposes, and so on.

If you think of it as a revenue raiser then a proportionate tax cut seems to me the logical and equitable way, particularly when it does not in any way reduce the progressivity of the system. The progressivity stays exactly the same, because you are cutting 10 percent in each bracket.

Representative REUSS. Mr. Peterson.

Mr. PETERSON. I would like to return for one moment to the issue of interest deductibility. I would hope that we would not write that off as politically impossible in the long run. The influence of the housing sector upon savings rates is really quite substantial. The figures have been quoted this morning. They are illusory. They are a product of the way we keep our accounts from an individual household's point of view. The major source of savings in the last decade has been the increase in the housing assets that he owns—or the household owns. And those are not in savings. They are an increase in asset value, an increase in wealth.

From an individual perspective, they are a major source of savings, but they do not enter into the national account, and that has been diverted from savings that could be going into productive capital investment. If it is ever going to be possible to tackle the mortgage interest deduction question, it would be in conjunction with an across-the-board tax rate decrease.

The principal political obstacle to that has always been that the mortgage interest deduction, the income—upper-middle-income tax advantage, in the Tax Code. Removing it would make the interest—make the tax rate structure more steeply progressive; would eliminate some value of existing homes. And for that reason, of course, it is an extremely controversial issue.

Done in conjunction with the tax rate increase, which has a major advantage to middle- and upper-income households, it may be politically feasible. The second or third generation tax reform effort after the first year's tax package has been approved.

I would certainly think that we should not write this off as forever and inevitably beyond our capacity to carry off.

Mr. ETZIONI. If I would be given the assignment to create a genuine revolution in this country—I don't mean a minor one, but a full-blown revolution—I wouldn't know a better way than to announce that you would not allow people to deduct their mortgages from their income taxes. It is not only going to push the middle classes into a very high tax bracket, but it would destroy the Internal Revenue's No. 1 asset, because the value of houses will drop by somewhere between 50 to 75 percent the day after that announcement.

Representative REUSS. I think those who talk about this suggest that it be applied just in the future; that you can pay off your existing mortgage, and deduct the interest on that.

Mr. ETZIONI. But you have to sell your house to somebody who will not be able to buy it. Nevertheless, I share the purpose of the suggestion. And I did a study of that, because the figures are like this: We used to put into residential houses 16 percent of our savings. We put now 32 percent, which shows how much of our general investment resources, in effect, go into residential housing.

But the way out of that would be, aside from marginal things already mentioned, vacation homes—I am afraid the only positive way I see is if you make other investments as attractive, you would reduce the special attraction for residential houses.

One of the major ways is the kinds of things referred to earlier—Brown, Rousselot, which would make stocks and bonds as attractive—not quite as attractive, because taking it away from housing in a big way—I think the margin then has no consequence. I don't see how it is politically feasible.

Representative REUSS. In the discussion of that problem, which we should have another day, you have to take account of the fact that it is really not very edifying, at least to me, to have the Federal Government vie with itself to provide more revenue-losing, budget-busting tax favors for one or another group to try to sweeten the pot. Why don't we go back to the situation where the world was young, where the noble savage could use economic criteria in deciding whether he wanted to invest in a home, stock, bonds, or wanted to spend it all?

Mr. WALKER. Could I suggest a possible political approach? In fact, it was presented, a decade or so ago by Senator Russell Long. He suggested you might get to the point where you could have one tax rate, or a series of rates, reflecting ability to pay lower rates of 15 or 20 percent, and so on.

Senator Long suggested that given the force of these single-issue special interest groups that would come in to fight this, that for a period of time, an individual would be given a choice of two tax returns: one would have all of the current deductions and credits, and so forth; the other tax return would be a short form which had nothing special—although I would qualify that and say you would have to leave charitable contributions in it, but you wouldn't have the mortgage deductions and this and that, and the rates that you set on the short form would be more attractive. When you went through the trouble of figuring your tax on both forms, you would find that the short form gave you a better break.

You continue that for several years, so that the long form would die through disuse. You might get there without having to take on the single-interest groups.

Representative REUSS. The same thing was suggested in those days by the other most powerful tax figure in America, Wilbur Mills, but nothing came of it all.

Mr. WALKER. That's down the way on the agenda, I guess.

Representative REUSS. On this nostalgic note, let us end our hearing with many thanks to a most excellent panel. And we will meet here tomorrow at 10 o'clock.

[Whereupon, at 11:52 a.m., the committee recessed, to reconvene at 10 a.m., Wednesday, January 28, 1981.]

THE 1981 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 28, 1981

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. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss and Mitchell; and Senator Symms.

Also present: James K. Galbraith, executive director; Bruce R. Bartlett, deputy director; Louis C. Krauthoff II, assistant director; Richard F. Kaufman, assistant director-general counsel; and David W. Allen, Mark R. Policinski, and Timothy P. Roth, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good morning. The Joint Economic Committee will be in order for a further hearing on this year's economic report.

Today we concentrate on income distribution effects of Federal policy, a subject usually absent from the current debate over economic policy. In this hearing we particularly seek enlightment as to the distributional effects of the Carter 1981 program, and particularly the program of the new administration. As to the latter, for example, what do its tax proposals, its military spending proposals, its tightening monetary policy proposals, its cut in social programs proposals portent, in terms of the income shares enjoyed or not enjoyed by the various quintiles of income receivers, and the relationships between that and the shares in the national wealth.

Among the subsidiary questions we will explore are to what extent current transfer programs absolved or alleviated the problem, whether various cuts in nondefense spending programs will likely increase the level of poverty, whether supply side policies now under consideration at the White House will have important longer-term effects on income distribution.

These are all difficult questions, but we are fortunate to have with us this moring three witnesses who are well qualified to deal with them, Barbara Bergmann, professor of economics at the University of Maryland. She is a welcomed and frequent visitor to this committee and has testified before us many times.

Sheldon Danziger, research economist, Institute for Research on Poverty, University of Wisconsin at Madison, recently coauthored an important study for our Joint Economic Committee on income transfer programs. He is also the author of several other related studies.

George Gilder, who is at the moment on the shuttle, but will join us very shortly, is program director of the International Center for Economic Policy Studies. He is the author of several books, the most recent of which is the widely discussed "Wealth and Poverty."

I know Senator Symms has an opening statement which he would like to make, and I will recognize him as soon as he comes for that.

Congressman Mitchell.

Representative MITCHELL. No, I don't want to make an opening statement this morning.

Representative REUSS. If not, I will observe that all of the witnesses have supplied us with prepared statements which under the rule, and without objection, will be received in full in the record, and we would now like to ask each one to proceed.

Our colleague, Senator Symms has just arrived.

OPENING STATEMENT OF SENATOR SYMMS

Senator SYMMS. Thank you, Mr. Chairman, and my colleague, Mr. Mitchell, from the House.

I appreciate the chance to be here. I am sorry I was a couple of minutes late, so I ask the indulgence of my colleagues here on the committee and those witnesses that are here, to make a very brief opening statement.

For several years the Joint Economic Committee has been in the forefront of what is known as supply side economics. In its annual report, hearings and numerous staff studies, it has been the view of the Joint Economic Committee that the U.S. economy needs a tax cut for both individuals and businesses, to encourage saving, investment, work effort, and productivity. There is no question that the widespread support and respect for supply side policies that exists today, both in academia and at the policymaking level, is due in no small part to the work of this committee.

There have always been those who denounce tax cuts and supply side economics as "trickle down economics," a giveaway to the rich, and a throwback to allegedly discredited classical economics. Such epithets do nothing to raise the level of debate, but merely substitute buzz words for careful analysis.

In my view, the economic argument against an across-the-board tax rate reduction is nonexistent. If we do nothing, tax rates will rise enormously this year, as inflation pushes people into higher and higher tax brackets. Such a nonlegislated increase in taxes is not only indefensible politically or ethically, but is doing enormous harm to our economy. Rising taxes alter relative prices, reducing the trade-off between work and leisure, savings and investment. They encourage growth of the underground economy and investments in exotic tax shelters, and they increase unemployment by reducing the workers aftertax wage, while increasing the cost of employment to employers.

Since the economic case is so strong, those who oppose tax reduction have taken to using noneconomic arguments at the expense of allowing our Nation's economy to further deteriorate, they talk about how a tax cut will increase the inequality of income distribution, as though there is some sort of ideal we should support, in which everyone is paid exactly the same, regardless of their ability or their output. Such notions are, I think, fundamentally alien to Americans who, unlike people in Socialist nations, are envious of another's success, as long as their is equal opportunity for all to succeed as well.

Mr. Chairman, thank you very much, and I look forward to hearing from our witnesses this morning.

Representative REUSS. Thank you, Senator.

Would you proceed, Ms. Bergmann.

STATEMENT OF BARBARA R. BERGMANN, PROFESSOR OF ECONOMICS, UNIVERSITY OF MARYLAND, COLLEGE PARK

Ms. BERGMANN. Thank you. I am afraid I'm going to turn out to be one of the people that the Senator was warning us against. Although I sometimes think I am the only one left in Washington.

The choice of economic policy options we face today is a difficult one. Part of the difficulty lies in the fact that the economy is suffering from a variety of diseases we only dimly understand, and for which no sure fast, painless cure is available. Another part of the difficulty is the sloganeering atmosphere, in which the economic policy discussion is taking place.

The slogan of supply side economics is on all lips. Those that claim to be of that persuasion are putting forward a number of policy proposals.

The nature of these proposals, their likely result, needs careful analysis. No one is against measures which can be guaranteed to promote the more efficient production of a wide variety of high quality goods and services at more stable prices. But can the measures proposed by the supply-siders—general tax cuts on all consumer incomes, tax cuts on business profits, and a reduction of regulation—be reasonably expected to produce the desired end without unsupportable side effects?

A serious concern with the supply side of the economy is nothing new. Starting in 1776 with Adam Smith, a supply side emphasis was the dominant line in economic thinking until the 1930's. The distillation of the classical supply side position is found in Say's famous law: "Supply creates its own demand." The measure of Say's law is that Government policy should free up supply and need not be concerned about the level of demand, or at least about demand efficiency.

It was the obvious inadequacy of supply-side economics in the Great Depression of the 1930's which brought into prominence what we may call the demand-side school, whose patron saint was John Maynard Keynes. Neither Keynes nor his followers openly discounted the importance of supply, but in practice they acted as though the direct converse of Say's law was true. Implicitly, their motto was: "Demand creates its own supply." They tended to assume that, unless demand went beyond the capacity of the economy, the supply would be there without much problem.

The breakdown of trust in demand-side practitioners has not occurred because of perceived supply deficiencies. It has occurred because the demand-side way of thinking implies that on any given day we can easily tell whether demand is deficient or excessive. This obviously is not true in our present environment.

In the demand-side lexicon, deficient demand is evidenced by both high unemployment and stable prices. In this case stimulants need to be applied to demand in the form of some combination of lower taxes, higher Government spending, easy money. Excess demand is evidenced in demand-side lexicon by both low unemployment and a rising price level. In this case the demand-sider's prescription was to apply restraint to demand by higher taxes, lower Government spending, tight money. Today, there is confusion as to whether demand is excessive or deficient. It is really clear we cannot define the situation in these simple terms any more.

Obviously neither one of these traditional demand-side prescriptions is appropriate—neither will simultaneously take care of our present combination of high unemployment and high inflation. But are the supply-siders' prescriptions adequate to do the job at which the demand-siders have so ignominiously failed? Or do we need some entirely different set of proposals?

Let us first examine the proposal from the supply-siders to cut income taxes on consumers. Here, the precedent of the 1964 tax cut is invoked. It is true that after that tax cut, the economy did grow, and the Treasury in time took in more tax revenues than it would have taken in without the tax cut.

We must ask ourselves, however, whether this episode is really a supply-side precedent. The economy grew after the 1964 tax cut because consumers had the purchasing power to buy more goods and services, and there was enough slack in the economy so that business could easily respond to the increase in demand by hiring more workers and utilizing capital more intensely.

There is no evidence that I know of that would allow us to attribute any major part of the growth in the economy in the mid-1960's to an increased incentive to work resulting from the greater hourly take-home reward provided by the tax cut. The evidence is entirely consistent with "demand creating its own supply" in orthodox Keynesian fashion. Thus, any agitation for a cut in income taxes based on the 1964 tax cut experience is not true supply-side economics, but rather what might be characterized as demand-side economics in supply-side drag. This characterization does not prove that an income tax cut is the wrong medicine for today. After, a tax cut on personal income would probably help unemployment, and in doing so would help the least fortunate.

However, it would probably also increase the deficit, and I would consider that counterproductive to the fight on inflation. Because of its mixed effects, I think an income tax cut—or at least a large one—might best be left out of the policy package for now, and I shall argue that below.

The second item on the supply-siders' list of good things to do is a cut in taxes on business, possibly in the form of a change in depreciation rules or an investment tax credit or a simple cut in the rate of tax on profits. It is alleged that such business tax cuts will increase investment, which will improve productivity, which will reduce the rate of inflation. All three of these effects are really quite doubtful. An investment tax credit was in effect between 1963 and 1969. After it had been in effect for 5 years, studies were made of the effect of this tax credit on the quantity of investment, by a group of highly reputable economists. Unfortunately, they were unable to come to any consensus as to whether the tax credit, which was equivalent to about a 7-percentage-point decrease in the corporate income tax, had had any effect on investment at all.

Although the effects of the investment tax credit of the 1960's were not discernable, let us simply assume that this time we might enact a business tax cut which would succeed in affecting investment and productivity, and ask how this might affect inflation.

The connection between productivity and inflation derives from the fact that wage increases which are offset by productivity increases do not increase costs. So if the rate of change of wages stays constant while the rate of change of productivity increases by x percentage points, the rate of change in costs will decrease by x percentage points; furthermore if the rate of inflation decreases at the same rate as the decrease of the change in costs, then the rate of inflation will, in fact, decrease by that same x percentage points.

The first thing to notice is that there are some important "ifs" in that last sentence. There is no guarantee, for example, that wages will respond to the rise in productivity by keeping their rate of rise constant. They may rise faster instead. Nor is there any guarantee that the rate of price inflation will moderate to the extent that cost pressures moderate.

A second point concerning the connection between productivity and inflation relates ~~to the~~ orders of magnitude of the changes to be hoped for. Lyle Gramley, a member of the Board of Governors of the Federal Reserve, has estimated that investment incentives which cost the Treasury $25 billion per year might raise the rate of productivity growth by 0.4 percentage points "not right away, but after several years."

And by the way, in the President's Economic Report, he takes a much similar estimate. He calls this "a fairly generous estimate, but a reasonable one." Through some unspecified calculation which may represent the triumph of optimism over common sense, Gramley translates the 0.4-percent increase in productivity growth not into an 0.4-percent decrease in the inflation rate, but into a 1-percent decrease. Without quibbling with Gramley as to whether a 0.4-percent decrease or a 1.0-percent decrease in the inflation rate "after several years" is the correct projection, it has to be clear that the $25 billion annual charge to the Treasury for tax relief for business is not going to buy us much in the immediate fight against an 11–12 percent rate of inflation. On this basis, supply-side remedies would take between 12 and 30 years to cure a 12-percent inflation.

If tax incentives to business are unlikely to make an appreciable dent in inflation, there is one effect they are sure to have. That $25 billion a year they would cost the Treasury is not going to be evenly distributed among all of us. The accompanying table, based on the latest available data from the Internal Revenue Service, shows that dividend income, which will be largely the beneficiary of the business tax cut, is highly concentrated in the upper income groups. Only 1.6 percent of tax returns showed adjusted gross income of $50,000 or above in 1977. This small group of high-income taxpayers had 46 percent of all dividend income reported to IRS on personal tax returns. More than a quarter of the dividend income reported by persons went to the people whose tax return showed adjusted gross income of $100,000 or more—people who belonged to the top one-third of 1 percent of all taxpayers. The benefits of tax relief to business will predominantly go to our richer citizens, as dividends and as capital gains. A cynic might say that that is what supply-side economics is all about: rewards to the suppliers.

[The table referred to follows:]

DISTRIBUTION OF INDIVIDUAL TAX RETURNS AND DISTRIBUTION OF DIVIDEND INCOME BY ADJUSTED GROSS INCOME CLASS, 1977

	Number of returns in AGI class (thousands)	Percent of returns in AGI class	Amount of dividend income in AGI class (millions)	Percent of dividend income in AGI class
Size of adjusted gross income:				
Under $20,000	68,312	78.85	$7,710	25.84
$20,000 to $30,000	12,121	13.99	3,608	12.09
$30,000 to $50,000	4,784	5.52	4,912	16.46
$50,000 to $100,000	1,140	1.32	5,318	17.82
$100,000 to $200,000	225	.26	3,485	11.68
$20,000 to $500,000	46	.05	2,609	8.75
Over $500,000	7	(1)	2,190	7.34
Total	86,635	100.00	29,832	100.00

[1] Less than 0.01 percent.

Source: Internal Revenue Service, "Statistics of Income—1977, Individual Income Tax Returns", Washington, D.C. 1980, pp. 17–18.

Ms. BERGMANN. The third policy proposal of the supply-siders is a decrease in governmental regulation of business. Some governmental regulation restricts market entry or competition, or raises prices directly. Tariffs and quotas on imports and governmental price support arrangements for milk and grain are examples. This kind of regulation has the effect of redistributing income in favor of the sheltered producers and against consumers generally. Reducing this kind of governmental regulation does not seem high on the list of our present crop of supply-siders. Quite on the contrary, some of them are in favor of helping out the steel and auto industries by still further governmental interference with free trade.

A second type of governmental regulation, exemplified by the regulation on occupational health and safety, on consumer protection, and on the environment also tends to raise prices. Here, however, producers do not benefit. The costs of those producers who have the dirtiest, the most hazardous and the most polluting operations are raised, and their volume of business and profits suffer accordingly. The cost of this kind of regulation is shared out between the producers affected and consumers generally. To the latter is eventually passed on the costs of the cleanup. This is the kind of regulation which our current crop of supply-siders seems to have the most enthusiasm for doing away with. While I would agree with them that each regulation should be made to show a balance of benefits over costs, I would urge that the process of assessing benefits and costs be a fair one.

I would be very surprised if the reduction of governmental regulation, even if desirable for its own sake, and I believe a lot of it would be desirable, proved to be a very big gun in the fight on inflation or unemployment in the short or medium term. The reason is the same one which limits the effect of productivity incentives—the scale of the inflation problem overwhelms the scale of the proposed remedy.

If I am correct, and supply-side remedies have little prospect of making significant headway against inflation, then what is there to do? I believe that we have a basic choice to make. We can either muddle along much as we are doing, and simply live with the inflation for another decade or so, or we can try a radical but dangerous and costly program to get rid of it fast. I can think of three radical but dangerous and costly programs, any one or two of which might work, in the sense of getting rid of the inflation:

One, put the economy through a really severe and prolonged depression.

Two, put on wage and price controls.

Three, use diplomatic and political means to make oil prices go into reverse.

I want to make it clear that I do not advocate any of these three, which are really more adventures than programs. I have listed them, however, to show what I believe to be necessary to show rapid progress on inflation.

What I would advocate instead is a program which would reduce the Federal deficit, but at the same time take care of the unemployment program somewhat. This would involve little or no cut in income taxes, making social security payments and unemployment insurance benefits taxable, and an expanded public service jobs program, although a newly designed one. I do not need to be told that President Reagan was not elected to carry out such a program, but I believe that it would constitute the best and safest attack on the economic problems on account of which the electorate rejected President Carter—inflation and unemployment.

Representative REUSS. Thank you, Ms. Bergmann, Mr. Danziger.

STATEMENT OF SHELDON DANZIGER, RESEARCH ECONOMIST INSTITUTE FOR RESEARCH ON POVERTY, UNIVERSITY OF WISCONSIN AT MADISON

Mr. DANZIGER. My prepared statement addresses the role of Government transfer payments to persons in reducing poverty and income inequality. Transfer programs have grown rapidly in the last 15 years, and there are now persistent calls for cutbacks in their size. However, these programs accomplish very important objectives which are often overlooked when some of the problems of the programs are criticized.

They cushion losses in economic well-being because of uncontrollable events that disrupt earnings, such as unemployment, disability, death or retirement. They guarantee access to necessary goods and services through such programs as medicare, medicaid, and food stamps. Most importantly, they have been the primary force for the reduction in poverty that has occurred in the last 15 years.

Some have claimed that poverty is now all but erased. They argue that the undesirable side effects of transfer programs are enormous. Work incentives have been eroded for both the poor, who are subject to high tax rates in the transfer programs, and for the rich who pay the taxes that finance them. Some of those taking this position argue that the growth of those programs be curtailed. Others want the programs to be scaled back or even eliminated.

I want to offer a different evaluation of the recent trend in income support programs. Substantial progress has been made, but the war on poverty has not been won. While the programs have increased disincentives to work and save, the magnitude of these disincentives poses no serious threat to the efficiency of the economy.

There are costs to the programs, but the benefits outweight the costs. Rather than a retrenchment, I would suggest a reorientation of transfer policy. The reorientation would attempt to lower the efficiency costs, the savings and work disincentives, while maintaining the redistributive benefits from the program. This involves an emphasis on integrating income support programs into the labor market for those among the poor who are able to work.

Table 1 in my prepared statement emphasizes several points. One, there has been a tremendous growth in the number of beneficiaries in the past 15 years. By 1978, 42 percent of all households, a number far larger than is commonly realized, received a cash benefit from one of the major income transfer programs.

The income transfer system which includes social security, railroad retirement, AFDC, food stamps, unemployment insurance, among others, is not a system in which benefits are received only by the poor. I think it is an important distinction to realize that we are not talking only about welfare programs that benefit only the poorest 10 percent, but about the whole range of programs that benefit over 40 percent of the population.

The average size of the benefit has increased significantly: The average transfer recipient received almost $4,000 in 1978. The rate of increase for transfers has been higher than the rate of increase in census income. One of the reasons for the large increase and one of the reasons for the reduction in poverty has been the fact that many of the programs have been indexed to the cost of living.

Thus, as the poverty line goes up with inflation, social security, food stamp, and SSI benefits have also gone up. If these programs were deindexed, if they were no longer increased by the cost of living, then poverty would increase.

I would also like to point out a few facts about tax burdens on the poor. A family of four in 1969, earning $3,743, the poverty level income, paid 7.6 percent of its income, on average, to social security and Federal income taxes. Through a series of measures—increases in the standard deduction, increases in the personal exemption and, most importantly, the introduction of the earned income tax credit—the tax rate on a family of four at the poverty line ($7,412) had fallen below 2 percent by 1979.

However, since 1979 inflation has increased the poverty line, but the standard deduction, the the personal exemption, and the earned income tax credit have stayed constant and social security taxes have increased. In 1981, the tax rate on a family of four at the poverty line will be over 8 percent.

Personal income tax reductions, such as the Kemp-Roth proposal, which propose across-the-board cuts in taxes will do little to reduce the tax rate on poor families because their Federal taxes are mostly for social security. A tax cut which increased the earned income tax credit could, however, reduce tax burden on the working poor.

This growth in transfer benefits has played an important role in the reduction of income poverty. In table 2, the column marked "census income" shows the official Government measure of poverty and shows a decline to less than 12 percent of persons. As has been pointed out, the official measures do not count benefits such as food stamps and medicaid, referred to as "in-kind income," which have increased in the last 15 years and have reduced poverty among the low-income population. The last column, where the data have been adjusted to account for in-kind income, shows that poverty in 1980 is estimated to be about 4 percent. That marks a significant reduction in poverty from 1959, when it was about 20 percent.

It is important to note, however, that even if one accepts the low estimate—and a number of people have used that estimate to argue that there is no longer poverty—that the 4-percent figure marks different poverty rates for different types of persons.

The next table shows the poverty rates by age and sex and race. If the war on poverty is won, it has probably been won only for families headed by white males. The 4-percent-aggregate figure masks very high poverty rates for women heading families, in particular black women heading families, and substantially higher rates for nonwhite males than for white males.

One of the largest reductions in poverty that has occurred recently has been among persons over the age of 65. Poverty for the aged, mainly because of increases in social security and medicare, has declined to a point where now the aged are no longer poorer than the population as a whole. Again, much of that decline can be attributed to the indexation of social security benefits in the 1970's, and to the earlier across-the-board increases.

One of the reasons we are doing better, but feeling worse about the poverty problem, is that most of the decline in poverty is due to Government transfer payments. If you go back to the initial declaration of the war on poverty, you find that the legislative intent, the idea embodied in the Economic Opportunity Act, was to get the poor to earn their way out of poverty. Individuals were to be brought out of poverty through their own work and not through transfer programs.

The data on market income poverty in tables 2 and 3—which are not generally published—shows that market income poverty has declined very little, if at all, in the past 20 years. It is because of the persistence of market income poverty that I would suggest a reorientation of income support policy toward programs which emphasize work rather than transfers for those who are able to work.

The reduction of income inequality has not been an explicit official goal in the way that the reduction of poverty has. Inequality has not changed in the past 15 years. Increasing transfers have created a larger wedge between what the poor have and what they would have had in the absence of their growth. If it were not for increased transfer payments, income inequality would have risen in the past 15 years. Thus, the increasing transfers have prevented increases in income inequality.

The redistributive effects that I have discussed have carried with them costs. Those costs are best exemplified in terms of work disincentives. A study which I and two colleagues at Wisconsin prepared for the Joint Economic Committee's "Special Study on Economic Change" reviewed over 70 studies of the work disincentives in current income transfer programs. Our results are summarized in table 6. Our estimate is that these transfer payments reduce hours of work by about 4½ to 6 percent per year. However, because those most responsive to the disincentives tend to have below average wages, the loss in earnings is probably in the range of 3 to 4½ percent per year.

The effects on social security on savings have been widely debated lately, with critics arguing both sides of the case. Our review of the evidence suggests that the savings effects are not that large.

The evidence on work and savings leads us to a conclusion that differs substantially from an alternative view that holds: (1) That the war on poverty has been won and; (2) the disincentive effects are so large that the answer to "How much more income support can we afford?" is "Not any more." This view overstates both the positive antipoverty effects and the negative efficiency effects of the current system.

Poverty has declined, but the original goal of the war on poverty—to reduce poverty through increased employment and earnings—remains largely unmet. While the system does create disincentives to work and save, their size is modest and poses no threat to the growth of the economy.

Over half of all households who would be poor in the absence of Government benefits are headed by the aged, the disabled, and single parents of children under the ages of 6. That is shown in table 7. Almost all of those in these categories have not been expected to work. Thus, 70 percent of the poor rely almost entirely on income transfers to get them out of poverty. Cutbacks in transfer programs, even if accompanied by increases in programs to increase employment and earnings, will leave this 70 percent further and further behind the poverty line.

The remaining 30 percent of the poor can be expected to work. Programs such as the targeted jobs tax credit, wage subsidies, and supported work, which are designed to increase employer demands for those with low skills and low earnings, can increase the employment of the poor without relying on transfer programs. These programs pursue antipoverty and income security objectives through the labor market.

While prospects for increases in income maintenance programs do not seem favorable, I think the current concern for supply-side programs can be accommodated in a way that does not hurt the poor if we can expand programs that increase the prospects that those among the poor who are able to work are able to find jobs.

Thank you.

[The prepared statement of Mr. Danziger follows:]

Prepared Statement of Sheldon Danziger

The Redistributive Effects of Recent Changes in Income Maintenance Programs[1]

The past three decades, and particularly the last fifteen years, have witnessed explosive growth in income maintenance and other social welfare programs. These programs accomplish important objectives: They prevent large losses in economic well-being because of uncontrollable events that destroy earnings capacity or disrupt earnings. They guarantee access to indispensable goods and services. They reduce poverty, thereby narrowing the income gap between rich and poor.

The gains achieved in all of these areas are substantial, yet some feel that the income transfer system has grown too large. Income poverty is now all but erased, they claim, and the undesirable side effects are enormous. Work incentives have been eroded—for both the poor and the rich. The incentive to save has been weakened, and as a result, economic growth is impeded and productivity retarded. Some of those taking this position argue that the growth of these programs be curtailed; others want the programs themselves to be scaled back or eliminated.

I offer a quite different evaluation of the income support system. The evidence does not sustain the claim that retrenchment is in order, even though all is not as it should be. Critics have overstated the gains against poverty and the costs of work and savings disincentives. Although the war on poverty has not been won, substantial progress has been made. And while the policies have increased disincentives to work and save, the magnitude of these effects poses no serious threat to the efficiency of the economy. From this reading of the evidence, reorientation rather than retrenchment is the appropriate policy response. Retrenchment could no doubt promote efficiency, but it will also increase poverty. What is required is to integrate the income support system into the labor market. Such a reorientation emphasizes programs to enhance earnings and employment in the private sector as a means to increase efficiency and reduce poverty.

The nature and growth of income maintenance programs

Government spending for income maintenance purposes is large, has grown rapidly in the past thirty years (particularly following the declaration of the war on poverty), and is the subject of perennial public debate. In 1978, these programs accounted for about $202 billion, an amount, after adjusting for inflation, that was over three times as large as in 1965. The most important sources of this increase are the introduction of Medicare and Medicaid in 1965, and the series of legislated increases in Social Security benefit levels.

The growth in expenditures results from increases in both in the number of beneficiaries and the size of the average benefit (table 1). Payments are received on a scale far larger than is usually perceived: in 1965, 37 percent of all households received a cash transfer; by 1978, 42 percent were recipients. Over 80 percent of all poor households now receive a cash transfer. The aged head about 20 percent of all households, but receive about 50 percent of all transfers. During this period, the average transfer for all recipient households increased by 55.3 percent, while Census money income increased by only 20 percent. One explanation for these differential growth rates is the relationship between benefit levels and the rate of inflation. During the early 1970's, Social Security and SSI benefits (and Food Stamp benefits) were indexed to the cost of living. This has meant that some transfer recipients have been provided with greater protection against inflation than is available to most workers. However, public assistance benefits hardly grew at all in real terms between 1965 and 1978. These benefits are not indexed and have not been raised in some states for over 10 years.

Poverty and income inequality

The incidence of poverty as measured by the Census has declined from about 22 percent of the population in 1959 to less than 12 percent today. If the value of in-kind transfers—now over $50 billion annually—is added to the cash incomes

[1] This statement draws on several papers co-authored with other staff members at the Institute for Research on Poverty. These include: S. Danziger, I. Garfinkel, and R. Haveman. "Poverty, Welfare and Earnings: A New Approach," Challenge Magazine, September/October 1979; S. Danziger, R. Haveman, and R. Plotnick, "Retrenchment or Reorientation: Options for Income Support Policy," Public Policy, Fall 1980; S. Danziger and R. Plotnick, "Income Maintenance Programs and the Pursuit of Income Security," The Annals of the American Academy of Political and Social Science, January 1981.

used to measure poverty officially, the incidence has fallen further to about 4 percent (table 2). Since a disproportionate share of the increased transfers has gone to the aged, poverty for them has fallen from 35 to 5 percent over the same period (table 3).

Moreover, even if one accepts the low estimate of 4 percent, there is still a serious poverty problem, particularly for women heading families and for racial minorities. About one-third of all persons living with black female heads of households, one-seventh of all persons living with white female heads, and one-tenth living with black male heads remain poor (tables 3 and 4).

The reduction in poverty did not occur because the programs of the War on Poverty provided a "hand up" for the poor to earn their way out of poverty. Rather, increases in cash and in-kind transfers account for most of the progress. Indeed, if only market income is considered, the aggregate incidence of poverty has remained unchanged at about 21 percent (tables 2 and 3). However, economic growth and expanded employment opportunities did lead to increased earnings, and reduced market income poverty for some groups, most notably married black men and persons living in the Southern Region.

Because the official poverty lines are increased only for prices, and not for increases in median incomes, the poverty line for a family of four has declined from 46 to 39 percent of median family income between 1965 and the present. If a ·y line, defined as a constant fraction of median family incomes or some other measure of income inequality is used, poverty has not declined at all since 1965, despite the massive increase in government transfer payments (table 5). If official measures are altered to account for both demographic changes (as reflected in the larger proportion of single, female headed and elderly households) and in-kind transfers, a slight downward trend in inequality appears. In any year, transfers significantly reduce inequality by raising the income of the poor—about 40 percent of all transfers go to the poorest 20 percent of all households. But this equalizing effect has not led to further declines in inequality because it has been offset by increased inequality of market incomes.

Effects on work and saving

In addition to their redistributive effects, income maintenance programs create incentives which adversely affect economic behavior. These incentives have received substantial attention in recent years. Whether referred to as supply-side effects or Laffer-curve impacts, or whether discussed in the scholarly journals or in the press, the critical issue concerns the impact on economic growth. At its core, this case against existing income support policy can be paraphrased as follows: Because of the incentives in income support programs, and the taxes required to finance them, work effort is discouraged and savings and investments are reduced. Thus, the growth in the income support system has played a significant role in the sluggish performance of the economy. Further expansion would have increasingly negative effects.

A large number of recent studies has sought to quantify the magnitude of the negative work and savings incentives. A review of this literature leads me to the judgment that transfers have led to reductions in labor supply of about 5–6 percent (table 6).

In recent years a large number of researchers have also addressed the effect on savings, particularly the Social Security-savings nexus. An impressive array of variables and empirical equations have been mustered in the "regression wars" among these contenders. The general result—and perhaps the current consensus among economists—is that Social Security has depressed private savings by a small amount, but that this amount has not yet been measured precisely.

While the recent growth of income maintenance programs has significantly reduced poverty while only modestly reducing work effort and savings, continued growth probably means a less-favorable tradeoff. Proportional expansion of existing programs will secure fewer redistributive gains and cause further erosion of work effort and savings.

This conclusion differs substantially from an alternative view, that holds (1) the war on poverty has been won, in large part, because of the rapid growth in income maintenance, and (2) the disincentive effects of the current system are so large that the answer to "How much more equality can we afford" is "Not any more." This view overstates both the positive antipoverty and negative work and savings effects of the current system. Though poverty has declined substantially, a significant problem remains; while the system does create some disincentives to work and save, their modest size currently poses no serious threat to the growth of the economy.

New directions for the eighties

These findings lead me to suggest that income maintenance benefits continue to increase for those persons who are not expected to work, but that policies to substitute employment and earnings for transfer payments be developed for those who are expected to work. Over half of all poor households are headed by the aged, the disabled, and the single parents of young children who have not been expected to work (table 7). Most, but not all, of these households currently receive income maintenance transfers. Because the official poverty lines are adjusted for cost of living increases, transfers to these groups must increase at the same rate, or poverty will increase. The prospects for such increases are not favorable, however. Benefit levels are not likely to be increased in programs where they are not already indexed because of taxpayer complaints about high tax burdens. Indeed, there have been proposals for de-indexing benefits in the programs that are indexed.

Welfare reforms that would have alleviated some of the problems of current programs (e.g., high benefit-reduction rates on earned income, uneven coverage, and benefit variations across states) were proposed by President Nixon in 1969 and President Carter in 1977 and 1979. These reforms were not enacted, primarily because they would have added to the cost of current programs.

Income maintenance policy must especially confront the financial needs of all female-headed families, not merely those with young children. About one-third of these households remain poor even though about 40 percent receive transfers, and about three-quarters already work at least part-time. Members of this group cannot now be easily classified as expected to or not expected to work. The past consensus that a woman without a husband should remain at home to care for her children has been eroded by the growth of labor force participation by mothers in two-parent families. If single parents do not increase their work effort, and if, as we have argued, benefits in existing programs are not likely to be greatly increased, then the standard of living of single parents will remain low.

Although it has proven difficult in the last several years to legislate changes in income maintenance programs, several programs designed to enhance employment and earnings among persons who are able to work have been enacted or expanded. As a result of the CETA amendments of 1976, a greater percentage of public service jobs go to the disadvantaged, particularly the long-term unemployed and welfare recipients. The Earned Income Tax Credit subsidizes the earnings of workers in low-income families. There is also the Targeted Jobs Tax Credit which subsidizes employers who hire persons with certain labor market disadvantages (e.g., the disabled, ex-offenders, welfare recipients). All of these programs pursue income security objectives through the labor market. Because of taxpayers' concern over the work ethic, they appear to be more politically popular than many income maintenance programs. Prospects for their further expansion during the 1980s seem favorable since these programs provide the potential for enhancing incomes without increasing dependence on government payments.

TABLE 1.—INCOME MAINTENANCE TRANSFERS AND THE CENSUS MONEY INCOME OF HOUSEHOLDS, 1965 AND 1978[1]

Income source	1965		1978		1965–78 real growth of mean (percent)[2]
	Mean for recipient households[2]	Percent of households receiving	Mean for recipient households[2]	Percent of households receiving	
Social security and railroad retirement	$2,407	22	$3,747	26	55.7
Public assistance[3]	2,006	5	2,079	8	3.6
Other cash government transfers[4]	1,801	18	2,973	17	65.1
Any cash transfer[5]	2,532	37	3,931	42	55.3
Census money income less cash transfers	12,826		14,873		16.0
Total census money income	13,767		16,518		20.0

[1] Households include families and unrelated individuals. Inkind transfers are not included among sources of income in this table.
[2] In constant 1978 dollars.
[3] Includes AFDC, SSI (OAA, AB, and APTD in 1965), and general assistance.
[4] Includes unemployment compensation, workers' compensation, government employee pensions, and veterans' pensions and compensation.
[5] The mean transfer for any transfer is higher than the mean for any individual category, and the percentage receiving any transfer is lower than the sum of rows 1–3 because many households receive more than 1 transfer.

Source: Computations by authors from 1966 Survey of Economic Opportunity and March 1979 Current Population Survey.

TABLE 2.—PERCENTAGE OF PERSONS WITH INCOME BELOW THE POVERTY LINES, 1965–78

	Market income	Census income	Adjusted income [1]
1965	21.3	15.6	[2] 12.1
1968	18.2	12.8	10.1
1970	18.8	12.6	9.4
1972	19.2	11.9	6.2
1974	20.3	11.6	7.8
1976	21.0	11.8	5.9
1978	20.2	11.4	(3)
1980	(3)	(3)	4.1
Percent changes 1965–78 [4]	−5.2	−26.9	−66.1

[1] Adjusted income for 1968–1974: See, Timothy Smeeding, "The Antipoverty Effectiveness of In Kind Transfers," Journal of Human Resources, summer 1977. Adjusted income for 1976 and 1980 for fiscal years and are only roughly comparable with earlier years. Unpublished tabulations from G. William Hoagland of the Congressional Budget Office.
[2] Estimate based on Smeeding's results for 1968.
[3] Not available.
[4] For adjusted data covers 1965–80.

Source: Unless noted otherwise, the computations are unpublished tabulations by the Institute for Research on Poverty from Survey of Economic Opportunity (for 1965) and various March current population surveys.

TABLE 3.—THE TREND IN THE INCIDENCE OF POVERTY AMONG PERSONS, BY RACE, SEX, AND AGE OF HEAD OF HOUSEHOLD, 1965–78

[In percent]

Household head	Market income	Census income	Adjusted income [1]
All:			
1965	21.3	15.6	10.0
1978	20.2	11.4	4.1
Percent change, 1955 to 1978	−5.2	−26.9	−59.0
White males, less than 65:			
1965	10.2	8.6	5.4
1978	8.3	5.5	4.2
Percent change, 1965 to 1978	−18.6	−36.0	−22.2
Nonwhite males, less than 65:			
1965	37.6	34.7	19.7
1978	17.6	13.3	9.1
Percent change, 1965 to 1978	−53.2	−61.7	−53.8
White females, less than 65:			
1965	38.3	28.1	24.4
1978	35.0	26.6	11.2
Percent change, 1965 to 1978	−8.6	−5.3	−54.1
Nonwhite females, less than 65:			
1965	73.8	66.2	48.3
1978	62.8	53.4	22.6
Percent change, 1965 to 1978	−14.9	−19.3	−53.4
White males and females, 65 and over:			
1965	57.6	24.6	11.7
1978	54.3	11.7	3.0
Percent change, 1965 to 1978	−5.7	−52.4	−74.4
Nonwhite males and females, 65 and over:			
1965	72.4	53.8	35.6
1978	69.7	31.2	14.1
Percent change, 1965 to 1978	−3.7	−42.0	−60.4

[1] Data for 1978 is not available; data shown is for 1980.

Source: See table 2.

TABLE 4.—INCIDENCE OF POVERTY BY REGION, HOLDING PERSONAL CHARACTERISTICS CONSTANT, 1978

Head of household	Northeast		Northcentral		South		West	
	Market income	Census income	Market income	Census income	Market income	Census income	Market income	Census income
Nonaged:								
White male [1]	6.85	6.68	3.69	3.69	4.41	3.11	5.30	4.26
Nonwhite male [1]	12.72	9.75	9.63	7.00	8.36	6.01	11.37	6.28
White female [2]	52.22	39.38	49.65	34.03	44.10	34.29	38.82	31.42
Nonwhite female [2]	65.00	54.96	58.26	48.16	63.54	55.01	59.03	40.25
Aged couple:								
White [3]	40.88	0.89	39.86	1.34	48.96	1.84	45.14	1.00
Nonwhite [3]	42.70	9.82	49.33	7.49	51.09	10.45	37.49	3.57

[1] Male is 35–54; lives in a metropolitan area; has completed 8–11 years of school; is not disabled; family size is 3 or 4.
[2] Same as 1 but female household head is divorced separated or with spouse absent.
[3] Male is 65–71; lives in a metropolitan area; has completed 8–11 years of school; is not disabled; family size is 2.

Source: Computations by authors from March 1979 current population survey.

TABLE 5.—DISTRIBUTION OF INCOME FOR FAMILIES AND UNRELATED INDIVIDUALS

	Percentage of total income received by each quintile			
	1965		1978	
	Market income	Census income	Market income	Census income
Quintile:				
1	1.32	3.93	0.76	3.86
2	9.62	10.82	7.77	9.85
3	17.99	17.65	16.82	16.74
4	26.05	24.97	26.69	25.17
5	45.03	42.62	47.95	44.38

Source: Computation by authors from 1966 survey of economic opportunity and March 1979 current population survey.

TABLE 6.—LABOR SUPPLY EFFECTS OF CURRENT INCOME MAINTENANCE PROGRAMS

Program	Percentage loss of work hours to economy
Social insurance	0.5–1.0
Old age and survivors insurance	1.0
Disability insurance	0.4
Workers' compensation and black lung	.4–1.0
Railroad retirement	(*)
Veterans' disability	.2–.4
Medicare	(*)
Public assistance:	
AFDC	1.4
SSI and veterans' pensions	.05–.1
Food stamps and housing assistance	.7
Medicaid	(*)
Total	4.6–6.0

*Not available.
Source: S. Danziger, R. Haveman, and R. Plotnick, "Efficiency and Equity Impacts of Income Transfer Programs: A Critical Review." Institute for Research on Poverty, November 1980, mimeo.

TABLE 7.—CHARACTERISTICS OF POOR HOUSEHOLD HEADS, 1978

Head is:[1]	Number with market incomes below poverty line (millions)	Percent of all poor household heads
Aged (65 years and over)	9.763	46.8
Female, child under 6 years	1.409	6.8
Student	1.087	5.2
Disabled	2.542	12.2
Working full time, full year	1.583	7.6
Single persons, living alone[2]	1.881	9.0
Male family head[2]	1.465	7.0
Female family head, no children under 6[2]	1.123	5.4
All pretransfer poor households	20.853	100.0

[1] Classification is mutually exclusive, and hierarchial. That is a female head over 65 is classified in the aged category because it is higher in the column.
[2] Working less than full time, full year.

Source: Computations by authors from March current population survey.

Representative REUSS. Thank you, Mr. Danziger.

Mr. Gilder, I am told, has not arrived. We will start then with questions of Ms. Bergmann and Mr. Danziger.

Representative Mitchell.

Representative MITCHELL. Ms. Bergmann, in your prepared statement you refer to a reduction in the Federal deficit. I assume you are suggesting that a reduction in Federal spending can be used as a method of fighting against inflation. Is that correct?

Ms. BERGMANN. Actually, I do think it would be a good idea to reduce the deficit. That does not, however, imply a large or even any reduction in Federal spending. That is, it would be possible—and, of course, I realize this is against the present trend of things—it would be possible to get some more money into the Treasury through some of the measures I advocate here, such as taxing social security benefits, such as taxing unemployment insurance benefits. It would be possible to have a balanced budget at a higher level, or a smaller deficit at a higher level of budgetary expenditures.

Representative MITCHELL. My thrust is that a number of economists have indicated, up to a certain point—and no one knows where that magical point is—a deficit has little or no impact on inflation when that deficit is taken within the context of a $2½ trillion economy. Perhaps, it is nice housekeeping to eliminate deficits and to balance the budget. Is it your thinking that deficits do indeed contribute to inflation?

Ms. BERGMANN. I think one element which has been overlooked in thinking about deficits is their effect on the monetary side. A deficit means, of course, that the Treasury has to put out some new Federal obligations, and what tends to happen is that the Federal Reserve accommodates those obligations by taking action as necessary to keep the new Government obligations, as they say, from flopping in the market.

Back in World War II and afterward, there was an understanding between the Federal Reserve and the Treasury that any bonds the Treasury issued would be supposed by the Fed. The deficits ran on merrily, and the Fed acquired the debt and this created a big rise in the money supply.

There was then an accord between the Treasury and the Fed that the Fed wouldn't have to do that anymore. But, in effect, the accord has been a dead letter. I think to reduce inflation we have to get the rise in the money supply down, we have to work that down. I don't say that that in itself is going to get rid of the inflation, but it is certainly necessary. And we have to look at not the Federal Government deficits but at the combined deficit of Government sector.

You also, by the way, have to look at private debts. We have developed new mechanisms for increasing the rate of private debts.

Representative MITCHELL. You discuss work being related to transfer programs. You emphasize work associated with certain types of transfer programs. At issue is where is the work to be found? We are experiencing an enormous change in the American society. I recently read about the automating and robetizing of industry. It is obvious that we will need fewer workers to do the job. The kind of unemployment in America is not the characteristic hard core unemployment. It is unemployment associated with inflation.

In a very fascinating seminar, we recently met with the representatives of labor and big business to discuss unemployment and job creation.

The larger corporation representatives indicated that we needed more education and training for the entry level jobs. However, they couldn't indicate education and training for what kinds of jobs because they are changing so fast.

Comment, very briefly, on this conceptual idea, which I embrace wholeheartedly. Also, given the state of the economy, both domestically and internationally, please transfer the conceptual idea into a practical working operation.

Mr. DANZIGER. I think that is an important point.

What I want to make clear is I don't think you can just take somebody on welfare and say, "You're not going to get welfare unless you go out and work." I think what you point out is that there are both supply side problems and demand side problems.

The kinds of programs I mentioned are designed to increase demands for the low-skilled. A recent study of the "New jobs tax credit" suggests that employment tax credits rather than investment tax credits can lower labor costs to the employer, and increase labor demand. Programs like supported work are also programs which attempt to increase employment by enhancing job skills.

Representative MITCHELL. Thank you.

That is really not long term. That is here, now. Automation does reduce employment potential.

Senator SYMMS. Ms. Bergmann, you mention, in your statement, that it was doubtful that business tax cuts could have any effect on investment. And you cite as evidence the fact that the tax incentive was between 1962 and 1969, and a group of highly reputable economists was unable to come to any consensus as to whether the tax credit had any effect on investment at all.

What I would like to do is just, in examining that record, after the investment tax credit was initiated in 1967, net investment in plant and equipment rose 72 percent in 3 years. After the investment tax credit was liberalized in 1964, investment was 127 percent. And after the investment tax credit was suspended in October of 1966, net investment began to fall. By the end of 1967 it had fallen by more than 14 percent. Doesn't that suggest that net investment is responsive to changes?

Ms. BERGMANN. Well, Senator Symms, I am sure you know that isolating the effects of one thing on another out of the aggregate of economic data is very difficult business, and a lot of economists are beginning to suspect that it is impossible, that the methods are so poor that we can't do it.

Now, what happened in the 1960's of course was that there was a great deal of slack, a great deal of unused capacity. What happened was an increase in demand for goods and services, spurred mainly by the cut in personal taxes and partly perhaps by the investment tax credit. I would think most of it was on account of the cut in personal taxes, the major engine of that increase in economic growth.

Now, what happens when you get increases in output is that it becomes more profitable to buy newer equipment, because if you don't buy the new equipment, you have to put into service some older equipment, which is less productive.

So I think the major spur to investment is actually increasing output and, of course, there was considerable growth in the 1960's. So to separate out the increase in investment due to the general surge of prosperity and the amount of the investment tax credit is very difficult.

These economists, whose results, by the way, are reported in a Brookings book, edited by Gary Fromm, came out in the early 1970's. As I say, they were unable to reach consensus on it. Some said there was an effect; others said there was not an effect. I think you have to say it was not an outstanding effect. They attempted to account for all of the things which had affected investment and see if there was anything left for the investment tax credit to have an effect.

Senator SYMMS. Doesn't it bother you to be looking at the present situation, as you say, I think, at the end of your statement, that you think we just have to muddle along the way we are muddling for another decade or so? How long can we do this before there is no growth or vitality left in our economy at all?

Ms. BERGMANN. I disagree that there is no growth or vitality in the economy. And I think that the rapid end of the recession shows that there is a lot of vitality. I think in the industries which are advancing we have a lot of vitality. We are developing new industries, and we are ahead. We are certainly still ahead in computers, which is obviously the industry of the future.

I don't worry about the American economy basically. Certainly the inflation is very troubling, and it worries me that we don't have an answer to it. And certainly I wouldn't say that we do.

Senator SYMMS. The Congress thought they had a balanced budget—there were some of us that didn't think so—May 15, fiscal year 1981. May 15, 1980, we voted that it would be a balanced budget. Now, it comes out it is $77 billion, including off-budget expenditures.

So if we are going to continue on like that, it means that people are going to anticipate into the future that the printing presses in Washington are going to continue to debase the currency. That looks to me like that is a rather bleak, dismal outlook for this country, that there has to be some corrective measures taken.

Ms. BERGMANN. As I say in my statement, I would move toward a more balanced budget. I am not against that. I am in favor of it. I would worry, of course, that tax cuts don't move toward a balanced budget. They tend to go in the opposite direction.

So, with respect to balanced budgeting, I don't quite understand how these investment tax cuts are going to do it.

Senator SYMMS. Wouldn't that have an inflationary impact on the deficit? It would depend on how it is financed. For example, if the tax cuts are designed to increase the incentive to save, so that much, if not all, of the deficit can be financed out of additional savings, rather than printing money, wouldn't that have an impact on it?

Ms. BERGMANN. Those are big "ifs," Mr. Symms. The evidence isn't there that that is what would happen.

Senator SYMMS. What about putting a freeze on increasing any entitlement programs, Government salaries, retirement programs, expansion of entitlement programs? Freeze them all where they are and rewrite the law so that we can stay within those boundaries?

Ms. BERGMANN. I think we ought to look very carefully at the entitlement programs. I think we ought to look very carefully at the rate at which they are being escalated and perhaps change that system.

On the other hand, I think we have to be very careful of doing harm to the most vulnerable part of our population. I would endorse some of the suggestions of my colleague here. I think there are a lot of people on entitlement programs who ought to be off of them. Now, they can't get off them just by throwing them off. You have to provide an alternative framework for those people to earn their way. I think that is very important.

I think, for example, a lot of the people who are not expected to work could be put in other categories and support given to them to get themselves self-supporting. I think those kinds of things are extremely important and would, in the longer run, save budget money. But at a 10-percent-inflation rate, it is inhumane to take people who are at the very bottom and say, "Too bad," while at the same time doling it out to people with incomes of more than $100,000.

Senators SYMMS. How much time do I have left, Mr. Chairman? Are we waiting for Mr. Gilder?

Representative REUSS. Yes.

Let me ask Mr. Mitchell whether he would like to ask additional questions. I know he has to go.

Representative MITCHELL. Yes.

Senator SYMMS. Then I will yield to Mr. Mitchell.

Representative MITCHELL. Unfortunately, we have a Democratic caucus at 11 a.m. in the House. Therefore, I appreciate your allowing me to ask one additional question of Ms. Bergmann.

You refer to the tax cuts and their impact on inflation in your testimony. According to your analysis, it would take some 20 years before that proposed tax cut would bring inflation down.

My question is: If those proposed tax cuts are implemented—tax incentives, credits, and so forth—what is your estimate on the time it would take for those cuts to have an impact on reducing unemployment?

Ms. BERGMANN. I tend to be of the demand side persuasion when it comes to the unemployment issue. If we want to reduce unemployment—and, obviously, we do—we have to keep the demand for goods and services high and possibly raise it higher than it is. But I think we have to consider the inflation matter.

Now, there is an old slogan in economics that if you have a lot of policy objectives, if you have, say, 10 policy objectives and if you have 10 instruments for dealing with the economic system, you may be able to accomplish all of your objectives at once even though some of them may be somewhat conflicting, as is the case with reducing unemployment and reducing inflation.

So this is what impels me to suggest that what we need is perhaps more programs, and possibly even costly programs, to get people to work, but certainly without a tax cut or without a substantial tax cut.

It is possible; I can't guarantee it. I hope I have conveyed my equivocal support for the state of economic science. Economic science does not have all the answers.

I would hope we could cautiously and slowly—and unfortunately slowly—move on both of these objectives at the same time.

Representative MITCHELL. In an earlier hearing before this committee—I believe it was Mr. Greenspan, who said if the tax cuts are enacted, optimistically, after 2 years they might begin to have a slight impact on unemployment. This supports my argument to keep in place some of the human service programs. We should not allow the Congress to almost capriciously dismantle these programs before there is an opportunity for the private sector to begin to employ these people.

I think it would be very foolish to assume that passage of tax legislation would justify the elimination of a number of human support programs. To use your word, I think that is inhumane.

Mr. DANZIGER. If I could comment, I think that is exactly right. If employment increases in the private sector, then there will be a reduced demand for transfer payments. But you can't cut transfer programs before employment is increased.

Representative MITCHELL. Thank you, Mr. Chairman and Senator Symms, for allowing me that final question.

Representative REUSS. Senator Symms.

Senator SYMMS. Mr. Chairman, I would just pursue one thing further.

We did have testimony yesterday and, Ms. Bergmann, I obviously have a slight difference of approach to the thing that you—but I view it, as I said, from your testimony, that to continue to do what we have been doing is like holding up your hands and saying that nothing can be done—we just have to live with this.

I think that is very discouraging for those people at the lower end of the income scale, because what they want is an opportunity to be able to participate in this society of ours and to continue on with the course that we have been doing.

For those who are locked into the bottom of the earning situation, they have no hope for the future. So if you take away their welfare benefits and they get a job, then they get taxed 100 percent of what you take away, because they've lost those. They have a job and we start taxing them immediately on what they are earning, so it appears to me that we have to go out and reduce taxes to restore the incentive system to the economy.

I know countless examples of businesses that I come in contact with in Idaho, small businesses that do employ high numbers of people, particularly in the potato and vegetable processing industry, where they do have a high labor-intensity to those jobs, of people who want to build new packing plants, for example, and they—in order to build a new packing plant with a small company, they have to earn $3 million to build a $1 million plant.

And with high interest rates, it becomes prohibitive. So they keep appealing to me to reduce the—"Give us a better depreciation schedule so we can build new plants." That is just one little microexample, but yet that is where jobs come from.

Ms. BERGMANN. I am in sympathy with any program which would legitimately reduce interest rates. But I think moving toward a balanced budget is very important, for the reason that I mentioned.

I would like to say something though about these people at the bottom. I think their problem is really very much separable from the employment problem, from the inflation problem. Those are really, you might call, short- to medium-term problems.

The problems of the permanent underclass, if you look at it, really comes from, I would say, two major sources—perhaps three:

One is race discrimination, so that we have people who don't have a fair shake in life and they get discouraged. And some of them go on these programs.

Senator SYMMS. Then we pass a minimum wage law and make sure they are all out of work.

Ms. BERGMANN. I am saying that is one reason we have that.

Another problem, which is largely the welfare problem, the AFDC problem, is the problem of getting support to children. And there I think we need a really good look—and we need some new incentives to—and new administrative procedures to get kids taken care of by their own parents, financially. We need a much better child support system, and then we need to look at those people who are now not expected to work, by and large AFDC mothers, and ask ought they be going to work. And of course sex discrimination, to some degree, prevents them from becoming self-supporting.

So I think the problem of the underclass, who are the target of all of these programs now, is a long-term problem of changing the institutional setup so that people become self-supporting and are expected to be self-supporting and don't have any excuse for not being self-supporting.

Senator SYMMS. Doesn't that come from jobs though? You can't create this without jobs.

We talk about reducing—if we reduce taxes—we had witnesses here yesterday that pointed out that to pass the Kemp-Roth bill, that it would really only take $10 to $15 billion in reduction in Federal budget to get the incentive started.

I think out of a $600 billion budget it should be reasonable to accomplish that. The tax cut can be—one of the witnesses said the tax cut is financed by three sources, direct reflows from the tax cut, increases in savings due to the tax cut, and reductions in Government spending. Reflows from the tax cut and savings stimulation probably account for one-half to two-thirds of revenue lost. And these are estimates that do not require great leaps of faith, as I think is the way the witness put it.

So it would appear to me for us just to stand idly by, all we are doing then is telling these underclass people, or low-income people that we are speaking about, that "There's no hope for you. We can't do anything about it. We are going to muddle along." I just can't accept that. I think we can do something about it. And we need to go back to where our strength is in this country, and that is give them an opportunity.

Ms. BERGMANN. I think we need more opportunity. Let me just point out though that a 7-percent unemployment rate, if it were evenly shared out among all of us, would not be so big and important. Say we were all unemployed 7 percent of the year, that would be 7-percent unemployment rate. The problem is concentrated on certain people, so it could be argued that the major problem is the concentration, rather than the unemployment rate per se, although I am certainly in favor of getting the rate down.

I don't think the Kemp-Roth bill would be a disaster. It wouldn't be in my preferred package. I think it would improve the demand climate. I don't think it would do much for the supply side. It would increase demand. And I think you would see the unemployment rate go down. I don't think you would thereby be moderating the inflation problem, and I think you would be kidding yourself if you thought it would be.

I am a Democrat, but I am anxious to see the economic policy of this administration succeed for patriotic reasons and for humanitarian reasons, because if we have a lot of economic distress, that is hard on everybody. It is most hard on the people at the bottom. And also, I think it puts our institutions in danger.

So, for patriotic reasons, I want this administration to succeed. And I am really telling you that the "supply side" program is not going to work against inflation.

Mr. DANZIGER. I would like to add something about jobs. If you look at my table 2, you will see that there was only a small decline in market income poverty in the 1960's. Tax cuts like Kemp-Roth, if they do increase employment, are not likely to help the hard core among the poor.

I would emphasize what Ms. Bergmann said about discrimination and other rigidities. I would much prefer to see programs which lower the cost to employers, like jobs tax credits, than cuts in minimum wages. We know that a cut in minimum wages will reduce the incomes of those below the poverty line, even if it increases the number of jobs.

But new jobs tax credits which attempt to lower the cost of labor to employers, can increase employment without lowering the wages received by workers. Even in the 1960's, when we had a high growth economy, there was a strong resistance by employers to hire these hardcore workers. Even if demand does increase now, there still is an important role for what has been called selective employment policies, policies designed to get employers to hire those hard-to-reach groups.

Senator SYMMS. I would expect the administration would come over with a much broader package than just the Kemp-Roth bill. It is going to have to take expanded depreciation schedules reduction, and I think the rate reduction on taxes is only equitable because we find middle-class families are getting tax increases that, just due to cost-of-living increases, is an unfair situation.

So we will see that, and we probably will see savings account encouragement for people to save, reductions in capital gains taxes, reductions in inheritance taxes.

I have often said the worst tax we have is the grave robber's tax. We go out here and encourage somebody to work and build up some kind of a business, and then if their inconsiderate enough to die, they take it away from them, so that they lose their interest to try to provide jobs for people by the time they reach 50, when they are just getting capable to do something. It is very, very prevalent in the farm belt, particularly.

I think we will see a broad picture and there will be, I am sure, spending cut reductions that will cause a great deal of consternation on all of us in the Congress who have pet projects that we want to see funded. I don't think we can get this accomplished without having an equally distributed package for everybody when it comes to increasing the spending. I think it is worth the effort, I think there is too much despair ahead for the future to have to make the change. I think we will probably get it done.

Ms. BERGMANN. I was looking at the economic report, which, by the way, I think is an interesting document and possibly it is a better report because President Carter lost the election. They can be a little more honest. But anyway, if you look in the back, you will see that per capita income has been increasing at a fairly decent rate. I don't really think that the economy is in all as much trouble as perhaps even the majority of the people think. We have been plugging along.

We are still very progressive. Some of our industries have some problems.

The inflation problem is—and I have to agree here with the economic report, the inflation is to a high degree psychological, rather than real. We have had losses in real income, but that has been imposed on us by the Arabs. That is not an inflation problem; that is an adverse change in the terms of trade.

Senator SYMMS. But we continue to print money. If the price of oil went up and had a fixed amount of money, the price of something else would come down.

Ms. BERGMANN. They tried that in the twenties. You have to read Professor Galbraith's book on the "Great Crash" to get an insight on that.

Senator SYMMS. I read Murray Rotherbard's and got a different point of view on the great crash and what caused it.

Ms. BERGMANN. In a sense, some of the problems we seem to have are illusory.

Senator SYMMS. I would like to thank you and our witnesses for being here with us this morning. I am sorry that Mr. Gilder wasn't here. I have another meeting to attend, so I will have to excuse myself.

Representative REUSS. I have a number of questions saved up, naturally. And if—we will see how we can accommodate Mr. Gilder.

I have some questions.

Mr. Danziger, you stated that the existing transfer payments, mainly food stamps and medicaid, are responsible for bringing the percentage of poverty people observable today down from around 10 percent of the population to 4.1 percent. I am looking at your table 3.

Mr. DANZIGER. That is mainly food stamps, medicare, but some public housing programs also.

Representative REUSS. There is nothing wrong with that, as a matter of social justice or economics or anything else, is there?

Mr. DANZIGER. No. I think the transfers are necessary.

Representative REUSS. They can't make it in the market since they are food, health, basic necessities. It isn't all that bad——

Mr. DANZIGER. I didn't mean to imply that.

Representative REUSS. I am sure you didn't. I just wanted to be clear.

I am puzzled at your table 3. If you would look at it with me, you said that that 4.1 percent of the population constituting the poor is deceptive and masks a much larger number of poor among minorities and women, something which I would have suspected and which your figures bear out.

My difficulty though in looking at table 3 is you show all kinds of people, minorities and women mainly, who are worse, who have a greater percentage of poor than the average. But nobody seems to have less except old people. Only 3 percent of the old people—that is the only group that has a lower share of poverty than everybody.

Mr. DANZIGER. My guess is there is a typo, and it may be 2.4 for white males.

Representative REUSS. That would reduce the swelling a good deal. Would you check on that?

Mr. DANZIGER. I will check on that.

Representative REUSS. It is a puzzlement as it is.

Mr. DANZIGER. The data is from a report which is not yet released by the Congressional Budget Office. I will check that.

Representative Reuss. Thank you.

Let me ask a question of either or both of you. Taking American family income in quintiles—which is what this Census Bureau traditionally does—the lowest fifth, the next lowest, and so on, I have the impression—but I would like to get correct by you—that from New Deal days, 1945, when the Census Bureau first started fooling around with quintiles, things got progressively better for the people in the lower half half of income and thus they had to get a little worse for the upper half. From 1945, that was true to about 1965 to 1968.

But since then that improving tendency for the lowest half has pretty much leveled out. And that process is not going on any longer. That is impression number one.

Impression No. 2 I have is that, at least in the last 10 years, the classes of income receivers who have taken it on the chin, relatively speaking, who have retrogressed rather than stayed even have been what you might call the lower-middle class, the second and third quintiles, particularly when you take into account transfer payments. Your 4.1 of the population figure suggests that the lowest quintile has been helped enough by transfer payments so that they have kept even.

I have given two impressions.

Mr. DANZIGER. They are both right. If you look at table 5, there is some data on the share of income received by each quintile. In the period 1965 to 1978 the share of the bottom quintile families and unrelated individuals was almost constant at about 4 percent. The increased transfers show that the difference between market income and census income was higher in the later than in the earlier year.

Representative REUSS. If you had wanted to make table 5 consistent with table 3, you would have put adjusted?

Mr. DANZIGER. That's right.

Representative REUSS. But that is not subtracting census income from market income?

Mr. DANZIGER. Adjusted adds in kind transfers to census income. There are no inkind transfers in the data in table 5.

Representative REUSS. Do you have the adjusted income? Did you add a third column?

Mr. DANZIGER. I didn't have them ready for today. I could get them.

Representative REUSS. Would you do that.

Mr. DANZIGER. Yes, I have to get the data from the Congressional Budget Office, but I can do that.

Representative REUSS. Do you recall—adjusted income it seems to me—and I would like Ms. Bergmann's thoughts on this—is a pretty good gage. After all, it is nice to have food stamps if you are hungry; it is nice to have medicare if you don't feel so good. I don't see any reason not to count those.

Mr. DANZIGER. I don't either.

Representative REUSS. If you don't get them, it isn't so nice.

Mr. DANZIGER. That' right.

The reason it is on some tables and not on others is because most of the tables are based on census data, in which inkind transfers are not reported. To get adjusted income requires a good deal of estimation. And the most recent set of estimates was prepared by the Congressional Budget Office but has not yet been released.

Representative REUSS. I commend you for doing this, and shame on the other 40,000 economists in this great land of ours who seem to be doing something else. I can't imagine anything more valuable.

Mr. DANZIGER. I think the table without the adjusted confirms your second point. If you look at the second and third quintile, their shares of census income have fallen. These quintiles for the most part do not receive food stamps and other inkind benefits.

Representative REUSS. They are both going down.

Mr. DANZIGER. Between 1965 and 1978, a sum of the shares of these two quintiles fell from 28.47 to 26.59 percent.

Representative REUSS. I feel proud of my instincts.

Mr. DANZIGER. Your instincts are right on both counts.

Representative REUSS. So you can't blame a lot of Democrats for voting for Reagan, can you—or I can't, I won't ask you. Had they had access to these figures, it might have been worse.

Ms. Bergmann, on Kemp-Roth, we are dealing, of course, with big bucks there because the revenue loss of Kemp-Roth in 3 or 4 years would be pushing $200 billion. That is not peanuts; that is one-third of the budget.

Both in its final—initial impact and in its more smashing ultimate impact, what do you envisage is going to happen to those released dollars which are going to be kept in the pockets of the people who earned them?

Ms. BERGMANN. By the way, when I said——

Representative REUSS. What are they going to do?

What diversion from the regular 4-percent-saving rate, in the direction of more saving, is there going to be?

And what do you think would be the likely increase in luxury, as opposed to other kinds of consumption?

And most important of all, what are the happy recipients of this tax reduction going to do with their savings? Are they going to put it into new plant and equipment, or are they going to bid up the price of existing land and houses and art and coins and stamps and gold and corporate rating assets, and so on? Where is it likely to go?

Ms. BERGMANN. By the way, when I said the Kemp-Roth wouldn't be a disaster, I meant the first year of it. I don't believe in the second or third year.

As I said, it wouldn't be in my preferred package. The first year, at least, would not be a disaster. I think a lot of it would go into luxury spending. Some of it might even go into investment to create plant and equipment to produce more CB radios and perhaps even more campers and fancier hiking boots and things of that sort, the things my children, by the way, clamor for.

And I would consider it somewhat immoral to divert part of our national income from goods and services for the poorest people to luxuries for even the lower-middle class, the upper-middle class and, of course, the wealthy.

The table I have shows the extent to which cuts in business taxes would redound to the benefit of the really small group at the top, so that, obviously, this would be a diversion.

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To come back to an earlier point, when you said that through 1968 the bottom class had improved itself—I think the way the improvement was made was, to some extent, through throwing money at them. It is better—it was better, I think, to throw money at them than to do nothing, because they were in very great distress and certainly it was good to get them into a medical care system.

But I would like to underline the idea which Professor Danziger has given out. The way to make further improvement is not to simply throw more money at them, but to try to develop programs which make them self-supporting.

As I said, I thought the problems of this class—two of the huge problems were racial discrimination and sex discrimination in employment, and also the problem of child support.

I don't know how much progress we can make on discrimination on employment in the next 4 years. I hope we can make some through the courts. Perhaps we can make some progress on reducing the burden on the taxpayer of children of separated parents. This might be the time to do that.

Representative REUSS. Looking at the general outlines of the administration's economic program as we now perceive it—particularly after the testimony yesterday of Treasury Secretary Regan and David Stockman—is it not likely that the enactment of that program would continue and accelerate the downward trend in the shares of the national income of the second and third quintiles? Those are the two of the five quintiles which in the last 15 years have gone downhill.

Ms. BERGMANN. I don't think there is any question about that.

Representative Reuss. Isn't the downhill tendency going to accelerate under a program which includes an important increase in military spending, a tax reduction program, the major element of which is Kemp-Roth, where some 50 percent of the benefits go to those making $30,000 a year and more and some 25 percent goes to those making $50,000 a year or more; and a reduction in expenditures including some reductions in social expenditures; and finally, an attempt to make Federal Reserve monetary policy tighter than it has been and, thus, interest rates higher than they otherwise would be?

Is not such a program almost remorselessly designed to clobber the unhappy occupants of the second and third quintiles?

Mr. DANZIGER. I think at best, in some longer run, we might get back to the income distribution situation where we now are. The short-run effects are obvious: Increased income to those in the higher brackets and reduced income to those in the lower brackets.

Ms. BERGMANN. I think, also, the reduction, the Kemp-Roth tax cut and also the business tax cut, will place an increasing percentage of the revenues raised on the social security tax, which is extremely regressive.

The heavy increase in that tax has been very significant—is a very significant part of the responsibility for making those people worse off.

And to the extent that the tax reductions come in the form of reductions in the personal income tax, rather than reductions in the social security tax, the problem worsens. I don't even think we ought to call it "social security tax." We ought to call it "payroll tax." There are many possible ways of financing social security.

Representative REUSS. In fact, let me ask, first, let's have a ballpark estimate of the income brackets we are talking about today for the first, second, third, fourth, and fifth quintiles. I know generally, from zero to $8,000.

Mr. DANZIGER. The midpoint is about $22,000 or $23,000, about half of the families are below.

Representative REUSS. The middle quintile would be $18,000 to $29,000, and the second about 9 to 18?

Mr. DANZIGER. That is a rough guess.

Representative REUSS. Is that not your recollection, Ms. Bergmann? Something like that.

Ms. BERGMANN. I defer to a more expert colleague.

Mr. DANZIGER. I think that would be right.

Representative REUSS. The social security payroll tax is almost fiendishly designed to clobber the second and third quintiles. I am not accusing designers in Congress of having had that in mind, but they couldn't have done a better job, could they, of murdering them, and being kind to people who don't work in the first quintile part of it, and the fourth and fifth quintiles, because the income base is cut off at about $28,000 right now, which is almost exactly according with this group.

Mr. DANZIGER. I could add one thing to that. The second and third quintile is also the group most likely to have a spouse working, and so there are often two earners paying social security tax in that range.

Representative REUSS. You are telling me something else that is interesting that I didn't know. Is that true, the second and third quintiles are the big breadwinner quintiles?

Mr. DANZIGER. There have been substantial increases lately in the percentages of wives in those quintiles working.

Representative REUSS. You say all of the ones in the fifth——

Mr. DANZIGER. There are increases of women working in all quintiles. I would point out that a family with two earners earning $20,000 each now will pay more social security tax than a family with one person earning $40,000.

Representative REUSS. Do you have figures to bear this out to add to your testimony?

Mr. DANZIGER. I could add that.

Representative REUSS. Welcome, Mr. Gilder. You have had the usual problems with the Shuttle?

Mr. GILDER. Yes.

Representative REUSS. Ms. Bergmann and Mr. Danziger, you may, if you wish, excuse yourself. If you're happy sitting where you are, then please suit yourself.

Mr. Gilder, we are delighted to have you. You have a prepared statement which will be received in full in the record, and would you now proceed. Unfortunately, some of my colleagues who were here had to go, but I am most happy that you are able to be with us.

STATEMENT OF GEORGE GILDER, PROGRAM DIRECTOR, INTERNATIONAL CENTER FOR ECONOMIC POLICY STUDIES, NEW YORK, N.Y.

Mr. GILDER. I apologize for my hour-and-a-quarter sitting on the ground at La Guardia.

I think the major goal of the economics associated with the Reagan administration is to replace a static concept of income distribution with a dynamic of opportunities and incentives. We want to redistribute incentives, rather than redistributing income. The very word "distribution" connotes a centralized system in which a predetermined fund of income is distributed or doled out from above. The implication is that more equal distributions are somehow preferable, and yet I think it is this very distribution mentality that is at the root of our economic problems today.

In static terms, after all, the distribution became far better, in some sense, during the 1970's. Welfare programs became more generous. Taxes became more progressive. Both rose far faster than inflation did. Inflation, meanwhile, tended to destroy the wealth of the upper brackets, decimating the real values of stocks and bonds, but left untouched the indexed incomes and in-kind benefits of welfare and social security recipients.

Social security, of course, was double indexed to the CPI for a while, and the CPI itself doubly registers inflation, since it includes the inflation premium in interest rates.

The middle class tended to keep its income intact during the 1970's through their ownership of housing, with its many tax benefits in an inflationary period, and though the increasing value of their hyper-indexed social security entitlement. Some analysts even declared that during the 1970's we abolished poverty, inasmuch, including transfer payments and in kind benefits, you can show that only 6.4 percent of the population remains under the poverty line.

This, of course, is baloney, as anybody who visits any poverty communities can readily discover. Income redistribution did not abolish or alleviate poverty. As a matter of fact, the "war on poverty" halted in its tracks an ongoing improvement in the lives of the poor and left a wreckage of broken families and broken communities which it will take decades to retrieve.

Since the launching of the so-called war on poverty in 1965 with all of its welfare rights programs and entitlement extensions, the rates of family breakdown, work force withdrawal, teenaged unemployment, crime, and other indexes of real privation mostly more than doubled among the big-city poor that were the focus of redistribution. Most tragic of all, 60 percent of black children are now brought up without fathers in the home, compared to 18 percent of the white children, and that represents substantially more than a doubling of those statistics of family breakdown among blacks during that period.

So the redistributory programs which did improve a static measure of the distribution of wealth and income during the 1970's, at the same time intensified, perpetuated and exacerbated poverty. Excessively high and progressive tax rates, on the other hand, tend to impoverish the whole society by retarding the entrepreneurial creativity that is the prime source of new wealth. Progressive tax rates don't redistribute income, it should be understood. They redistribute taxpayers. They drive taxpayers out of the active economy and into tax shelters and tax havens in other countries, and into consumption and away from investment.

Under conditions of stagnation, moreover, Government spending and taxation tend to increase as a proportion of GNP. So with the investments and productive activity and potential earnings of the rich redistributed out of the system, the middle class with its immobile earnings has to pay more taxes. And that is what tends to happen, as progressive tax rates increase, as they did throughout the 1970's, through the phenomenon of bracket creep. And so with vast effect of inflation on the real impact of taxes on unearned income, taxes on unearned income rose to a real level of some 200 percent, during many periods if adjusted for inflation.

This process means that the immobile middle class has to face steadily rising tax burdens. This, of course, provokes the middle class to rebel, and so you have tax rebellions. Then if the response to that rebellion is to cut taxes for the middle class alone, the system becomes still more progressive, and the problem may even be exacerbated.

In any case, the result has been that less money is collected from the rich and more from the middle class all in order to sustain social bureaucracies that keep the poor in a condition of dependency and extend poverty into future generations.

The Reagan policy will focus not on redistributing money but on expanding incentives and opportunities. Although the immediate effect on the distribution of incomes may be regressive—I don't know that it will, but it could conceivably—the distribution of prospects and potentialities will be vastly improved. The result will be a more open economy, with more rich people, less real poverty, and better prospects for all Americans.

These benefits, however, depend on maintaining all three themes of the Reagan policy; halting the growth of transfer payments, welfare payments, and other counterproductive Government spending; retrenching tax rates on all forms of personal income, with adamant resistance to any further efforts to increase so-called progressivity; and continued maintenance of monetary restraint.

Above all, we must avoid the approach recently followed in England, which has a distribution of income worse than our own, according to the static measures. That is, monetary restraint is measured by M-1 and the monetary base, combined with expanded Government spending, higher taxes on individuals, but targeted supply-side tax cuts for businesses. The European experience, particularly in Britain and Sweden, conclusively refutes all claims that opportunity and productivity can be enhanced with depreciation reforms, investment credits, and special incentives for contractual savings, while tax rates on personal income remain exorbitant.

The United States needs depreciation reforms, but economists who believe that corporate tax cuts and credits alone will suffice to revive the economy, must explain why Britain stagnates, despite 100 percent 1-year depreciation, much lower corporate tax rates, and Sweden declines, despite the lowest levels of corporate taxation in Europe.

The international evidence suggests that low marginal tax rates on earnings foster a more equal distribution of income, even in static terms of Gini coefficients, than do direct programs of redistribution. Asian countries like Taiwan and Japan, with marginal tax rates approximately one-half the U.S. levels on comparable incomes, show extraordinarily equal distributions of income.

Excessive welfare benefits and excessively progressive income taxation produce a stagnant economy, in which the established rich keep their position by exploiting tax shelters, the middle class pays the tax, while the creation of new wealth is stifled by high marginal tax rates on real income and capital gains. Incidentally, even after the Steiger amendment reducing the capital gains top rate to 28 percent, the Government still collects more than 100 percent of all of the real capital gains net earned in the economy, which is quite an amazing fact produced by the reality that most capital gains are nominal rather than real under current conditions.

So the key to reducing inflationary pressures and expanding the distribution of opportunities and incentives in America is enactment of the 3-year Kemp-Roth 30-percent cut in personal tax rates, combined with retrenchment of the confiscatory inflated rates on so-called unearned income and with judicious reform and simplification of depreciation rules.

The chief function of this program will be to make the rich pay more taxes and make the economy work better and relieve poverty.

[The prepared statement of Mr. Gilder follows:]

Prepared Statement of George Gilder

A major goal of the economics associated with the Reagan administration is to replace the static concept "distribution of income" with a dynamic of opportunities and incentives. The word "distribution" connotes a centralized system in which a predetermined fund of income is "distributed"—or doled out from above—to a subject citizenry. The implication is that more equal "distributions," however accomplished, are preferable to "distributions" that correspond better to the variety of human performance in the economy. The further implication is that the economy is a zero-sum game, managed by government, in which one man's gain is likely to be another's loss. To the extent that such a zero sum concept is promoted in policy, it fosters a bitterness and factionalism that is inimical to capitalist creativity and stifles the expansion of opportunities and incentives for creation of new wealth.

The distributionist mentality is at the heart of our current economic distress. In static terms, the distribution of income and wealth became more equal during the 1970s. In the idiom favored by distributionists, welfare programs became more "generous," taxes more "progressive," and both rose far faster than inflation. Inflation, meanwhile, tended to destroy the wealth of the upper brackets, decimating the real value of stocks and bonds, but left untouched the indexed incomes and in-kind benefits of welfare and social security recipients. Social security, in fact, was double indexed to the CPI for several years in spite of the fact that the CPI itself registers inflation twice, by including the inflation premiums in interest rates.

The middle class tended to keep its income intact during the 1970s through their ownership of housing, with its many tax benefits in an inflationary period, and through the increasing value of their hyper-indexed social security entitlement. With welfare becoming more generous, with taxes more progressive, and with the rich as the prime victims of inflation, the 1970's were a golden age of redistribution. Some analysts even declared the abolition of poverty, as only 6.4 percent of the population remained under the poverty line if transfer payments and in-kind benefits were tabulated in their incomes.

The fundamental misconception of the distribution mentally is manifest in these poverty statistics. As Joseph Sobran has written, real poverty is a matter not of income but of prospects. Redistribution improves the incomes but destroys the prospects of the poor. Since the launching of the so-called "War on Poverty" in 1965, the rates of family breakdown, work force withdrawal, teenaged unemployment, crime, and other indices of real privation all more than doubled among the big city poor that were the focus of redistribution. Most tragic of all, 64 per cent of black children are brought up without fathers in the home, compared to 18 percent of white children.

What in fact occurred during this period was a vast expansion of redistributory programs that halted in its tracks an on-going improvement in the lives of the poor. By destroying the man's role as provider, so-called "generous" welfare benefits tend to cause family breakdowns, retard work effort, and spread demoralization. Far from abolishing poverty, redistribution tends to intensify and perpetuate it.

Excessively high and progressive tax rates, on the other hand, tend to impoverish the whole society by retarding the entrepreneurial creativity that is the prime source of new wealth. Progressive tax rates don't chiefly redistribute income; they destroy income and redistribute taxpayers. Taxpayers move out of the productive economy and into tax shelters or overseas tax havens. They consume more and invest less. They make less money that way, thus presumably pleasing the distributionists, but they also create fewer jobs and less wealth for the entire economy.

Under conditions of stagnation, moreover, government spending and taxation tends to increase as a proportion of GNP. With the investments and potential earnings of the rich redistributed out of the system, the less mobile middle class has to suffer a rising tax burden. This is the dead end of the redistributionist program. Less money is collected from the rich and more from the middle class, all in order to sustain social bureaucracies that keep the poor in a condition of dependency and extend poverty on into future generations.

The Reagan program will focus not on redistributing money but on expanding incentives and opportunities. Although the immediate effect on the distribution of incomes may be regressive, the distribution of prospects and potentialities will be vastly improved. The result will be a more open economy, with more rich people, less real poverty, and better prospects for all Americans.

These benefits, however, depend on maintaining all three themes of the Reagan policy: halting the growth of transfer payments, welfare programs, and other counterproductive government spending; retrenching tax rates on all forms of personal income, with adamant resistance to any further efforts to increase so-called "progressivity"; and continued maintenance of monetary restraint. Congress must support all three themes of policy.

Above all, we must avoid the approach recently followed in England: monetary restraint as measured by M-1 and the monetary base, combined with expanded government spending, higher taxes on individuals, and so-called targeted supply-side tax cuts for business. The European experience, particularly in Britain and Sweden, conclusively refutes all claims that opportunity and productivity can be enhanced with depreciation reforms, investment credits, and special incentives for contractual savings, while tax rates on personal income remain exorbitant. The United States needs depreciation reforms (if they are not skewed in favor of real estate tax shelters). But economists who believe that corporate tax cuts and credits alone will suffice to revive the economy must explain why Britain stagnates despite 100-percent 1-year depreciation and Sweden declines despite the lowest levels of corporate taxation in Europe.

The international evidence suggests that low marginal tax rates on earnings foster a more equal distribution of income, even in static terms of Gini coefficients, than do direct programs of redistribution. Asian countries like Taiwan and Japan, with marginal tax rates approximately one half the U.S. levels on comparable incomes, show extraordinarily equal distributions of income. Excessive welfare benefits and excessively "progressive" income taxation produce a stagnant economy in which the established rich keep their position by exploiting tax shelters, while the creation of new wealth is stifled. High marginal tax rates on real income and capital gains constitute a government protection act for established wealth against new wealth.

The key to reducing inflationary pressures and expanding the distribution of opportunities and incentives in America is enactment of the 3-year Kemp-Roth 30-percent cut in personal tax rates, combined with retrenchment of the confiscatory inflated rates on so-called unearned income and with judicious reform and simplification of depreciation rules. This tax program will make the rich pay more taxes. It will increase the proportion of taxes paid by the top earners by increasing their numbers and diverting their investments from tax shelters into the taxable economy.

Representative REUSS. Thank you very much, Mr. Gilder.

I'm going to read to you a number of statements you've made in your writings, including your new book, "Wealth and Poverty," which is, rightly, stirring up a good deal of interest, and ask for your comment on it.

The first statement has to do with transfer payments and military spending, and I quote from you:

Although transfer payments have significant inflationary effects, the European experience tends to suggest that defense spending has a larger effect on price, because it competes for scarce resources and manpower and pours money into the economy without producing marketable goods.

Incidentally, I'm not reading these statements of yours to scowl at them. I think they are good.

My question, based on that statement of yours, is this: In the testimony you have given this morning, you have detailed the difficulty you have with endless transfer payments, and you have made your case very strongly; however, it seems to be true that military spending is even more inflationary and, therefore, to the extent that we spend militarily any more than needs to be spent for our national security, that hurts capital formation and constitutes a real tax on investment, does it not, just as excessive inflation-causing transfer payments would do more so?

Mr. GILDER. I think the defense spending is more inflationary in several ways. Most significantly, it competes for the most valuable personnel in the economy, the highly trained technical personnel which private business now is intensely competing for itself, for civilian purposes. Nonetheless, of course, defense spending is indispensable, and must be maintained, if we are to have any economy at all to defend.

But there is no question that the need to increase defense spending imposes greater strains on the economy and makes it more difficult to repress inflationary pressures. There is no question about that. It is as inflationary as anything we do in the economy. However, during the Eisenhower administration we had far higher levels of defense spending as a proportion of GNP and managed to prevent the kind of price rises that we are experiencing. There is no question that it is a major problem.

Representative REUSS. Starting from the unfortunate base of underlying inflation from which we start, 9 or 10 percent, or whatever, a big increase in military is more likely to present inflation problems than was the case in the relatively tranquil noninflationary Eisenhower period. And thus, whatever we do about military spending, we are going to have to take more drastic steps than we otherwise would take to keep the overall inflationary indexes down.

Mr. GILDER. That's correct.

Representative REUSS. Let me read another statement of yours:

The United States, through nominally private but heavily regulated insurance schemes and subsidies spends almost twice as much per capita on health care as in Great Britain. U.S. health care spending is probably a greater burden on the economy than Britain's national health.

Another provocative statement. Doesn't it suggest that our present health care and delivery system is a disaster, and it needs to be remodeled? This isn't a senimar on medical economics, and I'm not going to ask you to go into detail, but that which we do now certainly can't be defended, can it?

Mr. GILDER. I think it does need significant reforms. I am not an expert on health care reform, however. My crucial point is that the idea that we have a smaller burden of Government spending than

European economies do, is erroneous, that, in fact, we do have a smaller burden than most of these European economies only if nationalized medicine is included. And I believe that the American medical system, heavily regulated and heavily subsidized, has an impact on the economy very much the same as the nationalized system in Germany or England. And as a result, to say that Germany has some 40 percent of its GNP taken by the public sector—is deceptive, because if we include our private medical insurance systems which have virtually no role in capital formation, operating almost precisely as transfer agencies, we have just as large a level of spending for those public purposes as Britain, Germany, and France do.

In other words, you can't point to these economies and say that we could increase our transfer payments and Government spending to their levels, without grave damage to the future of our economy.

Representative REUSS. A third statement of yours, which I find hard to refute, has to do with housing:

> While 24 million investors in the stock market were being buffeted by inflation and taxes, 45 million homeowners were leveraging their houses with mortgages, deducting the interest payments on their taxes, and earning higher real returns on their down payment equity than speculators in gold or currencies. American citizens had found a way to invest even if the Nation's capitalists did not.

You, there again, have said something very needing to be said. What you are saying there is that, on balance, we as a nation, by reason of our various policies on inflation and taxation, have diverted capital investment from real plant and equipment to homes.

Mr. GILDER. In vast quantities.

It is interesting, however, to see the effects of the so-called Kennedy tax cut of 1964, which is designed very like the Kemp-Roth tax cut being proposed today. I don't have the figures exactly right, but I think the proportion of investment spending that went to residential real estate was about 58 percent before the tax cut, with about 18 percent going to business fixed investment. After the tax cut, those figures reversed themselves, with 60 percent of capital spending going to business investment and 20 percent or something to residential real estate, so that the cuts in personal income taxes of that dimension can have a direct and immediate impact on those crucial proportions and is a very effective way of dealing with this problem, which is a very serious—I think it is virtually our most serious problem.

The United States spends three times greater proportion of its savings on housing than Japan does, despite the fact that Japan had a faster growing population during the 1970's. And it has eight times greater proportion of its spending on housing than do European countries.

It is not that we haven't been saving enough, it is just that most of our savings have gone into the purchase of residential housing. It is a ridiculous way to run an economy if you have other purposes. And we now give 100 percent capital gains exemptions for housing and rollovers and allow people to deduct the inflation premiums in the mortgage interest rates.

There is no consideration of imputed rent. We have endless benefits for the residential housing industry. And people aren't dumb, so all of their money has been going into residential housing and our economy has been impaired as a result.

I think this is really a serious problem. And if in our current predicament we respond to trouble in the residential housing market by channelizing more capital into it, we will severely damage our hopes for a stable and productive economy. We can't really meet our capital crisis if we continue directing most of our capital into residential real estate, often not even improving its real value—by tax devices, inflating its value. It really is a crucial problem.

Representative REUSS. Are you talking about residential real estate, homes across the board? Or are you talking about residential real estate at higher levels? I should think the latter, because only the top 15 percent of income receivers tends to itemize their deductions and thus to take deduction from Federal income tax with interest paid on mortgages.

Mr. GILDER. Is that right? I don't know what that figure is. Everybody who owns a house, however, does benefit from the increasing capital value of it. Even if they don't get income tax deductions always, they do benefit from the rising capital value of the house that results from all of the special tax benefits associated with housing. They also benefit from rolling over the capital gain on the house when they move. So most people do benefit from the increasing value of housing in one way or another.

It is just that in the long run the value of these houses has to be sustained by the value of our businesses and their productivity. And to the extent that productivity doesn't increase, these housing values will be subject to real decline.

Another problem is the use of various real estate projects as a tax shelter. And of course they are one of the primary tax shelters, again because of all of the special tax benefits that the construction industry receives. That is another serious distortion in the economy. When talking about savings, it is important not to just treat the aggregate amounts, as if the chief problem in our economy is inadequate capital formation in some aggregate sense, rather than distorted capital formation as a result of poorly conceived laws.

England has more capital formation than we do, at a higher rate—quite a lot higher rate of savings. It all is insulated in existing corporate structure, because they have all of these special benefits for existing corporations, 100-percent depreciation. And they have confiscatory tax rates on personal income, so nobody can get out of the existing tax structure. You have no entrepreneurship out of the existing corporate structure, so you have no entrepreneurship and investment creativity. And the economy declines.

The same way with Sweden. You can't have capitalism without capitalists. The idea that by giving all sorts of tax—targeted, supply-side tax cuts to businesses, but prohibiting the accumulation of personal income, you can have a dynamic economy, is refuted by the experience of the most stagnant European economies, all of which have tried it, and by the simultaneous experience of Asian economies—particularly Japan—that have marginal tax rates on personal income, about half ours at comparable levels, but have depreciation rates that may well be less generous than ours are.

So the targeted, supply-side alternative to enhance productivity as an alternative to Kemp-Roth is futile. If you don't combine it with personal income tax cuts on marginal tax rates, you won't get any productivity gains I don't think. You will get maybe some—depreciation changes will improve the capital structure to some extent. But the international evidence doesn't sustain the idea that the gains will be nearly as great as from broadly based cuts in marginal rates.

Representative REUSS. On homes—having identified better than average housing as a leading shortstop or a savings that otherwise would go into industrial plant and equipment, which is very much needed, having made that identification, what steps, tax or otherwise, would you advocate for changing?

Mr. GILDER. I think the chief thing to do is, again, what I have said to begin with, is Kemp–Roth. Beyond that, I think cuts in the capital gains tax on equities is important. The problem is the relationship between the tax conditions imposed on housing and those imposed on investment in corporations or small businesses.

And now, because of the 100-percent capital gains tax exemption for all sales of houses by residents over age 55 and because of the rollover factor, you can avoid capital gains entirely just by rolling over your current capital value into another house.

Representative REUSS. You would repeal the rollover?

Mr. GILDER. I prefer cutting taxes, as opposed to imposing new taxes. I would extend it to equities.

Myself—my own judgment is that benefits for housing are excessive. And changes in them that reduce the attractiveness of housing investment relative to other investments would be beneficial to the economy, whether it is restricting the rollover or whatever.

However, the crucial point is to reduce the taxation on equities rather than to increase the taxation on anything else in the economy. I think our economy is overtaxed as it is. I think you can reduce this distortion by eliminating the situation where more than 100 percent of all of the real capital gains earned on equities goes into capital gains taxes. That is quite an extraordinary situation after the major cuts that were achieved just 3 years ago.

Representative REUSS. You would not change then the present deductions for interest payments on mortgages?

Mr. GILDER. I'm not sure. I think I would, yes. I think I would.

I think, first of all, that taxes on unearned income from savings are just vastly too high, so that the real tax rate on unearned income is often over 100 percent and sometimes over 200 percent, as Alan Blinder testified before this committee a few months ago. He even found some rates that were over 300 percent, adjusted for inflation. This is a ridiculous way to tax.

The current situation is you have these exorbitant rates on interest income and complete exemptions on interest payments. The result is the kind of distortion which we see today.

My absolute top priority is cutting the marginal tax rates on personal income, both earned and unearned. And I don't want to imply that it would be good for the economy to impose more taxes on housing without a radical change in the taxes on personal incomes.

Representative REUSS. The lack of likelihood could be due to immunity rather than judgment.

But let's get back to economics. You say, first of all, as your statement so well set forth, above-average housing is shortstopping vast amounts of the Nation's savings, which would otherwise be headed toward new plant and equipment, which is what we really need. I couldn't agree with you more.

Your second point is that rather than alter the tax and other factors which are made by this shortstopping, you would enact a Kemp-Roth-type bill, which gives the major part of its tax reductions to those over $30,000.

That is what the Congressional Budget Office tells us, about 50 percent of Kemp-Roth benefits would go to those making more than $30,000 a year. As Charls Walker said yesterday, those are the people who are not as likely to spend that in consumption as people in lower brackets. Therefore, if you want to get more savings, that is what you have to do. And who am I to quarrel with that?

At any rate, if I could just make my point, if your attack on this housing shortstop problem, as you have so well delineated it, is by the prompt enactment of Kemp-Roth or something like it, aren't a lot of those people confronted by horrendously high interest rates brought about by the additional budget deficit, among other things? Aren't they likely to want to and have to use a lot of the new dollars they find in their pockets as a result of Kemp-Roth for buying still more luxury housing, and thus making it even worse and making everything you said in that excellent quote I read even more true.

Mr. GILDER. As I said earlier about the impact of such tax cuts, year after year in Japan and in 1964 in the United States, the result is exactly the opposite. The effect, as one sees, is to increase personal savings and to reduce consumption spending of all kinds, and to move investment out of real estate and into capital spending. This is quite a dramatic effect.

The reason for it is that each marginal tax rate deters saving twice. It deters you from earning the additional dollars that you are most likely to save in the first place. And then it deters you from savings. And because of that, cuts in marginal tax rates impart a double stimulus to savings and only a single stimulus to consumption.

This is why, historically, tax cuts in marginal tax rates have always had the opposite effect from the one that you describe and why Japan, during the years that it was cutting its marginal rates, almost every year increased its savings from 16 percent to 23 percent of its GNP, while the United States, with its steadily increasing marginal tax rates, went in the other direction and at the same time stimulated this vast retreat into housing to avoid high marginal tax rates on income, income from investments.

Representative REUSS. We will see. I think probably Kemp-Roth will be passed. When I see you in a couple of years we will see who is right.

But let me just record myself as saying you might be surprised. You might find that all of these high flyers who are buying these overbig houses under the present law and glory in their capital gain exemptions and their $100,000 once-in-a-lifetime exemptions, and in the deductibility of their mortgage payments, are going to take even more joy after Kemp-Roth in over investing in luxury homes. Let's see what happens.

Mr. GILDER. The alternative is for the Government to keep this money. I just don't see the evidence for this fear.

The crucial message, I would say, is really to scrutinize tax rates and the tax structures and the results in other countries and in the United States over the last 50 years. And when you do that, you just don't find this evidence of the inflationary effect of tax cuts, while you do find that in the United States taxes have been increasing 80 percent faster than inflation for the past 10 years.

It is hard for me to see how further tax increases can be anti-inflationary when, in general, taxes have been rising so much rapidly than inflation. We have reached the end of that line. It doesn't work.

There is lots of evidence that cuts in marginal tax rates can have very beneficial and positive and even short-term impact on the economy. Even the advocates of these cuts don't understand the short-term impact. They keep speaking of Kemp-Roth as immediately releasing great surges of productivity throughout the system. I don't think that happens right away. The first thing it does is it moves money out of tax shelters and into productive investment. It is an automatic and immediate effect. You cut 10 percent in the top brackets, particularly a cut from 70 to 50 in the unearned income rate, and you immediately render unprofitable thousands and thousands of tax shelters that have been contrived across the economy.

You've reduced the need for corporations to spend increasing amounts of money on lawyers and financial specialists. You've reduced the preoccupation of lots of the most ingenious and best educated financial talent in the country, contriving ways to subvert the economy rather than to promote it. There are all sorts of immediate effects from reducing tax rates that now are over 100 percent after inflation on unearned income.

It is a bizarre, ridiculous, indefensible system, as I think Jimmy Carter might have said once upon a time, although not understanding quite why.

Representative REUSS. Thank you. Do either Ms. Bergmann or Mr. Danziger have anything they would like to add?

Ms. BERGMANN. I have to agree with Mr. Gilder on the tax shelter business. Of course, one suggestion might be for getting rid of some of the tax shelters. Another possibility, which I find somewhat intriguing, is moving toward a consumption tax, perhaps with exemptions at the lower end to make it somewhat progressive. That might have the same effect. On the whole, I think just taxing capital gains at the same rate as other income would get rid of a lot of the tax shelters and perhaps that could be done through an expenditure tax or through the regular tax system.

Mr. DANZIGER. I would like to make one comment about the distribution of income and comparisons between here and particularly some Asian countries. One of the reasons I think we have such a high need for transfers is because we have a very unequal distribution of wages. One of the reasons Japan has a much lower need for transfers is that they have a different kind of employment system with a very much compressed distribution of wages.

I think if we had policies which could reduce inequality in wages to the kind of level that exists in Japan, then there would be reduced need for transfers. The problem I see is that an immediate policy to reduce transfers that does nothing to change the kinds of wage structures we have, would lead to a very large increase in the problems of people at the bottom.

Representative REUSS. Ms. Bergmann, Mr. Danziger, and Mr. Gilder, thank you very much for being with us here this morning. The committee will recess until tomorrow morning.

[Whereupon, at 12:20 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, January 29, 1981.]

THE 1981 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 29, 1981

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. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss and Richmond; and Senators Jepsen, Bentsen, and Sarbanes.

Also present: James K. Galbraith, executive director; Bruce R. Bartlett, deputy director; Louis C. Krauthoff II, assistant director; Richard F. Kaufman, assistant director-general counsel; and Keith B. Keener, Deborah Matz, Michael Nardone, Mark R. Policinski, and Timothy P. Roth, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good morning. The Joint Economic Committee will be in session for further hearing on its annual report.

This morning we are going to talk about the differences between the Sun Belt and Frost Belt States.

Let me interrupt myself to welcome to the committee a splendid new member, Congressman Fred Richmond of New York, who has just joined us and, on the eve of his appointment, is setting a marvelous attendance record.

Representative RICHMOND. Thank you, Mr. Chairman. I'm indeed happy to be here and I hope to work very closely with you.

Representative REUSS. You will find our Vice Chairman Jepsen a marvelous person to work with, too.

Representative RICHMOND. Mr. Chairman, if you say so, he must be.

Representative REUSS. As I was saying, we have a little conflict going on between the Sun Belt and Frost Belt and, in this war, I hope that peacemakers will shortly appear and their names, when they do appear, will be blessed because we don't really need in this country an Alberta-Ontario kind of driving apart; which, in some quarters at least, seems to be going on.

Of course, we had as large-scale population movements in the last two decades as we have had during the entire history of the Republic. We have seen a tremendous southerly and westerly shift in jobs, population, and income from the Northeast and Midwest to the South and West. Some 2.5 million more people moved out of the

North than moved into it during 1970 to 1977 alone, and while nonfarm employment grew by 45 percent in New England and 53 percent in the Great Lakes region between 1950 and 1977, employment in the Mountain States grew by 186 percent and in the Pacific States by 155 percent.

The growing regions have frequently offered employees lower wages. They have provided plentiful land and lower taxes. Individuals have been lured by employment opportunities as well as by a perceived higher quality of life, warmer weather, less crowding, lower crime rates.

Notwithstanding their contrasting appearances, older and newer regions do share some common problems. Both are adjusting to changes in size and composition of their populations. Local governments in the older and colder regions suffer the effects of reduced tax bases while newer regions struggle with overcrowding, large concentrations of individuals living in poverty, and inadequate public facilities.

Frequently Federal policies have encouraged the natural economics of migration toward the Sun Belt: Tax policy that encourages new construction rather than rehabilitating; and water policies which have made possible the good life in much of the South and West.

The Federal Government cannot and should not attempt to reverse current trends. What it can do is to examine our Federal policies for implicit regional bias, and when found, reduce that bias.

The recent report by the President's Commission for a National Agenda for the 1980's did not seem to recognize this important role of the Federal Government, the need to provide regional balance. The report instead suggests that balance is illogical and that only the Sun Belt holds economic hope for the Nation and its people.

In recommending Federal neutrality, the report is in reality urging a do-nothing approach to resolving regional conflict. Balance requires carefully tailored policies to meet diverging needs while fostering growth.

The Commission report is also discouraging toward the creation of a national urban policy, the articulation of which was one of President Carter's major accomplishments. Without a national urban policy, urban programs will remain uncoordinated, fragmented, and duplicating, and will continue to attempt to meet the diverse needs of our cities in a hit or miss fashion.

As I say, the Joint Economic Committee approaches this problem from a point of view which believes that conflict is not necessary, that differential rates of growth have been true in our country from the beginning and if humanely managed can be accomplished with a minimum of displacement and suffering.

It's significant that the members of this congressional panel include people from both Sun Belt and Cold Belt and so it is with the panel of expert witnesses before us: Bernard Weinstein of the University of Texas at Dallas who was instrumental in the report on the eighties; Felix Rohatyn of New York, a familiar and welcome figure before this committee who is a fierce contender for the rights of the Cold Belt; and finally, Mayor David Rusk of Albuquerque, a Sun Belt city which, however—if I may preempt the mayor's testimony—is not without its problems.

So with the hope that something can be accomplished by a cooperative approach, we are going to conduct this hearing.

Let me call now on our distinguished vice chairman, Senator Jepsen.

OPENING STATEMENT OF SENATOR JEPSEN, VICE CHAIRMAN

Senator JEPSEN. Thank you, Mr. Chairman.

In recent years we have been hearing much about how the Federal Government is responsible for the economic decline of the industrial Northeastern part of the United States. It is alleged that the Northeastern States in general get back substantially less Federal spending per dollar of Federal taxes paid, while the Sun Belt States of the South and West get substantially more in Federal spending than they pay in taxes. Thus, the Federal Government is taxing the Snow Belt while subsidizing the Sun Belt.

The Federal Government has been urged to reverse this system by pumping money into declining Northeastern industries, like autos, steel, and textiles.

On the surface, there appears to be a persuasive case for the arguments made by representatives of the Snow Belt States. But when one looks below the superficial evidence, the case seems to collapse. The data which supports the Snow Belt case, for example, assumes that all of the corporation taxes paid by a particular corporation are paid by the residents of the State in which the corporation has its headquarters. The implication is that the people of Michigan, for example, pay all of General Motors' taxes. At the same time, the data show all the benefits of a particular defense contract going to the residents of the State where the headquarters of the prime contractor is located. However, a recent study done for this committee shows that ultimately much of this money ends up back in the Northeast via subcontracts.

There also appears to be a lack of attention paid in much of this debate about regional growth and decline to factors within the various States which encourage or discourage development. The declining States of the Northeast by and large tend to have heavier burdens of Government regulation and taxation than those in the Sun Belt that are prospering. Texas, for example, has no State income tax on individuals or corporations. You might ask is it any wonder, therefore, that the Texas economy is booming?

I know that some may concede these facts but argue that the Northeast is locked into a vicious downward cycle in which economic decline breeds poverty which prevents the States from making cuts in spending which cause taxes to be increased on a smaller tax base. But the example of Northeastern States like Massachusetts, which just a few years ago was sometimes called Taxachusetts, disprove this notion. Since Governor King began reducing the tax burden, cutting back on spending and regulation, the Massachusetts economy has begun to turn around. And even New York has clearly benefited from its meager efforts at tax cutting, although it remains the most heavily taxed State.

I look forward to examining these issues in more detail. Thank you, Mr. Chairman.

Representative REUSS. Thank you, Senator Jepsen.

Senator Bentsen, do you have a statement?

Opening Statement of Senator Bentsen

Senator Bentsen. Since I feel rather strongly about the issue, I might comment briefly in saying that I'm deeply concerned about a rivalry building up that looks like it might help balkanize this country in the way of regional conflict. We have always seen change and we will see people continue to move. It would be wrong to assume that we want them all to move to Texas, because we don't. I can drive down my freeways in Houston and Dallas at 14 miles per hour choking on the fumes of the cars ahead of me, and we are not resolving all of those problems as quickly as we would like and we have some serious ones.

Mention was made of poverty in some of these areas and I happen to know the per capita income in the United States and in south Texas, so we too share these problems. We come to the question of who gets the most of the Federal revenue. It depends on which set of figures you want to choose. You can prove just about what you want to.

I take a look at what happens to the highway trust fund, and Texas, a State that makes a major contribution to it, gets back a substantially lower percentage than it sends to the Federal highway trust fund. I could continue ad infinitum in trying to prove one point or another.

The Federal Government can't just turn its back on these problems. I agree with Felix on that, but I would also say that you can't try to lock in the status quo. The Federal Government can't accomplish that and should not. We will have industries that will phase out and you will have people who desire to move, and what we should be looking more at is trying to retrain for new industries and new jobs and, in turn, providing some allowances when it's felt necessary. You just can't retain the total population in one particular area. Attitude toward growth has a great deal to do with what happens. Senator Jepsen has told about the revival of New England, so things can be done by local interests and it isn't just up to the Federal Government to try to overcome it.

I'm very pleased to see three such distinguished people here who have an intimate knowledge of the problem and I'm sure we will benefit by their diverse views. Thank you, Mr. Chairman.

Representative Reuss. Thank you, Senator Bentsen.

By alphabetical order then, let's start out with Mr. Rohatyn. I want to thank all witnesses for the very helpful and complete prepared statements they have given us. Under the rule and without objection, they will be received in full. And now, Mr. Rohatyn, would you proceed in your own way?

STATEMENT OF FELIX G. ROHATYN, PARTNER, LAZARD FRERES & CO., NEW YORK, N.Y.

Mr. Rohatyn. Thank you, Mr. Chairman. You see me wounded as a result of a skiing accident and not a weekend argument.

Representative Reuss. In the Sun Belt or Cold Belt?

Mr. Rohatyn. In Utah.

Representative Reuss. I see.

Mr. Rohatyn. I still think skiing is less dangerous than politics.

Mr. Chairman and members of the committee, it is a pleasure and a privilege for me to testify at these hearings. The issue of regional balance and economic policy is of vital interest to me both in my capacity as chairman of the Municipal Assistance Corp., and simply as a citizen of New York City.

Over the last decade, Chicago lost 12 percent of its population, Baltimore 14 percent, Cleveland 24 percent, and St. Louis 28 percent. The proportion of taxpayers moving out was undoubtedly greater. During this period, Houston gained 24 percent, San Diego 25 percent, Phoenix 33 percent. A recent study by the Conference Board measured regional standard of living by examining cost-of-living and household income in 18 metropolitan areas. By those measurements, residents of northeastern metropolitan areas had living standards 25 percent to 33 percent below their southern and western counterparts.

During the same period, some of the most important American industries have been failing badly. In 1979, U.S. Steel lost almost $1.5 billion. In 1980, the Ford Motor Co., Chrysler, and General Motors will each have lost between $1.5 and $2 billion. International Harvester almost $500 million, and Firestone $100 million.

It is no coincidence that our cities under the greatest strain are tied to our industries in most severe difficulty. Existing trends are likely to exacerbate rather than attenuate this situation with the result that another decade like the last one will divide the country into "have" and "have-not" regions with unpredictable, but probably highly unpleasant, consequences. As taxpayers leave older urban centers, the remaining tax base collapses inward, requiring higher taxes and providing lower services to a population unable to pay the former and increasingly needy of the latter. It is a recipe for social strife. At the same time, our bellwether industries, the industrial locomotive that drove this country for the last century, are in the throes of a similar self-eviscerating cycle. Harshly impacted by foreign competition, unable to raise the vast amounts of capital needed to modernize, they live from hand to mouth, not investing in the future in order to survive today. Allocating the blame is easy. There is enough for everyone: Costly and ill-advised Government regulation and policies—including the cowardly avoidance of taxing gasoline at much higher rates—weak managements and shortsighted unions collaborating in the creation of massive, inefficient, high-cost low productivity organizations; an educational system ignoring the crafts and an ethical culture lionizing rock stars.

The fact that everyone is to blame does not mean, however, that we should throw up our hands and say, "Let them go." It means rather that sacrifices can be shared by many to reverse the trend.

The United States today is challenged not only by foreign competition in its basic industries; it also depends on highly unstable countries not only for its basic energy supply, but also for the strength or weakness of the dollar. We are simultaneously challenged today by internal shifts in national wealth, partly as a result of oil and gas price decontrol, which will threaten our social and economic stability as a Nation, if allowed to continue unchecked.

From 1980 to 1990, decontrol of oil and gas prices will generate about $120 billion of revenues to the energy-producing regions of this country. This is a tax which will mostly be paid by the consuming regions of the Northeast and the Midwest in the form of royalties and severance taxes. At the same time, a national program of tax cuts heavily oriented to the supply side is bound to accelerate the trend of manufacturing businesses away from this part of the country. Federal budgetary cutbacks to offset the combination of tax cuts and defense spending increases will heavily impact the Northeast and Midwest while in the Sun Belt they will be more than made up by increases in revenues resulting from energy pricing as well as sharp increases in defense spending. Local taxes in that area can be reduced, services maintained, all kinds of incentives provided for industry. In the Northeast and Midwest, the results will be pressures to reduce local services and/or increase local taxes. The drain of businesses and taxpayers away from the Northeast and Midwest will obviously increase with inevitable results on the regional tax base.

We will then be faced with city after city in this part of the country less and less able to support a larger and larger proportion of their population in need of public assistance. The industries which formerly provided employment and support continuing in decline; those taxpayers able to leave migrating to the Sunbelt, leaving behind a growing mass of unemployed or unemployable unable to move or afraid to try. Not even a country as large as ours can maintain its democratic institutions half rich and half poor, especially when the economic trends will make it very apparent that for the "have-nots", things will get worse and not better.

The scenario described here is far from a "worst case" scenario. It does not envisage further oil price increases as a result of the Iraq-Iran war. It does not envisage steeper defense spending as a result of possible crisis in Poland nor further inflationary pressures in food or other areas. It is impossible to predict the speed at which this scenario will unfold. But its implications seem quite clear. They are the result of the inexorable logic of economic actions and reactions, of the zero sum game of an economy in stagflation.

Simultaneously, the United States today, in its basic industries, needs a second industrial revolution. The currently fashionable notion of "backing the winners instead of the losers" is as facile as it is shallow. The losers today are automotive, steel, glass, rubber, and other basic industries. The thought that this Nation can function while writing off its basic industries to foreign competition is nonsense. Nothing is more inhuman than unemployment, nothing is more inflationary than unemployment, coupled with trade adjustment payments on top of benefits on top of welfare. Nothing will do more to erode the confidence of our allies, and consequently, our defense posture throughout the world, than the picture of a nonfunctioning economy and an industrial base in disarray with its consequent impact on national defense. What we have to do is to turn the losers into winners, restructure our basic industries to make them competitive, and use whatever U.S. Government involvement is necessary to do the job.

This country's goals must be twofold. First, to have a functioning economy, with stable, consistent growth, and emphasis on the creation of private sector jobs; and second, to have all elements of our society, and all regions of the country participate in that growth as fully as possible.

There has been much talk recently about "reindustrialization" and "industrial policy," the former being described as the Government bailing out the large, and inefficient, also know as "Lemon socialism" to its detractors, the latter a policy of deliberately "picking the winners" and providing Government support for their accelerated development. It is counterproductive, other than by additional tax benefits in the area of research and development, to attempt to have Government "pick the winners." First of all, Government is intellectually incapable of doing so, and second, the winners do very nicely without government assists.

It is equally counterproductive for Government to bail out large, inefficient or noncompetitive organizations if the only result is to have them limp along, neither dead nor alive, a menace to their healthier competitors and to themselves.

I believe this country needs an industrial policy committee to the restructuring of its basic industries to enable them to take their place as health competitors on the world markets, coupled with a regional policy whose aim will be to maintain the United States as a country in which all geographical areas—and thereby all classes and races—share the burdens as well as the benefits this country has to offer. This industrial policy will reinforce the regional policy and vice versa. Together they will strengthen the entire country.

The United States is more than a country. It is a continent. It is by looking at half this continent as an underdeveloped country that we must look for remedies. Other countries, Italy with the Mezzogiorno, France with its southern provinces have attempted to develop away from their industrial heartland; we, on the other hand, must maintain our industrial heartland, possibly smaller but viable, and the urban centers tied to it. It is purely and simply in the national self-interest to do so and therefore is also in the interest of our presently faster growing regions. We need a viable steel industry as a security measure. We need a viable auto industry because one of every eight jobs in this country still depends on it; we need viable Northeastern and Midwestern cities because the cost of the alternative, both economic and social, will be immense.

I believe a Reconstruction Finance Corporation for the 1980's should be created for that purpose.

To the immediate outcry against revival of the New Deal, I would point out that the original RFC was created by Herbert Hoover in 1918 and that a Texan named Jesse Jones ran it under FDR. In addition to saving numerous banks, some cities, many businesses and financing synthetic rubber development during World War II, and new aluminmum capacity during the Korean war, it made money for the taxpayer and prevented much larger dislocations during the Depression.

To cries of interference with the free market system, I would point out that, at present, the price of our energy is not freely set—it is set outside of our country; the price of our food is not freely set; the price at which we borrow money is not freely set. Although free markets are clearly desirable, the fact of the matter is that we do not live in a free market economy and never will. We live in a mixed economy in which prices and capital are subject to Government influences and will continue to do so.

The RFC should provide the kind of capital our older industries sorely lack: equity capital. In exchange for providing that capital, and the job security that would come with it, the relevant unions should be asked to make their contributions in the form of wage concessions and work rule changes aimed at productivity. The lenders, banks and insurance companies might be asked to convert some loans to preferred stock and commit additional capital together with the RFC. Special classes of securities could be created, with appropriate credit ratings and consistent with the "prudent man rule" in which union pension systems could invest. The RFC, like any large equity investor, should have the right to insist on management changes and changes in the board of directors if it deems it appropriate. It should not become a permanent investor, but a revolving fund which steps in when necessary and sells its holdings in the marketplace when it has done its job.

At present, there is no instrument capable of dealing with a problem like Chrysler or New York City, except on an "ad hoc" basis, in front of congressional committees. In the case of New York City, the Municipal Assistance Corp., was able to play the role an RFC could play. MAC extracted concessions from banks and unions, the city and the State in order to put together a financing package—including Federal credit assistance—together with fundamental reforms which permitted the city to achieve a truly balanced budget in 1980, 5 years after near bankruptcy.

Only now, after over a year of wrestling with the problem, is the Chrysler Loan Guarantee Board beginning to come to grips with some of the difficult steps needed to give Chrysler a chance to survive. The board is asking for a total wage freeze (including COLA's) from the UAW; it is asking the banks to convert half their loans to preferred stock, and to forgive 70 percent of the balance completely; it is pushing the management to seek a foreign merger or joint venture partner. The tragedy of this is that it is probably too late and too little. Had these actions been demanded 2 years ago by an RFC which could simultaneously have promised additional equity capital, it might have had a chance of success. As it was, the congressional committees demanded little and gave a lot; the Loan Guarantee Board, in the middle of a Presidential campaign, looked the other way. Now reality is sinking in, but the opportunity has probably been lost. Without substantial fresh capital and a merger partner, Chrysler's chances of survival are de minimis. An RFC might have created those possibilities 2 years ago. It is now probably too late.

Chrysler is not alone. A number of large industrial companies, airlines, savings and loan associations, and possibly banks, could be in serious difficulties if we cannot break out of our current high interest rate, high inflation, low growth economic environment. Great hopes are being placed with the new administration's economic program, but there is no guarantee of quick success. Should we not have a safety net to handle an economic emergency involving several large entities at the same time instead of improvising expensive band-aids in the heat of crisis and politics?

An RFC could, at the same time, play a major role in a regional policy. City after city, in the Northeast and Midwest, faces budgetary problems and crumbling infrastructure. The Boston Mass Transit System was recently shut down for lack of funds; the New York MTA operates a subway system so old as to be a physical danger and will need $15 billion over 10 years to provide adequate service. Bridges, sewers, sanitation, and mass transit, schools and firehouses have been allowed to run down and degrade. The RFC could provide low-interest, long-term loans to enable municipalities to maintain their physical plant. By improving the quality of life such investments could help retain taxpayers while providing jobs to help the existing tax base. As in the case of industrial investments, the RFC could ask for participation by other parties; the various States could be asked to create organizations like MAC to provide local budgetary oversight; the local unions and banks could do their share. In many cases, reform and restructuring would have to be the quid pro quo for capital on favorable terms.

How, one might ask, would such an RFC be capitalized and financed? An RFC with capital of $5 billion and authority to issue five times its capital, or $25 billion in bonds guaranteed by the U.S. Government could be envisaged. Its charter should provide that it could not ever provide more than 50 percent of the financing for any project, the balance to come from the private sector. It could then generate total investment of up to $60 billion. The RFC need not stay in existence more than 7 to 10 years after which it could be liquidated, with its assets taken over by the Treasury. Its capital should be subscribed to by the Treasury, not necessarily all at once. Alternatively, its capital, or part of it, could be subscribed to by some or all of the States in which it would function. Its federally guaranteed bonds could be sold on the open market, but should preferably be part of a different arrangement. They should be sold to certain of the OPEC countries with large dollar surpluses such as Saudi Arabia, Kuwait, and the Emirates.

OPEC constitutes more than an insecure energy source. It also constitutes a more and more important capital source. At current prices, over the next 5 years we will pay over to OPEC approximately $500 billion for petroleum, about half the present value of all companies listed on the NYSE. Possibly a third of that amount, or $150 billion, could be in excess of OPEC's own investment requirements and will consist of short-term dollars balances, most belonging to the Saudis, Kuwaitis and Emirates, subject to the whims and winds of Middle Eastern politics. We must borrow back, on a long-term basis, as much of these funds as possible in order to strengthen the dollar and relieve the pressure on our credit markets. What can we offer in exchange? To the moderates like the Audies, military protection, continued attempts to find a rational Israeli-Jordanian solution to the West Bank problem, greater efforts at U.S. conservation and production to lengthen the life of their reserves. The RFC, with its Federal guarantees, would be a completely appropriate vehicle for part of these OPEC surpluses and would constitute true recycling.

Another possible source of funds would be part of the surplus funds to be generated by our own oil producing regions. In Canada, the oil producing regions have created the Heritage Fund in order to invest their several billions of excess funds in Canadian industry and other Canadian Provinces. A similar arrangement could be envisaged here to assist the RFC in its regional policy investments. Why not have Alaska invest some of its excess funds in an east coast, terminal facility for exporting coal?

Of course, none of this is likely to happen tomorrow. The current economic theology is the 1980 version of "Laissez Faire." It is a theology neither Republican nor Democratic. President Carter's Commission for a National Agenda for the 1980's, a prestigious bipartisan academic group, has just recommended that the government encourage the current population shift to the Sun Belt even though doing so will impose "traumatic consequences" for the major urban centers of the North. The Commission goes on to say we must accept the decline of northeastern and midwestern cities as inevitable; "There is a fundamental problem in attempting to halt the shrinkage of metropolitan areas." But Government policies heavily contribute to the exodus, and we might remind the Commission that there was a fundamental problem in going to the Moon, a fundamental problem in winning World War II, a fundamental problem in eliminating slavery. The Commission's recommendations include the kind of advice that made Mr. Carter into an ex-President. For it was the perception of a President who could not cope with events that defeated him just as it defeated Herbert Hoover 50 years ago. This country did not become great by a mere acceptance of the status quo. To those who throw up their hands at current trends and say "So be it," it behooves to ask "And then what?"

In a world where capital will be in shorter supply than energy, is it really a valid use of resources to have to build anew the existing northern schoolhouses, firehouses, transit systems, etc., in the Sun Belt to handle the immigrating millions instead of maintaining and improving what we already have in place here? Is it rational to think that northern cities teeming with unemployed and unemployable will not be permanent wards of the Federal Government at massive financial and social cost? Is it realistic for a Commission reporting on our so-called urban problems not to face up directly to the fact that urban problems cannot be discussed separately from race problems, and that the notion of "taking the people to the jobs" completely overlooks the basic fact that that is not a viable possibility for many of those people in large parts of this country? Is it rational, in the name of the mythical free market, to let our basic industries go down one after the other in favor of an equally mythical service society concept in which everyone will serve everyone else and no one will be making anything?

An arc of economic crisis and decay stretches today from Baltimore to St. Louis; tied to the same umbilical cord are our older cities, our older industries, our hardcore unemployed. This entire portion of the United States, which I would call "Older America" shares similar burdens: shortage of energy; dependence on older industries highly impacted by foreign competition; large urban centers dependent on significant federal aid programs to support large numbers of unemployed, minorities, and illegal aliens; less and less capability of attracting the younger technocracy wishing to work in the Sun Belt. Although old in relation to the Young America of Houston, Phoenix and Los Angeles, it must be remembered that this part of the country still includes more than 50 percent of our manufacturing capacity, our most important financial and cultural centers, our biggest harbors. "Older" does not mean decrepit. It is not only wine and intellect that gain with age. Who could argue that Paris cannot compete with Houston even though they are hundreds of years apart in age? A city or a region can age vigorously if national policies encourage it. The implications of disproportionate shrinkage, in such an important part of the country as this one with its inevitable social dislocations and tensions, are far from an unmixed blessing for the growth regions of the Nation. Older America must have a coordinated political and economic strategy for survival. This is not a question of ideology or party. For politicians of Older America, the economic and social agenda must be as bipartisan as foreign policy used to be at the national level and for the same reasons. Unless we can stem the tide during the next 5 to 10 years, there will be little left worth turning. A coalition of Northern and Midwestern Governors, legislative, business and labor leaders must set an economic and political agenda for the 1980's.

This agenda must address itself to: Changes in Federal formulas to offset the regional shifts of national wealth due, among other reasons, to oil-price decontrol; assistance to older industries in the form of special tax and credit assistance; special assistance to urban centers with high unemployment both in the budget and capital improvement area; a fair share of defense and synthetic fuel program contracts and subcontracts; a coal-based energy plan where investments in new production as well as new transport and harbor facilities would favorably impact the region; and the creation of an RFC to serve as a catalyst for such a program.

Such an economic agenda must be carried out by the congressional delegations of older America who are going to be involved in the daily give and take, the endless bargains that make up national legislative policy.

I wish President Reagan every success. I am an American. I am a capitalist. I believe in freedom of opportunity, of choice, of thought. Nothing will be better for me, my business, my family, my children, than to have lower inflation, a stronger America, renewed growth. Even though I am skeptical of the current conservative wisdom and of the economic theology that goes with it, the voters clearly want to see it attempted and I believe that is a healthy thing. What has been tried recently has clearly failed. We must, however, be realistic about its implications. In its early stages, in this part of the United States, the pain of spending cuts and continued inflation will far exceed the pleasure of tax reductions. In its later stages, the benefits of stimulus and increased defense spending are likely to benefit the rest of the country disproportionately leaving older America more and more in the shadows and increasing regional disparities and tensions. It is well to remember that the decade of 1960–70, in which we enjoyed a high level of sustained economic growth, also witnessed the largest exodus of employment suffered by New York City and State and set the stage for the crisis of 1975. Although we cannot prosper unless the Nation does, it is quite possible for the Nation to prosper while we watch from a distance.

The United States is probably the only country in the world today whose biggest problems are also its biggest opportunities. Becoming self-sufficient in energy, rebuilding our basic industries and our oldest cities, there is work enough here for everyone in this country as far as the eye can see. Of course, we need tax cuts and regulatory reform and a balanced budget. But alone they will not do the job. An activist Presidential leadership working with business and labor will be needed to make it happen. This may mean temporary intervention on wages and prices, creation of an RFC, taxing gasoline at higher rates, instituting some form of national youth service if not the draft, tying together inner-city school systems to new private employment opportunities. It does not mean the end of the free market system, on the contrary.

Our defense posture throughout the world, our ability to protect ourselves and our friends, and to deter our enemies, all depend on a stable, solid economic, industrial, and social base at home. Our national security and our industrial base on the one hand, our social fabric on the other, are two sides of the same coin.

America, as we know it, cannot survive half rich, half poor, half suburb, half slum. All Americans, in all parts of the country, must share in its benefits as well as assume its burdens.

Thank you, Mr. Chairman.

Representative REUSS. Thank you, Mr. Rohatyn.

Mayor Rusk.

STATEMENT OF HON. DAVID RUSK, MAYOR, ALBUQUERQUE, N. MEX.

Mr. RUSK. Thank you, Mr. Chairman.

I appreciate the opportunity of meeting with the committee. I must say I was intrigued at the previous speaker's characterization of his part of the country and indeed my old home town, New York, as part of older urban America. I recall history. The residents of New Mexico in the pueblo cities were experiencing problems of rent control, regional imbalances in trade about 700 or 800 years prior to the arrival of Peter DeWitt on Manhattan Island. So I think we have a longstanding urban experience certainly in New Mexico.

I'd like to speak not just as a Sun Belt city mayor, one which is projected to perhaps rank fifth or sixth in the Nation in the great new job creation over the next decade, but also drawing upon my own personal career experiences where I served 5 years as an antipoverty civil rights worker in Washington, D.C., in the very neighborhoods that surround this Capital. I served for close to 3 years as the program developer and program director on the Manpower Administration. I spent many hours in hearings such as this working with staff principals in the Congress on national manpower legislation. I then was loaned by the Federal Government as a Federal executive to the city of Albuquerque. I was the fourth Federal official to take advantage of the Intergovernmental Personnel Act for the transfer provisions that were passed in the early seventies. I served as a department head of Albuquerque city government, 3 years in the New Mexico State Legislature, and finally for the last 3 years as mayor of Albuquerque.

I might comment on the alleged Sun Belt-Frost Belt controversy. Although I would note at the time when I served on the Committee of Mayors in the Conference of Mayors to deal with the problems of growth areas, one of the Sun Belt members was Mayor George Sullivan of Anchorage, Alaska, so there are phenomena that are shared regardless of the geography and climate of areas.

I would like to contrast perhaps Albuquerque, which I know well, and the Cleveland area which I think symbolizes a number of the problems that I see in the regional trends.

Let me state, Mr. Chairman, as you very well pointed out, in the last several decades all areas of the country have grown in terms of new job creation, but the South and Southwest have grown at a faster rate than the older, more established areas; and indeed we need to because historically we have been far behind the rest of the country in living standards.

When I moved to New Mexico in 1971, per capita income in New Mexico ranked us 49th among the States, exceeded, if you will, only by the State of Mississippi. In the last decade, in the period of rapid growth, New Mexico has grown to 43rd in that list. That growth has been fueled primarily by energy extraction which is a nonrenewable resource for us.

One of our great concerns is how do we reap the benefits of what nature took tens of millions of years to create when it takes only decades for man to rip it out and then try to invest our fossil fuel income in long-term economic development that is not dependent upon those exhaustible resources.

I suspect we can all play the statistical game. I think that any regional analysis suggests that despite growth that certainly money living standards are less in the Southwest, in the South, the Old South, than many other areas of the country. Although we are growing in population, and although we are all conscious of the movement of people from the Northeast and Midwest to the Sun Belt, a great deal of our population growth also reflects a new role that the Sun Belt is playing.

For generations in the past, New York City, Cleveland, Philadelphia, Detroit, Chicago represented ports of entry into this country for newcomers to our land, whereas the principal migration into this country now comes from Mexico; and it is the cities of the Sun Belt who are now the ports of entry and a great deal of our population growth I think reflects that.

One of the problems we have in Albuquerque when we look at the Hispanic population of our community, 93 percent were born in our State; 65 percent of all families in poverty are Hispanic. There's a significant gap between average family income, average Hispanic family income, and average annual family income; and I should tell you, by the way, that in southwestern parlance, if you're not Indian, Hispanic or black, you're Anglo. Pacino or Pulowski or Goldstein—they're all Anglo in the Southwest.

Well, the new migration, more educated, more skilled, more experienced, and working-age people from the Frost Belt, combined with the immigration of Mexican nationals, legal or illegal, into our community severely dampens the impact of new economic opportunities upon the long-term resident native New Mexican. So we are not deriving from that as much benefit as we would like to because of responding to the job needs and the competition of these other two groups.

As you yourself, Mr. Chairman, point out, historically leadership in terms of rates of economic growth has transferred from region to region throughout our history and that has been good for this Nation, for we have not seen the patterns of development which so characterize, for example, so many countries in Latin America where there's one great area of growth, often the national capital, and the rest of the Nation stagnates and dies.

So I would hope that we look upon the growth of economic opportunity in the Sun Belt as a national benefit to us all, something which is working to restore the disparities in regional standards of living.

I think also we need to be conscious that our perceived advantage for new investment in the Sun Belt may be fairly fragile. As I read the Presidential Commission's report on the Agenda for the Eighties for the Cities, I saw very little recognition of the fact that we may be facing—we are facing dramatically different transportation patterns and habits and costs. My community is dependent on the automobile for over 95 percent of all trips in our community. Our bus system carries 1.4 percent of all of our person trips in Albuquerque. We have no rail system. We are critically dependent upon the supply of gasoline at an affordable price whereas in the older cities of our country you have rapid transits. You have commuter rail systems. You have bus systems. You even have a road network sufficient for large populations in place which we do not have. I would think that if we faced drastically different conditions regarding the price and supply of gasoline by the end of this decade that a community such as mine will not look as attractive to major industrial investors who need to be concerned about moving large groups of people to jobs at their plant, and there is a competitive advantage that will be restored for the older industrial areas of the country.

Two years ago—let me say all through the time I worked in Washington for the Federal Government, served in the Congress, all through the time that I have been in the Southwest, I certainly have perceived that there are older cities of the Northeast to Midwest that have critical, critical problems, and if I had to place a city at the top of that list in terms of a distressed city, it would be, for example, Newark, N.J. I think we would all agree to that.

Imagine my astonishment when 2 years ago the Department of Commerce published a list of the wealthiest metropolitan areas in the country in terms of medium income, and eighth on that list was the Newark metropolitan area.

Now I think that illustrates something that we really have to come to grips with in terms of urban policy. I'd like to illustrate it by returning to Cleveland.

I recognize that Newark is a severely depressed city, but it is surrounded by very wealthy suburbs. To return to Albuquerque and Cleveland, the greatest difference between Albuquerque and Cleveland is not that we are in the Sun Belt, not that we are experiencing a more rapid rate of increase in job creation, not that our population is growing as an area; but that in the 40 years since World War II both of us have experienced a decline of our central cities and a growth of our suburbs; but Albuquerque has incorporated virtually all that suburban growth into our central community.

In other words, we have basically a metropolitan government embraced in our dominant city government. In 1940, Cleveland, 878,000 people, accounted for 72 percent of the total urban area population. In Albuquerque, with 35,000 people, accounted for 51 percent of our total urban area population. Cleveland has dropped to 30 percent of its population, although their urban area population has almost increased by 50 percent over these 40 years. Albuquerque has grown to almost 80 percent of our urban area population.

This has, first of all, vast consequences for municipal finance. Virtually everybody in the Albuquerque area who utilizes the facilities of city government, who utilizes the services of city government, pays for them. Our school system goes beyond that. Our school system embraces all of our city, all of our county, and all of the urban areas in an adjacent county which is part of our natural market. We have a two-county Albuquerque public school system. So even though our community is poorer than Cleveland, we are able to finance the services and the facilities we need because we are able to tap basically all the wealth in our community to support that and to apply that wealth to meeting the problems of the lower income groups, the minorities that have been bypassed by these natural trends.

Let me describe to you two cities. City A has an unemployment rate of 7.2 percent. City B, 8.4 percent. City A has family income at least 10 percent above city medium. City A has a significantly lower proportion of poverty impacted and minority population. City A has twice the property valuation per capita of City B. Which is City A? Cleveland. Which is City B? Albuquerque. Which is collapsing? City A, Cleveland. Which feels we can address the challenges of our future with confidence in our ability to solve them largely ourselves? Albuquerque.

Why? Because we have worked through conscious policy to assure that our governmental and taxing and planning and management jurisdictions expand as our community expands.

The Cleveland area and practically every other metropolitan area in the country has not.

Now I'm a civil rights man. I'm an old antipoverty worker and I don't think that I'm naive about many of the factors that cause these patterns of development to occur or the barriers to be overcome in trying to reorganize the metropolitan areas of our country along metropolitan lines of governments. Indeed, although I have for 3 years been sounding this theme within the Conference of Mayors, I haven't found many allies. I have, as a Sun Belt mayor, consistently voted with the policy interests of Detroit and Cleveland and New York and Philadelphia and Chicago, in favor of targeted Federal assistance, in favor of targeted tax incentives, in favor of targeted grants, in favor of helping these communities.

When I talk about city-county consolidation, metropolitan tax sharing, reorganizing the jurisdictional lines of metropolitan areas by State legislatures, I don't find many allies. Suburban mayors see these ideas as the municipal equivalent of school busing for racial balance and they are right. Inner-city mayors are content and secure with the power base, minority based power bases, that have developed in their cities which provide for their election, and they are afraid of broadening that base, and I can hardly get anybody else among my fellow colleagues to speak up and step forward on these matters.

But how long should I, as a mayor of a metropolitan area which has lower incomes, higher unemployment, higher proportion of poverty, less property tax base than these other older urban areas—how long should I continue to support targeted kinds of programs for parts of those areas when neither the central cities nor the suburbs nor the State legislatures are prepared to step out and confront the fact that there is wealth; there are resources; there is potential to be harnessed in these older urban areas, but they don't get to it because of the political considerations and the social and economic considerations of their organization.

And it gets me frustrated and angry. I worked on this with the Carter White House for 3 years. There was a pretty reasonable idea that came forth to get that process started at one point. It was in the context of a debate over the renewal of revenue sharing.

The basic concept was the States really don't need it and the States really don't mostly. Our State doesn't need Federal revenue sharing. Our State government has more money than they know what to do with.

But the concept was in order for the State governments to receive their share of revenue sharing, each State would have to initiate a process of analyzing and setting forth a plan for reorganizing the jurisdictions of the urban areas of those States, encouraging city-county consolidation, devising systems of metropolitan-based tax sharing, each one of which would be patterned to the unique circumstances of those communities and those States. It was proposed that as a condition for receiving State revenue sharing that each Governor would have to establish a State commission to examine all these questions; that money would come from revenue sharing to adequately staff at a very high level each of those commissions. So the commissions would have to analyze the problems and develop an action plan for metropolitan reform in those States and that the Secretary of the Treasury would assure that various kinds of benchmarks are met in terms of both the development of plans and the implementation of them and if a State failed to meet those benchmarks the Secretary of the Treasury would be empowered to cut off or reduce the revenue sharing flowing to the State.

Well, the Governors didn't like it. They didn't want to take those tasks on. Most mayors didn't like it for reasons I have expressed, and even those mayors that did like it didn't trust their Governors to head up this process. So the idea never made it out of the White House and out of the Treasury Department and was never set before Members of Congress in your consideration of renewal of revenue sharing.

I think that there's no more important agenda before urban America than recognizing that our economic forces have created a different urban America in geopolitical terms than existed several generations ago, but there's great vitality, great resources, great talent, great potential in virtually every one of our urban areas, and that it needs to be tapped and energized.

When I look at the agenda for the 1980's and the enthusiasm for going with the flow, as one might describe the Commission's recommendations, I get very disquieting feelings because it sounds very much to me like the enthusiasm that existed in the late 1940's and 1950's and into the 1960's for the creation of suburbia and all the Federal programs and policies that consciously or unconsciously helped to support that movement.

Now we see the very sorrow of the American dream. The cities are dying and as that part of the whole body of an urban area dies the gangrenous infection spreads throughout the body and the suburbs are experiencing problems too. From 1940 to 1970 the Cleveland metropolitan area grew in population. Between 1970 and 1980 it lost

300,000 people. Much of those lost were from the city of Cleveland, but some of the loss was from the whole area, and I think that reflects the fact that you cannot have a healthy community without all parts of that community being healthy.

I urge this committee to consider seriously these matters for I think that the reorganization of our metropolitan areas is the greatest single tool to revitalization of all areas. It's not easy. It's not quick. It's a 20- or 30-year process, but the leadership has to come from somewhere. It has to begin somewhere and I think that the experience and the perspective of members of this committee is as fine a place to launch that effort as anywhere. Thank you.

[The prepared statement of Mayor Rusk follows:]

PREPARED STATEMENT OF HON. DAVID RUSK

Mr. Chairman, members of the committee, I appreciate the opportunity to appear before this committee to offer some thoughts on what has been popularly characterized "the Sunbelt-Frostbelt controversy." My comments reflect not so much scholarly analysis as my own career experience: civil rights/antipoverty worker in Washington, D.C.; U.S. Manpower Administration legislative director; municipal department head; New Mexico state legislator; and, for the last three years, Mayor of Albuquerque.

I would like to talk about two cities . . . Albuquerque and Cleveland . . . and the two States in which they are located. Each has their unique characteristics; yet each is sufficiently representative of "the Sunbelt" or "the Frostbelt" to illustrate some points I hope to make.

SUNBELT ECONOMIC DEVELOPMENT

In the past decade New Mexico has experienced steady economic growth. We have risen to 43rd among the States in per capita income. Our economic growth has been fueled primarily by energy production: gas, oil, uranium, coal-fired electric generation. Albuquerque too has prospered as the regional support center for the growing energy industries: transportation, finance and insurance, wholesaling and retailing, health and higher education.

In addition, Albuquerque just recently has become a prime market for expanding high technology light industry. Five national blue-chip corporations are building new plants in Albuquerque this year. Within five years these may provide as many as 10,000 new jobs.

However, with all this economic growth New Mexico and Albuquerque are still playing "catch-up." In 1979 the typical Albuquerque family's effective buying income was $16,521. That of the typical family in the Cleveland metropolitan area, $21,374.

Nor is the cost of living in Albuquerque significantly lower. A recent Labor Department study placed living costs in Albuquerque at an index of 100.5 of the average of 211 cities while the average cost-of-living index for eight Ohio cities stood at 101.4. Thus, by these measures both effective buying income in cash—and real terms—is 20 percent lower in Albuquerque than in typical Ohio communities.

Unemployment, underemployment and low incomes continue to be New Mexico's—and Albuquerque's—fundamental problem. We are developing economically, yet our very population growth (which causes so much political alarm in the Frostbelt states) erodes economic opportunities for native New Mexicans. Most newcomers to Albuquerque from the Frostbelt are better educated, better skilled, more experienced than native New Mexicans. Many newcomers successfully compete with long-term New Mexicans for new jobs. Meanwhile, at the lower end of the scale, Mexican nationals . . . legal or illegal immigrants . . . provide a growing unskilled labor pool. The overall impact is to dampen the value of our economic growth for longer-term New Mexicans.

Throughout our nation's history leadership in economic growth has moved from region to region. Shifting regional economic patterns has been one of our nation's strengths. By contrast many Latin American nations have historically experienced economic growth in only one region . . . often "le capital" . . . while the rest of the country stagnates.

It would be both ironic and tragic if national policy was arrayed against the economic growth of the Sunbelt states. Both the South and and the Southwest have been "underdeveloped countries." Both . . . the South (1865) and the Southwest (1848) . . . have been peoples conquered by a foreign nation. From the perspective of the American nation the progress and resurgence of these regions should be judged desirable and beneficial.

Moreover, the Sunbelt's perceived regional competitive advantages for new industry may be short-lived. The older cities of the Northeast and Midwest have commuter trains, rapid transit, public bus systems (however deteriorated) in place as well as road networks generally sufficient for their existing, higher-density populations. Most Sunbelt cities do not have significant public transit systems nor road networks in place to accommodate substantially larger, lower density populations. In Albuquerque, for instance, only one and one half (1½) percent of all person-trips are by city bus. Approximately three (3) percent are by foot or bicycle. Over ninety-five (95) percent of all people movement in Albuquerque is by private car.

Thus, our city . . . as many others throughout the Sunbelt . . . is overwhelmingly dependent as the automobile and critically vulnerable to dramatic increases in gasoline prices or supply shortages.

Such crystal ball gazers as the President's Commission on the Agenda for the Eighties have not adequately considered the real impact of higher gasoline prices and lesser supplies on America's cities. I would urge continued high Congressional priority for Federal programs to improve the nation's mass transit systems. Cut backs would undermine the total national interest. Cutbacks would also rob older urban areas of strong competitive advantages they will have to attract new investment in a world where the single occupant automobile may become as rare as whooping cranes.

METROPOLITAN GROWTH AND BALKANIZATION

The most significant contrast between Albuquerque and Cleveland does not lie in relative rates of population or economic growth but in the following data:

In 1940 the City of Cleveland (pop: 878,336) accounted for seventy-two (72) percent of the total urban area population.

In 1940 the City of Albuquerque (pop: 35,449) accounted for fifty-one (51) percent of our total urban area population.

By 1980 Cleveland (pop: 572,632) had dropped to thirty (30) percent of a total urban area population (1,893,170) which had still increased by half over forty years.

In contract, by 1980 Albuquerque (pop: 328,829) had risen to almost eight (80) percent of our total urban area population.

In effect, Albuquerque and Cleveland had experienced the same post-World War II patterns of central city decline and suburban expansion. The City of Cleveland, however, has been slowly strangled by its suburbs. Albuquerque has annexed our suburbs into our expanding municipality as the suburbs have developed.

Metropolitan Albuquerque has, in effect, one city government, one county government, and one school system (which not only includes all of Bernalillo County but the urban communities of an adjacent county recently added officially to our metropolitan area).

In short, virtually all people who use the City of Albuquerque's facilities and services particiapte in paying for them.

The consequences of this fact are immense for our community. Albuquerque city officials, like others elsewhere, are very conscious of fiscal pressures, of unmet needs, of the widening gap between inflation-driven costs, on the one hand, and lagging growth in revenues, on the other. But by any measure of comparison in terms of municipal finance we are one of the nation's more fortunate cities.

Albuquerque maintains, by choice, cash reserves equal to eight to ten percent of our annual municipal budget. Our city utility systems pay for themselves while charging our customers comparatively moderate rates. Our municipal bonds are AA-rated.

By contrast, the City of Cleveland's fiscal year chaos is well-known.

Let me further characterize our two communities: City A has an unemployment rate of 7.2 percent, City B, 8.4 percent. City A has family incomes at least ten (10) percent above City B's. City A has significantly lower proportion of poverty impacted and minority populations than City B. City A has twice the property valuation per capita of City B.

Which is the more fortunate community? Clearly City A. Yet Albuquerque, New Mexico is not City A but City B, while City A is Cleveland, Ohio . . . the whole city of Metropolitan Cleveland.

In the Cleveland area and throughout the Frostbelt expanding urban areas have been "balkanized" in the post-war era. Jobs, wealth, the middle-class have moved to new independent, incorporated suburbs ringing the older central cities. In the Sunbelt (at least until recently) most growing communities have avoided this balkanization.

I am not going to continue this analysis, for it is a familiar litany of urban problems indeed. But, as I see it, white, middle class America created the suburban dream . . . with one goal being to exclude the poor and minorities. Now we find that dream souring for entire metropolitan areas because of the gangrenous decay of the central cities.

Yet how can we in Albuquerque . . . with less industry, lower incomes, greater poverty, higher long-term unemployment, less property valuation . . . confront our problems with confidence and say "we can do it" while other more advantaged metropolitan communities stagger along from crisis to crisis. "We can do it" because we are organized to tap the total resources of our community in a more unified way.

In metropolitan community after metropolitan community throughout the Frostbelt there are great untapped resources and potential vitality. However, archaic and divisive political boundaries must be scrapped and such areas treated as unified, governmental wholes. City-county consolidation, metropolitan tax sharing, elimination of myriad local, general and special purpose governments are some of the necessary strategies.

This is not an easy task to be accomplished overnight. Social class and racial prejudice helped fuel these trends and will be difficult to overcome. Indeed, I can hardly find any of my fellow mayors who will sign up for this crusade. Suburban mayors see little benefit for their communities (and for themselves). In their eyes metropolitan government is the municipal equivalent of school busing for racial balance. Central city mayors fear the dilution of their power bases.

Local officials alone, federal incentives, cannot bring this transformation about. Local governments are the creation of state governments. Where successful metropolitan governments have been created (such as Indianapolis, Jacksonville, Nashville) the key actions have been taken by progressive, far-sighted state legislatures. However, post-war Federal policies have helped create the suburban-central city schism. The Federal government must devise strategies and incentives to encourage action at the state and local level.

One promising idea was developed (in part at my personal urging) by the Carter Administration. The renewal of state government's share of revenue sharing was to be conditioned upon each state's undertaking a major systematic program of metropolitan reorganization and local government fiscal refrom. Each governor was to establish a special commission to analyze the specific needs of metropolitan areas in each state. The commission was to have major staff support provided out of each state's general revenue sharing allocation.

The commission was to design a unified program of reforms at state and local levels. At each step of the process if a state did not meet key benchmarks the Secretary of the Treausry would be empowered to cut off that state's share of general revenue sharing.

However, the idea was abandoned. Governors didn't want it. Many mayors didn't want it, and some of those who did didn't trust the governors.

This was one idea which deserves to be revived and reexamined. There are surely other strategies and incentives.

The Sunbelt-Frostbelt conflict is substantially a fraud perpetrated by the news media and learned academies for whom the catch-phrase is an easy route to publication.

As a Sunbelt mayor I support Federal efforts to revive America's older cities Albuquerque benefits from a revitalized, vibrant Cleveland, Detroit, New York. Our own current growth poses us sufficient challenges without new Federal policies that would encourage greater regional migration. Our first commitment is to take care of our own.

So I support the basic thrust of the Carter Administration's Urban Policy. I would not want to see it abandoned through the enthusiasms of the new team in town. I support targeted Federal grants-in-aid which will benefit primarily older Frostbelt communities. I support special tax incentives which would encourage private investment into the same distressed communities. And I find absurd the

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thought that it would be easier for a resident from the Hough district of Cleveland to move to Albuquerque, New Mexico than Rocky River, Ohio.

But I grow increasingly embittered when we metropolitan communities who have less are called upon to support special efforts for those metropolitan areas who have more while they . . . citizens, local officials, state legislators, congressional delegations . . . resist even the first steps to unifying the resources of city and suburbs to confront their common problems and opportunities.

This Joint Economic Committee is composed primarily of members of Congress from so-called Frostbelt states. I urge you to step out in bold new directions . . . exciting, if politically perilous . . . to stimulate the reorganization of Urban America. There is no more important agenda for Urban America. There is great untapped talent, wealth and vitality in most older urban areas if we all have but the courage and persistence to organize and apply it.

Thank you very much for inviting me to appear today.

Representative REUSS. Thank you, Mayor Rusk.

Now, Mr. Weinstein.

STATEMENT OF BERNARD L. WEINSTEIN, PROFESSOR OF ECONOMICS AND POLITICAL ECONOMY, UNIVERSITY OF TEXAS AT DALLAS

Mr. WEINSTEIN. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you this morning. In the few minutes allotted for my presentation, I would like to comment briefly on three separate, though related issues. First, are we currently in, or entering, the second phase of a double-dip recession; second, what are the implications of the new administration's economic proposals for various regions of the country; and third, what is the long-term outlook for the Frost Belt and the Sun Belt?

Are we in a recession? Never has the economics community been in such disagreement about where we are, where we've come from, or where we're going. Early in 1980, most of the forecasters predicted a significant downturn for the year. Indeed, during the second quarter real GNP plunged 9.9 percent at an annual rate. But the third and fourth quarters recorded positive growth so that we eked out a small gain for the year as a whole.

The national unemployment rate has held steady at about 7.5 percent for the past 4 months, though the number of unemployed persons in November 1980 was 1.7 million higher than a year earlier. Still, our sluggish economy managed to employ 300,000 more workers in November 1980 than in November 1979. From July to November last year, job growth amounted to more than 1 million on a seasonally adjusted basis.

Naturally, unemployment rates vary from State to State. But, curiously, among the 10 largest industrialized States, only 3 are posting unemployment rates more than 1 point above the national average—Illinois, Michigan, and Ohio. All of the New England States are well below the national average, and New York's unemployment rate is actually below that of California. Even more surprising is the fact that Massachusetts' 5-percent unemployment rate is below that of Texas which is 5.7 percent.

What the unemployment data suggest is that if we are in a recession, it is primarily an automobile recession with the burden falling principally on a few Midwestern States. The rest of the country appears comparatively robust. Of course, the most recent runup of interest rates has yet to work its way through the economy, and inflation continues in the double-digit range with no sign of abating. So the national economic outlook for 1981 remains extremely cloudy. My guess is the economy will record little movement during the first two quarters but begin to accelerate around midyear. With an imbedded inflation rate of 9 percent, however, I don't foresee much relief from rising prices for the next several years.

What about the regional impacts of what is sometimes referred to as Reaganomics? At this juncture, it is virtually impossible to predict how the Reagan administration's economic policy proposals will affect different regions of the country. Some observers, including Mr. Rohatyn, are convinced that broad-based tax cuts, increased military outlays, decontrol of energy prices, and reduced domestic expenditures will, on balance, work to the competitive disadvantage of the older, industrialized States of the Northeast and Midwest. Others, including myself, believe that supply-side economic policies, as espoused by the new administration and the Joint Economic Committee, hold great promise for revitalizing all regions.

It is interesting to note that the theme of today's hearing is "Regional Balance and Economic Policy." I remember back in 1976 the "Joint Economic Report" of the Congress recommended that all major executive and legislative proposals be accompanied by an analysis of their impacts on regions and subregions. I also recall that several years ago the Northeast-Midwest Institute proposed that regional development policy be added to monetary and fiscal policy as a third tool for influencing the economy. I hope the Joint Economic Committee and the Congress are not giving serious consideration to such proposals at this time. Regional balance cannot, and should not, be an explicit goal of macroeconomic policy in an open economy such as ours where factor endowments, technology, aggregate demand, and regional growth rates change constantly. Furthermore, in the absence of enunciated regional policies, market forces have brought about a near convergence of regional incomes and have also improved the overall productive efficiency of the national economy. As the London Economist pointed out in a recent article, the rise of the Sun Belt has helped America's international competitiveness, increased investment by capturing firms that might otherwise have gone abroad, and raised living standards for all Americans.

Mr. Rohatyn and other spokesmen for the Northeast and Midwest have framed a legislative agenda that calls for changes in Federal formulas to offset regional shifts in national wealth, assistance to older industries in the form of special tax credits, special financial assistance to urban centers with high unemployment, and a fair share of defense and synthetic fuel contracts. They usually justify these initiatives on the grounds that Federal spending programs over the past several decades have systematically subsidized the growth of the Sun Belt while drawing resources away from the northern tier States. However, northern claims of regional discrimination in Federal spending are not supported by available data.

If you will turn to table 1 which is at the end of my prepared statement, you will see that the mid-Atlantic region of the United States receives far more Federal aid per capita than any other region—$502 compared with $400 for the Nation as a whole. The mid-South region, with the Nation's lowest per capita income, ranks eighth with per capita aid at $368. More significantly, the nothern States have increased their relative share of the Federal aid pie over the past 12 years, at the expense of the Nation's poorest regions.

In any case, the impact of Federal aid and Federal procurement on regional growth and decline has been much overstated. The North has been losing people, jobs, and investment to the Sun Belt for several decades. For the most part, the migration of population and employment opportunities is occurring in response to economic forces affecting the cost and efficiency of production. New Federal interventions such as those proposed by Mr. Rohatyn will not slow these trends.

Revitalization of the northern tier is surely in the long-term interest of the Nation, and there are several areas where new Federal initiatives could be extremely beneficial to the North as well as other regions. Export promotion policies, regulatory reform, and Federal incentives to promote technological innovation are but a few examples. But developmental policies designed to aid specific regions or industries run the danger of subsidizing inefficiency while penalizing more productive sectors of the economy. Proposals to restrict the ability of industries to relocate, to revise labor laws to promote compulsory unionization, to target Federal tax incentives to so-called distressed cities, and to impose restrictive energy and environmental policies on underdeveloped areas could have detrimental long-term impacts on national economic development.

There is one specific regional issue I'd like to comment upon further. As energy prices are decontrolled, oil, gas, and coal producing States will realize substantial increases in their severance tax revenues—at least in the short run. These revenue gains have been dubbed "unfair windfalls" by the Northeast-Midwest Institute and other interest groups representing nonproducing States. Severance tax warfare, it is claimed, will accelerate the movement of people, jobs, and wealth from the Northeast to the Sun Belt as energy-rich States will be able to hold down, or reduce, income, property, and other taxes on their residents. Mr. Rohatyn has stated frequently that decontrol will bring about a $120 billion transfer of wealth from the energy have-nots to the energy haves. Several bills were introduced during the 96th Congress that would have limited the ability of States to levy taxes on energy production, and similar legislation will likely reappear during the new Congress. In addition, the U.S. Supreme Court has agree to hear an appeal by Commonwealth Edison Co. and 10 other utilities claiming that Montana's 30-percent levy on coal production interferes with interstate commerce in violation of the Constitution. I also understand that two dozen Congressmen and Senators from the Northeast and Midwest have filed an amicus brief with the Court.

While the popular press has played up the alleged tax bonanza to energy-producing States from decontrol, more careful analysis suggests that projected incremental receipts will, on balance, just about cover projected increases in public outlays for education, police, roads, water, and health care in these States.[1] Furthermore, the ongoing debate over severance taxes has included little reference to the recently enacted windfall profits tax, which is not a profits tax at all but rather a Federal excise tax on energy production. For example, the Federal Government will collect approximately $13 billion from Texas oil producers during 1980–81 under the windfall profits tax; but Texas

[1] Congressional Budget Office, "Energy Development, Local Growth, and the Federal Role." June 1980.

will receive only about $1 billion in oil severance taxes. It should also be mentioned that the northeastern and midwestern regions of the Nation are slated to receive a substantial share of the proceeds from the windfall profits tax for mass transit, low-income energy assistance, and energy conservation programs.

In short, I find the argument that decontrol of energy prices will result in a massive redistribution of wealth among regions totally unconvincing.

Finally, let me spend a minute looking at the future of America's regions. Writing in the January 22 New York Review of Books, Mr. Rohatyn, referring to the older parts of America, stated that "unless we can change the direction of the political economy during the next 5 to 10 years, there may be little left in the way of industry and productive life to be saved." I would urge Mr. Rohatyn and other northern business and political leaders to take a hard look at the most recent economic projections prepared by the U.S. Department of Commerce Bureau of Economic Analysis.

Over the next 20 years, real personal income in "stagnant" New York is expected to grow by $55 billion while "booming" Nevada will post a mere $8 billion gain. In fact, 6 of the 10 States growing the most in total personal income during the next two decades will be northern industrial States: New York, Illinois, Ohio, Michigan, Pennsylvania, and New Jersey. True, 8 of the 10 slowest growing States are northern industrial States; but BEA predicts that the slowest 10 States will grow about $69 billion more in constant dollars than the 10 fastest growing through the end of the century.

Moreover, growth rates in personal income and per capital personal income will be smaller from 1978 to 2000 for the four southern and western regions than was the case between 1969 and 1978. In contrast, growth rates in personal income and per capita personal income generally will be larger from 1978 to 2000 than from 1969 to 1978 for the Midwest, New England, and Great Lakes regions. [See figures 1 and 4.]

Senator SARBANES. Professor Weinstein, I hate to interrupt, but just for the sake of my own information, do you know what the population of New York is, and the population of Nevada? It would help me.

Mr. WEINSTEIN. New York's population is around about 15 or 16 million.

Representative RICHMOND. 18.5 million.

Senator SARBANES. 18.5 million. And Nevada is?

Mr. WEINSTEIN. Nevada is about 500,000, I guess.

Representative RICHMOND. One million.

Senator SARBANES. I just wanted to put this $55 billion versus $8 billion projected growth in personal income in some perspective. Thank you.

Mr. WEINSTEIN. These projections of income are not surprising. As figure 3 indicates, regional income convergence has been in progress for many decades, a marvelous testimony to the workings of a relatively free market. But the adjustment process is far from complete. Even in the year 2000, per capita income will remain below the U.S. average in most of the southern and Rocky Mountain States while the Far West, Great Lakes, and Midwestern States will still be above the national average. [See figure 2.]

The policy implications of these trends should be obvious. When discussing regional growth and decline, we must always remember that our terms are relative, not absolute. We must also avoid the mindset that believes economic growth is a zero-sum game—that one region's gain is another's loss. The North will rise again as production and living costs in the south and west soon catch up to northern levels.

Mr. Rohatyn is fond of quoting President Kennedy's phrase that "a rising tide floats all ships." A return to full employment and high economic growth rates will aid the lagging regions of the Nation much more than any geographically targeted Federal assistance or spending programs.

Thank you.

[The table and figures referred to by Mr. Weinstein follow:]

TABLE 1.—DISTRIBUTION OF GRANTS BY REGION, SELECTED FISCAL YEARS

Federal regions ranked by Federal dollars per capita, 1980	1980 total grants	Per capita 1968	Per capita 1980	Per capita Percent increase, 1968–80
1st: New York, New Jersey, Puerto Rico, Virgin Islands	$14.1	$90	$502	458
2d: Maine, Vermont, New Hampshire, Massachusetts, Connecticut, Rhode Island	5.7	94	467	397
3d: Idaho, Oregon, Washington, Alaska	3.7	113	464	311
4th: Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming	3.1	133	451	239
5th: Virginia, Pennsylvania, Delaware, Maryland, West Virginia, District of Columbia	10.6	88	435	394
6th: Arizona, California, Nevada, Hawaii, other territories	10.6	113	377	234
7th: Illinois, Indiana, Michigan, Ohio, Wisconsin, Minnesota	17.1	70	377	439
8th: Kentucky, Tennessee, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida	14.1	91	368	304
9th: Iowa, Kansas, Missouri, Nebraska	4.1	82	346	322
10th: Arkansas, Louisiana, Oklahoma, New Mexico, Texas	8.2	103	328	218
Total	91.5	90	400	344

Source: Special Analyses, Budget of the U.S. Government, Fiscal Year 1982.

FIGURE 1

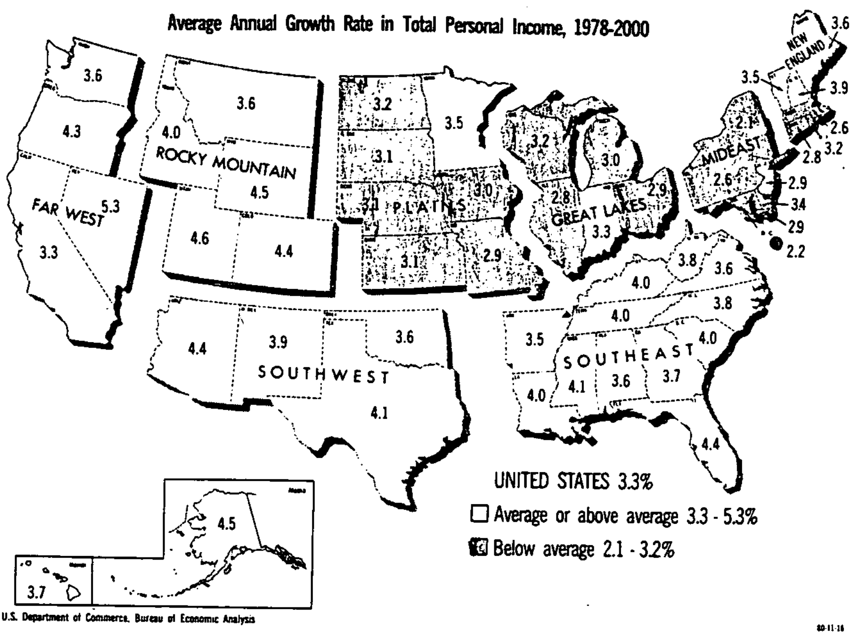
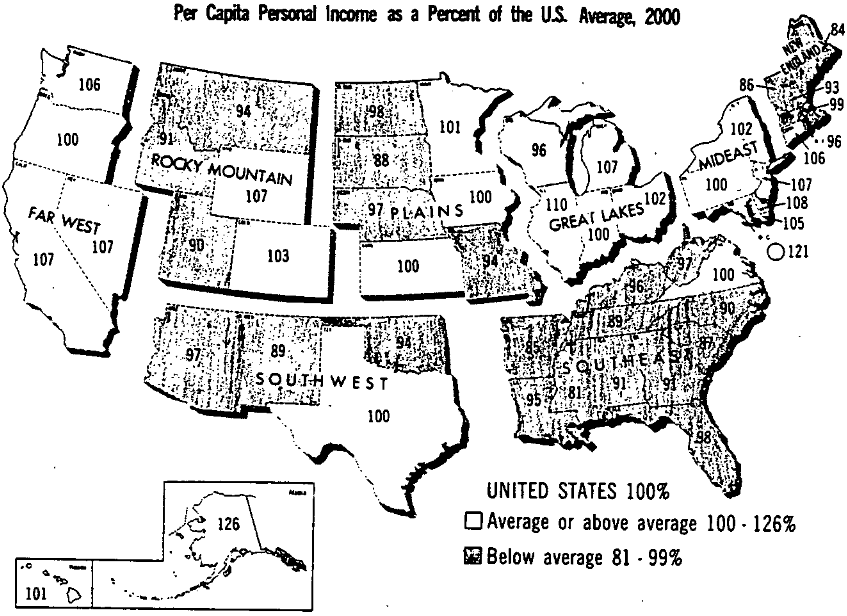


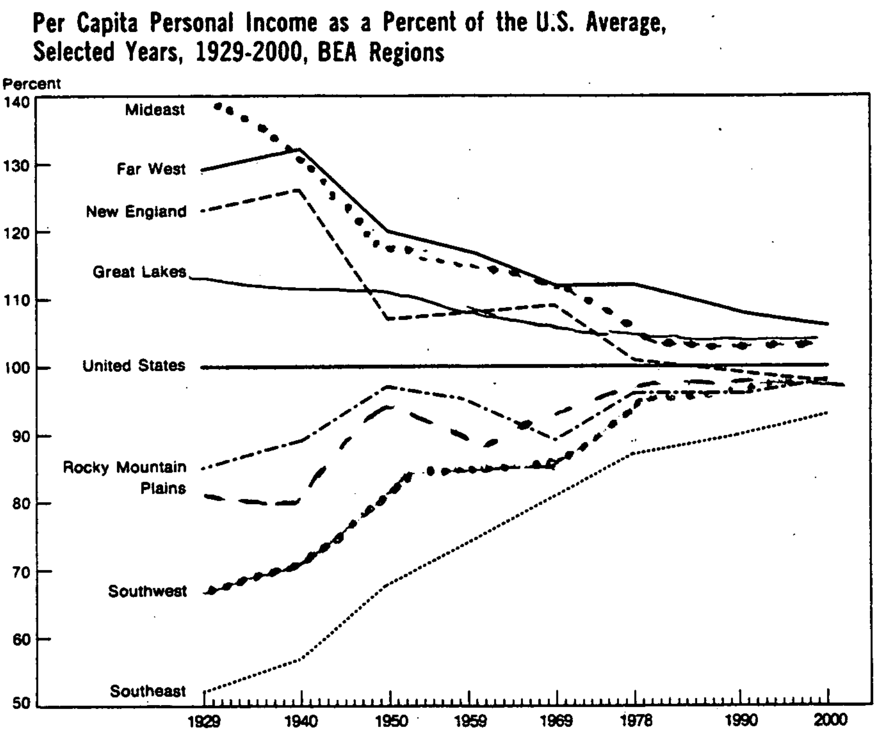
FIGURE 2

Per Capita Personal Income as a Percent of the U.S. Average, 2000



U.S. Department of Commerce, Bureau of Economic Analysis

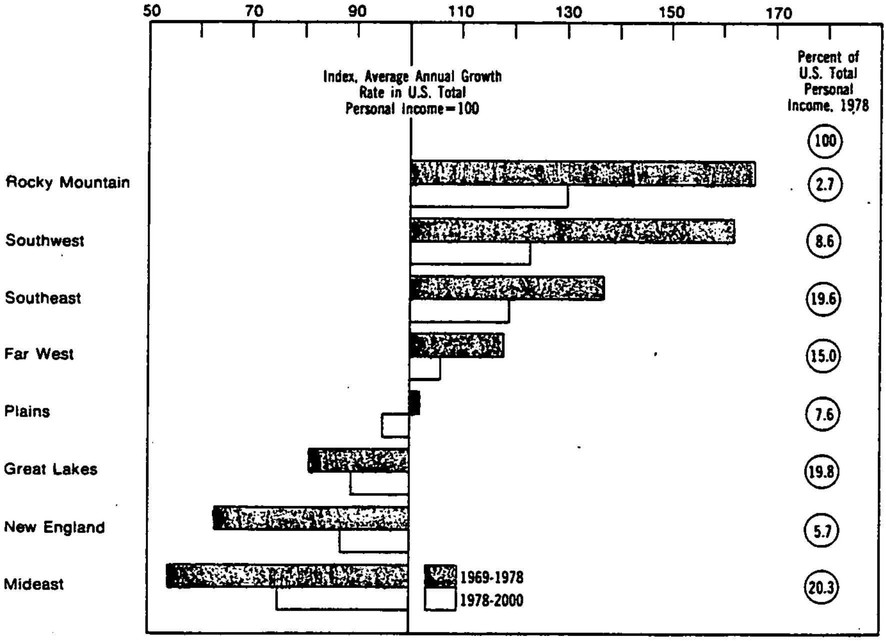
FIGURE 3



U.S. Department of Commerce, Bureau of Economic Analysis

FIGURE 4

Average Annual Growth Rate in Total Personal Income, 1969-1978 and 1978-2000, BEA Regions



Note.—Regions ranked by average annual growth rate in total personal income, 1978-2000

U.S. Department of Commerce, Bureau of Economic Analysis

Representative REUSS. Thank you, Mr. Weinstein.

We will now examine the witnesses. There are so many questions in so little time. We will operate on the 5-minute rule.

Mayor Rusk, I listened with rapt attention to your job-like question of how long do you have to put up with the Cold Belters whose cause you espoused when, unfortunately, it happens to be that the Cold Belt States, Midwest and Northeast, which have most balkanized their local communities when—thank God for whoever was in the Texas Legislature and the New Mexico Legislature when they permitted by State law cities like Houston and Dallas and Albuquerque to grow so that wealthy people in the suburbs couldn't opt out of paying for the cost of what was essentially a city.

And I think your point was that God helps those who help themselves and it ill-behooves Cold Belters to come down too hard against Sun Belters while doing nothing to get their own governmental house in order. Is that correct?

Mr. RUSK. That's correct. And I fully understand the tremendous resistance to these kinds of changes.

Representative REUSS. One reason my attention to your remarks was so rapt was that I'm the author of the legislative proposal you described; namely, during the 1970's I tried very hard to get the Federal

Government to use revenue sharing as a catalyst to get the States to do the right thing, that is, to, among other things permit metropolitan fiscal problems to be handled on a metropolitan or statewide basis instead of saying to the mayors of central cities, "You've got to find the resources to take care of the poor."

Mr. RUSK. I was not aware you were the author.

Representative REUSS. I'll send you a copy of the leading work, "Reuss Revenue Sharing, Crutch or Catalyst," Praeger 1971, 295.

Mr. RUSK. We haven't made much progress.

Representative REUSS. Unfortunately, the only ally I could recruit for this legislative program, which program of mine was a dismal failure in the Nixon, Ford, and Carter administrations respectively—the only ally I could get was the dear League of Women Voters who did fine, but they didn't have enough troops.

I raise all this because it occurred to me as you spoke that maybe you could rally your Sun Belt political colleagues into some sort of an effort to get a Federal incentive to the States to do the right thing.

The Agenda for the Eighties has a hint or two of this when on page 66 of their report on Urban America in the Eighties they say,

> Only a very few States currently are willing or politically disposed to assume significantly greater responsibility for cities in their jurisdictions despite their increased capability to do so. Rectifying inattentiveness and inadequacy at the State level might well be considered a major thrust of Federal policy intervention in the decade ahead.

I think the report is driving at the same thing you were talking about.

Mr. RUSK. Yes.

Representative REUSS. And I commend to you as a political tactic getting the Sun Belt, who are in no inconsiderable force, pumping for this. It might then come to pass and a good part of the gripes of the Cold Belt would thus be met. Not, however, Cold Belter that I am, I hasten to add—not all of the gripes.

At that point let me turn to Mr. Weinstein. I certainly agree with you that it's entirely proper and maybe good that throughout our history there have been population shifts and right now it's benefiting the Sun Belt and that's not bad. That's good in terms of national history. However, aren't there a couple of very important factors which have to be taken into account by Texans and New Mexicans as well as by Wisconsonites and New Yorkers and Marylanders; namely, two things: the humane point, that you have in your Buffalos and Clevelands and New Yorks and a hundred other Cold Belt cities, a lot of people who, for reasons that may not be heavy on logic but they are heavy on human considerations—family, friends, churches, shops, that's the way it's always been—that's where they are—and though I would agree that we ought to do more at preparing such of those people who want to migrate to Phoenix or Los Angeles or Houston to do so, nevertheless, a great many stay behind.

And my question is, for reasons of social policy, shouldn't their happiness be a care of the Nation as well as of the State and local community?

Second, has not this Nation in the course of its first going on 200 years built up a great storehouse of physical assets in the so-called Cold Belt? Aren't there homes and factories and sewer and water and utility facilities and commercial centers which it would be a shame to let thoughtlessly die on the vine?

And therefore, it is enough just to say as a nation, we'll let nature take its course and let everybody move where the laws of economics say they should move and the devil take the hindmost to those who are caught not moving?

Mr. WEINSTEIN. Let me offer several responses. I guess what disturbs me is that the popular press and some northern politicians have created an image that the northern quadrant of the country is being denuded of people and industry and that the trend is going to continue. I don't think the evidence supports that view.

The issues that you have raised really deal with some conflicts between economic and social policy or between people oriented policies and place oriented policies and strategies, and I think what the President's Commission report was really saying is we need to separate some of these efficiency and equity considerations. We have been too much concerned with place oriented policies and not enough with people oriented policies.

And the other thing you should remember is that same report advocated a Federal takeover of welfare which would go a long way toward improving the tax base of all Northeastern cities, or at least freeing up resources that could be used for other type programs.

Representative REUSS. I read the report and I think part, at least, of the bad press which it got in the Cold Belt—and I think it was a deserved bad press—was that its bark was frequently worse than its bite. It did seem to snarl at the Cold Belt in a manner that ill-behooved the national rapport, but that may have been rhetorical and linguistic.

Mr. WEINSTEIN. As Mayor Rusk suggested and some of my own research has indicated, energy costs, commuting costs, production costs, and cost of living are rising rapidly in the South and West. Pretty soon the Sun Belt is not going to be able to market itself on the basis of cheap labor or cheap energy or cheap anything, and that is going to work to the competitive advantage of the Northeast which has the infrastructure. It really does come down to economics. If there is an economic base, a true economic base serving national and international markets, northern cities will survive and thrive.

Representative REUSS. Well, getting back to the two points I make then, I gather—but I don't want to put words in your mouth—that you don't object to either of those points—the humanity, the human beings point and, for heaven's safe, let's not throw away trillions of dollars worth of physical assets in this time of shortages.

Mr. WEINSTEIN. I certainly don't dispute that. On the other hand, over the long term, I think the market will recognize and adjust to that—the existence of that infrastructure.

Representative REUSS. In the long term, as somebody said, we will all be dead, and some poor souls living in Buffalo now are concerned.

Mr. WEINSTEIN. I do want to endorse Mayor Rusk's view on metropolitan governments because that really is the do or die for the future of the cities. I've worked for the past several years with the Southern Growth Policies Board and we have recently completed a study of annexation practices in the Southern States. We have found that cities in States with liberal annexation laws are doing well, and in those States that have tight and restrictive annexation laws in the South, cities, especially the large ones, are facing the same kinds of problems that you find in the Northeast.

Representative REUSS. Well, I give full credit to those Southern States which for reasons I have never been able to determine saw the light years ago and enacted schemes of government which made balkanization much less easy. My time is up. Congressman Richmond.

Representative RICHMOND. Thank you, Mr. Chairman.

Mr. Rohatyn, your comments about the RFC are very pertinent. I think you agree with many of us that we all can learn a great deal from the Roosevelt era about putting the United States back in shape again. Some of the Roosevelt plans I see in the RFC and the WPA could well be reactivated now.

My only problem with the RFC is I believe your focus is too small. We realize this Nation needs right now a minimum of 10 brandnew steel mills; that each steel mill will cost a minimum of $3 billion; that right in the last generation we have only built 1 steel mill in the entire United States, during which time Japan built 16. So just in steel alone, in order to repossess our frontal position in steel, we need roughly $30 billion.

Now let's go into other basic industries which are in equally sad shape. Let's go into the rail system which is in sad shape and the automotive system which is in bad shape. I think your RFC plan must be incredibly larger in order to really help the Nation as a whole.

Now the second question to you is how do you plan to float an RFC which you describe so eloquently in your study at any interest rates approaching today's current rates?

Mr. ROHATYN. Mr. Richmond, let me first say that on just the notion of the RFC, it seems to me the numbers I was talking about were relatively large and I was, in deference to the mood of the day, trying to identify the RFC much more with Herbert Hoover than Franklin Roosevelt.

Representative RICHMOND. Except they are impractical when you take today's requirements.

Mr. ROHATYN. What I am trying to say, and I'm quite serious, it seems to me that any credit assistance mechanism, which is what an RFC is, that would in effect have Government backing, should never be more than just a fraction of the total investment involved in any project.

I took as an example our use of Federal guarantees in the New York City financing plan where the last financing plan we put together and in which you participated amounted to about $4.5 billion, and of that $4.5 billion, essentially less than $1 billion was guaranteed by the Federal Government, and we use that as a kind of an effect to raise the balance of revenue that we needed elsewhere.

I think the revitalization or whatever you want to call the process that will revive our basic industries and our railroad system and et cetera, that basically most of the capital is going to have to come from a vigorous economy which will generate the revenues and the taxes out of tax reform, whether it's Kemp-Roth or whether it's a variant of the economic program.

I think there are areas where an RFC is needed partly to act as a catalyst and partly to extract those concessions that have to be made in some industries to make them competitive, both from the unions, from the customers and from the lenders; just as I agree with the mayor from Albuquerque that you ought to use the Federal Government to extract concessions from State legislatures and local legislatures to create regional government structures.

Representative RICHMOND. That's forgetting one thing, Mr. Rohatyn—interest rates. How are you going to float an RFC and have it do any sort of constructive work at anything approaching today's interest rates? Or basically, even before you discuss the RFC, what remedy do you have to bring this Nation back to some reasonable financing basis so that anybody can buy new equipment and modernize with or without the RFC?

Mr. ROHATYN. Mr. Richmond, I'm not God.

Representative RICHMOND. Don't you see, Mr. Rohatyn, the RFC sounds fine. The RFC is wonderful.

Mr. ROHATYN. I don't believe the economy of this country can function at this level of interest rates. On the other hand, you cannot bring interest rates down by themselves. Interest rates are a reflection of both the demand for money and the underlying inflation rate. You're not going to see interest rates come down in this country until you have accomplished a number of things.

One is to reduce government deficits. The other is to do something about the fact that you have a trillion dollars out there in the Eurodollar market which are being sent over there every year for what you're paying to OPEC for oil, and interest rates are affected by the underlying rate of inflation in terms of your wage and price increases.

Until you get at all of those, your interest rates aren't going to come down and no RFC, whether it's $20 billion, $50 billion or $100 billion is really going to affect that issue.

Now, obviously, any kind of credit-issuing organization can provide subsidized interest rate financing. I don't think that that is necessarily, except occasionally, a particularly good thing to do. I think that the RFC is a piece of a mosaic but the overall mosaic has to be an economy that functions and an economy that grows at a low rate of inflation and with interest rates that are much lower than today.

This country grew up on cheap energy and cheap credit. Now we have had an explosion in the cost of energy and we have superimposed on that an explosion in the cost of credit. I don't think it can function with both those cost factors exploding in the same decade.

Representative RICHMOND. Thank you, Mr. Chairman.

Representative REUSS. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Professor Weinstein, I was interested, first of all, in your statement that "The rest of the country appears comparatively robust" on this unemployment and recession question. Compared to what?

Mr. WEINSTEIN. With reference to the national unemployment rate, with reference to the job growth that has occurred over the past 6 months.

Senator SARBANES. As I understood it, it was compared to the few States that are actually in a depression; is that not it?

Mr. WEINSTEIN. That's another way of looking at it.

Senator SARBANES. How much solace should we take from the fact that you use as a benchmark a few States that are in a depression and then tell us that the rest of the country appears comparatively robust compared to them?

Mr. WEINSTEIN. Well, if you look at it on a State-by-State basis, you will find that most States are below the national average. The national average is high primarily because you have three large States that are suffering from an automobile depression. I'm not saying that's good.

Senator SARBANES. How about compared with other economies? Do you think we're pretty robust compared to the economies of other countries?

Mr. WEINSTEIN. Well, certainly we compare favorably with the United Kingdom and——

Senator SARBANES. That's a lot of help. We're going from bad to worse.

Mr. WEINSTEIN. I'm not saying that a 7.5-percent unemployment rate is desirable. What I'm saying is if you look at it on a State-by-State basis, the severe impact seems to be occurring in three States; that if it were a broader-based recession you would expect to find higher unemployment rates in more than three States.

Senator SARBANES. If you strike the word "macroeconomic" from the underlined sentence, would you still make that statement? "Regional balance cannot, and should not, be an explicit goal of macroeconomic policy,"—if you strike the word "macroeconomic," would you still make that statement?

Mr. WEINSTEIN. If you wanted to substitute "Federal," because I'm thinking of tax and spending programs as well as monetary and fiscal policy in the broadest sense.

Senator SARBANES. You don't think the question of regional balance ought to be a matter of any Federal policy? Is that your position?

Mr. WEINSTEIN. Yes; that is my position.

Senator SARBANES. Would you say that most other countries in the world, and certainly those of any significant geographical size, seem to treat the question of regional balance as a pertinent matter of policy?

Mr. WEINSTEIN. Yes, they do, and they have not been very successful. The Italian Government has been trying to revive southern Italy for decades with very little success. You can also find examples all over the developing world.

Senator SARBANES. I know there are problems with it, but you wouldn't have that a matter of policy consideration at all; is that correct?

Mr. WEINSTEIN. It seems to me that in the absence of specific regional policies that we have seen a very significant conversion of regional incomes and development in our lagging areas.

Senator SARBANES. Do you think our policies should have been devoid of regional impact?

Mr. WEINSTEIN. Of course not. All Federal policies have regional impact.

Senator SARBANES. If that's the case, how can you ignore as a policy matter the question of regional balance?

Mr. WEINSTEIN. I would argue that over time, Federal policies, macroeconomic policies, fiscal, procurement, and what have you, have treated different parts of the country fairly and equally even though the intent of these programs was not to do that. Obviously, Federal policies have——

Senator SARBANES. It all works out in a wash? Is that it?

Mr. WEINSTEIN. I think it does. I think if you look at the aggregates in terms of economic growth, in terms of industrial development, it has worked out that way.

Senator SARBANES. I want to get to those aggregates. That comes later in the paper.

Do you think a State should be able to place any level of severance tax that it chooses on its energy?

Mr. WEINSTEIN. I think a State has a right to levy any level of tax that it wants to, but I don't think that the State has the ability to make that level stick. To my mind, the whole severance tax issue could be defused if we had some rationalization of our national energy policies and in particular if we made some changes at the Federal level in legislation that requires the use of a specific fuel for a specific purpose. For example, the Power Plant and Industrial Fuel Use Act which says that all utilities and large industrial users must convert to coal or nuclear by the end of the decade. We also have environmental regulations that require the use of low sulfur coal. So what you're doing with Federal regulation is mandating the use not only of coal but of low sulfur coal which is only found in two States. In a sense we convey a monopoly to places like Montana and Wyoming.

What we need is more interfuel competition and not the mandating of specific fuel use for specific purposes, let the market decide what fuel to use.

Senator SARBANES. In other words, you think it was a mistake to require the utility companies to shift from oil to coal?

Mr. WEINSTEIN. I think it's a mistake to have a Federal legislation requiring that that shift be accomplished with the use of a specific fuel and that it be done in a specific time period, especially since we're sitting on a large natural gas bubble now. Over time, in the absence of Federal intervention and regulations, I would expect all fuels to be priced on some kind of a Btu equivalency basis and I would think that utilities and large industrial users would choose their fuels accordingly. And also, if you did that, you wouldn't be conveying what I would call monopoly power to States like Montana and Wyoming.

Senator SARBANES. In other words, you do think it was a mistake to require the utilities to convert from oil to coal?

Mr. WEINSTEIN. Yes.

Senator SARBANES. How do you address the problem of trying to become less dependent on oil? How do you address the problem that we have significant coal resources, so much so that we are exporting coal, but that we now import almost one-half of our oil; and we perceive an interest in becoming less reliant upon oil, half of which comes from abroad, and more reliant upon coal, all of which comes from here? Do you disagree with that effort to shift and become less reliant on oil?

Mr. WEINSTEIN. No; I don't disagree with that effort at all.

Senator SARBANES. How are you going to do it?

Mr. WEINSTEIN. I think the reason our coal production has not increased as much as we had hoped reflects a whole series of regulatory practices, environmental requirements, labor problems, and a host of other problems that would take hours to get into.

I do think, as I said a moment ago, that if we remove all price controls and allocation schemes on fuel use, that the market will work in the way that coal will become the major fuel in the future.

Senator SARBANES. Do you think from the national point of view that we should provide incentive measures other than the market price to try to shift us from reliance upon one energy source, much of which is abroad, with the problems that run with that, to an energy source which is here at home?

Mr. WEINSTEIN. I think the market can accomplish that transformation much more efficiently than Government intervention.

Senator SARBANES. And how is that going to happen?

Mr. WEINSTEIN. How is that going to happen?

Senator SARBANES. Yes.

Mr. WEINSTEIN. I would assume that the higher price for oil and gasoline will make alternative fuels more attractive.

Senator SARBANES. Why won't they go to the same price? Why can't you assume that the price will be the same?

Mr. WEINSTEIN. Well, I think over time the price will be the same on a Btu equivalency basis, but the cost——

Senator SARBANES. Assuming the price is the same, how do you move from being dependent on the foreign source to greater use of the domestic sourse?

Mr. WEINSTEIN. Well, isn't that already happening? I believe over the last 2 years, in terms of the quantity of oil imported, we have been bringing in less.

Senator SARBANES. We have had a recession too, and that's got something to do with it.

Mr. WEINSTEIN. Plus higher prices.

Senator SARBANES. And some conservation too, but we have had a recession. I don't see how you are addressing these broad national questions.

On the severance tax, I take it to be your view that the State can impose any tariff it wants and that doesn't concern you?

Mr. WEINSTEIN. That doesn't concern me? I think the State has a right to levy taxes on energy production, but I qualify that by saying that in a world of interfuel competition, the coal-producing States in particular would not be able to levy excessively high taxes.

Senator SARBANES. Why not?

Mr. WEINSTEIN. Why not?

Senator SARBANES. The oil-producing States would compete with them? Right?

Mr. WEINSTEIN. The oil-producing States and the gas-producing States would compete with them.

Senator SARBANES. What about the States that are nonproducing in coal, oil, gas, and so forth?

Mr. WEINSTEIN. I think Mayor Rusk raised some of these perspectives and I tried to address the whole question of the cost associated with development. I don't believe, and the evidence that I have seen does not indicate, that projected revenue increases are excessive relative to the public service costs associated with the development that's going to occur.

Senator SARBANES. That's a different issue. That issue would be addressed in your prepared statement, if you strike the words "totally unconvincing" and put in the word "overstated." Then you say that "the argument that decontrol of energy prices will result in a massive redistribution of wealth among regions overstated," then you can make that argument. But I don't see how you can deny there's a concern, if the severance tax is unlimited as for the producing States, that it puts the nonproducing States in an extremely vulnerable and difficult situation. You can't deny that, do you?

Mr. WEINSTEIN. Even if we accept the $120 billion figure—and that is over the next 10 years—$12 billion a year does not strike me as a major redistribution of wealth.

Senator SARBANES. You're talking about the degree. I'm talking about the kind. Is it you view that the severance tax, no matter how high, is not of concern to you?

Mr. WEINSTEIN. My view is that, in the proper economic environment, the severance tax cannot be set at excessively high rates.

Senator SARBANES. It can be set by all the producing States with respect to all the different sources of energy. You have no limitation then.

Mr. WEINSTEIN. But it seems to me what we ought to be doing is encouraging competition among the States and among fuel uses.

Mr. Chairman, if I might submit for the record a paper that I presented at the National Tax Association's annual meeting several months ago that deals with this whole question of severance taxes, it might be helpful for the record.

Representative REUSS. Without objection, we would be delighted to have that included in the record.

[The paper referred to was subsequently supplied for the record:]

[Presentation to National Tax Association Annual Meeting, New Orleans, La., Nov. 18, 1980]

STATE ENERGY TAXATION: PRODUCER STATE ISSUES

(By Bernard L. Weinstein)*

A. INTRODUCTION

There is little doubt that the prices of domestic energy resources will rise considerably over the next decade. Crude oil and natural gas will be totally deregulated by 1985, and growing use of coal as a boiler fuel will put upward pressures on coal prices.

As energy prices rise, ad valorem levies on production—such as most State severance taxes—will generate substantially higher revenues. For example, a recent Congressional Budget Office study, using a petroleum industry model, estimates that total State and local revenue to oil producing States will increase $112 billion between 1980 and 1990, about $10.8 billion per year, as a result of decontrol.[1] Another CBO study projects that the 10 major coal producing States will realize gains of over $1.3 billion annually by 1990 from severance and production taxes, assuming no change in existing tax rates.[2]

*Professor of political economy, University of Texas at Dallas, Richardson, Tex.

[1] Congressional Budget Office, "The Windfall Profits Tax: A Comparative Analysis of Two Bills," Staff Working Paper. Washington, D.C., U.S. Government Printing Office, November 1979, p. 22.

[2] Congressional Budget Office, "Energy Development, Local Growth, and the Federal Role," Staff Working Paper. Washington, D.C., U.S. Government Printing Office, June 1980, p. xii.

These revenue gains have been dubbed "unfair windfalls" by the Northeast-Midwest Institute and other interest groups representing nonproducing States. "Severance tax warfare," it is claimed, will accelerate the movement of people, jobs, and wealth from the Northeast to the Sunbelt as energy-rich States will be able to hold down, or reduce, sales, income, property, and other taxes on their residents.[3]

B. THE RATIONALE FOR SEVERANCE TAXES

Severance taxes have been part of the state fiscal picture since 1846 when the state of Michigan first imposed a tax on the extraction of iron ore. Currently, 33 states impose severance taxes on mineral and timber production. In fiscal 1979, the combined yields for all states were $2.9 billion, or 2.3 percent of all state government tax revenue.[4]

Traditionally, severance taxes have been justified on the grounds of real resource depletion—i.e., once severed from the soil, the resource no longer constitutes part of the state's economic base. In practice, the severance tax is an "excise" levied on producers for the privilege of extracting "non-renewable" resources such as coal, oil, gas, iron ore, and sulfur. (It is arguable whether timber is renewable or not.)

During the years ahead, an even stronger case can be made for levying severance taxes. Development of new energy resources, especially in the more rural western states, will place serious strains on state and local budgets. People and businesses flocking to new energy-related communities will need expanded services such as education, police and fire protection, and health care. New roads, water systems, and sewerage will also be required. These front-end costs cannot be easily underwritten by the existing tax base, and concern has been expressed about imposing significantly higher tax burdens on the permanent residents of energy-producing areas who are frequently farmers and ranchers.

Severance taxes on both an efficient and equitable means of financing the public service costs associated with energy development. Administration of the tax is quite simple since the state revenue department only needs to know the quantity produced and the transaction price (in the case of ad valorem severance taxes). On equity grounds the tax also holds up since it spreads part of the development costs among final users of energy resources in the form of higher product prices.

While the popular press has played up the alleged tax bonanza to energy-producing states from higher severance tax yields, more careful analysis suggests that projected incremental receipts will, on balance, just about cover projected increases in public service costs, at least for coal and synthetic fuel plant states. For example, a recent CBO study looked at the additional costs and revenue associated with coal and synthetic fuel development in the ten major coal-producing states: Alabama, Colorado, Illinois, Montana, New Mexico, North Dakota, Texas, Utah, West Virginia, and Wyoming.[5] Production was assumed to increase 9 percent annually through 1985 and 7 percent annually between 1985 and 1990. Incremental public service costs were estimated for water, sewage, waste, police, fire, recreation, education, roads, land acquisition, and general government administration. According to CBO, five states—Alabama, Illinois, Texas, Utah and West Virginia—are likely to experience costs in excess of revenue if existing tax rates are maintained and if coal production increases to assumed levels. The remaining five states are likely to experience revenue surpluses. It should be noted that CBO estimated only the direct costs associated with energy development. Social costs, such as environmental degradation, congestion, higher crime rates, etc., were excluded from the calculations.

Finally, the imposition of severance taxes can be justified on the grounds of states' rights since all tax powers not delegated to the federal government devolve to the states. In this regard, any federal attempts to limit or preempt state severance taxes would pose serious constitutional questions. The Northeast-Midwest Institute argues that energy resources belong to the nation as a whole, not the producing states, and that the federal government thereby has the right to eliminate individual state severance taxes in favor of a federal system that would share revenues among all 50 states.[6] Carried to its logical conclusion, this line of

[3] See Northeast-Midwest Institute, "The Effects of Rising State Severance Tax Revenues: 1980–1990," Regional Energy Impact Brief No. 10. Washington, D.C., Northeast-Midwest Institute, February 1980.
[4] U.S. Bureau of the Census, "State Government Tax Collections in 1979," GF79, No. 1. Washington, D.C., U.S. Government Printing Office, January 1980, p. 7.
[5] Congressional Budget Office, "Energy Development . . . ," pp. 36–45.
[6] Northeast-Midwest Institute, op. cit., pp. 11–12.

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reasoning implies that all natural resources belong to the nation as a whole and that any state may lay claim to the resources of another. For example, while Texas may be long on oil it is short on water. Does water in Wisconsin inherently belong as much to Texas as to Wisconsin itself? Does the federal government have the right to redistribute water from Wisconsin to other states on the basis of need? If so, a total restructuring of intergovernmental relations, accompanied by a slew of constitutional amendments, will probably be required.

C. WHY SEVERANCE TAXES HAVE EMERGED AS A POLITICAL ISSUE

Energy severance taxes have been condemned by northern politicians and consumers not only because of the alleged windfalls to the producing states but because of the exportability of the taxes. The fact that energy consumers in New York and Massachusetts are helping to pay the taxes in Wyoming or Louisiana is somehow deemed "unfair." In practice, of course, all states attempt to export some of their taxes. Just as Texas' severance taxes are passed on to out-of-staters, so are taxes paid by automobile manufacturers to the city of Detroit passed on to those who buy cars and trucks in Dallas. Likewise, consumers of steel are indirectly paying taxes to Pittsburgh, and every transaction on the New York Stock Exchange is subject to a state-imposed transfer tax regardless of the Stockholder's state of residence. Florida "exports" its tourist taxes and Nevada "exports" its gambling taxes.

Another new objection to severance taxes is that they place excessive burdens on interstate commerce. In this regard, the U.S. Supreme Court recently agreed to hear an appeal by Commonwealth Edison Company and 10 other utilities claiming that Montana's 30 percent levy on coal interferes with interstate commerce in violation of the Constitution.[7] But a close look at the data does not support claims of excessive burdens to final users.

According to the North Dakota Tax Department, severance taxes on coal amount to less than 2 percent of consumer electric bills.[8] At current prices for coal, Wyoming's 17 percent severance tax is estimated to add only $6.00 per year to the bill of a consumer using 7,000 kwh annually. In fact, local sales taxes on electricity are typically more burdensome on consumers than severance taxes. For example, one ton of lignite coal would produce about $65 worth of electricity if it were sold in Detroit. Michigan, with a 4 percent sales tax, collects $2.60 from the consumer who buys that electricity. In contrast, North Dakota would receive only 89 cents in severance tax and Montana would receive $1.60.

The Northeast-Midwest Institute and other northern interest groups have argued that higher severance tax collections will enable energy states to keep other taxes low and thereby enhance their ability to attract new industry. Industrial growth in the South and West has been occurring for several decades as the result of national development trends and market forces, and the presence or absence of severance taxes has been a negligible factor in this growth. As discussed earlier, higher severance tax collections in most states will be allocated to cover the direct and indirect costs associated with energy development. Furthermore, studies conducted by the Advisory Commission on Intergovernmental Relations and other researchers over the past two decades have uncovered no direct link between the state/local fiscal structure and industrial location. Claims that severance tax "windfalls" will provide the catalyst for even greater industry and people migration are grossly overstated.

Concern has also been voiced that higher severance tax collections by energy-producing states will seriously distort the intergovernmental fiscal system. Several intergovernmental grants include a tax effort factor in the allocation formula, and growing severance tax yields will allegedly give rise to a false measure of actual tax effort since a portion of the tax is exported. There are two basic errors to this claim. In the first place, the tax effort measure in federal formulas is always expressed relative to fiscal capacity, and capacity is usually defined as state personal income. As energy development proceeds, personal income in those states will rise considerably. This growth in the "denominator" of the effort factor will more than offset the growth of severance tax collections in the "numerator:" thus, no appreciable change should be recorded in measured tax effort. Secondly, if energy-producing states use higher severance tax collections to reduce or eliminate other personal and business taxes, measured tax effort relative to

[7] Wall St. Journal, Dec. 9, 1980.
[8] Byron L. Dorgan, State Tax Commissioner, Letter to the Editor, New York Times, May 13, 1980.

rising fiscal capacity would drop and those states would receive less, rather than more, federal dollars.

It is curious that the ongoing debate over the severance tax issue has included little reference to the recently enacted windfall profits tax, which is not a profits tax at all but rather a federal excise tax on energy production. For example, the Texas Energy and Natural Resources Advisory Council has estimated that the federal government will collect approximately $13 billion from Texas oil producers during 1980–81 under the windfall profits tax. In contrast, Texas will receive only about $1 billion in oil severance taxes.

Furthermore, the northeastern and midwestern regions of the nation will receive a substantial share of the proceeds from the windful profits tax. Revenues have been earmarked for mass transit, low income energy assistance, and energy conservation programs that primarily benefit northern states and cities. At the same time, the Powerplant and Industrial Fuel Use Act of 1978 (PIFUA) will require massive outlays by southern and western utility companies to convert from natural gas to coal as a boiler fuel. The costs of conversion have been estimated at $13 billion, and the southern states, with one-third of the nation's population, will bear 89 percent of the burden.[9] While the South is incurring enormous outlays to convert from gas to coal, Congress is likely to provide direct subsidies to northern utilities to help underwrite the costs of converting from oil to coal.

D. DEFUSING THE SEVERANCE TAX ISSUE

The Northeast-Midwest Institute has proposed several options for dealing with the severance tax "problem." These include (a) outright limitations on the dollar value or rate of severance taxes and (b) the creation of a comprehensive federal severance tax in lieu of individual state taxes.[10] Several bills were introduced during the 96th Congress that would have limited the ability of states to levy taxes on energy production,[11] and similar legislation will likely reappear during the new Congress.

As mentioned earlier, the whole question of federal limitations or pre-emption poses some serious constitutional considerations, and any legislative initiatives of this nature would surely be challenged in the courts. Such clearly discriminatory public policy wuold also fan the fires of economic sectionalism, driving a political wedge between the energy haves and the energy have-nots. Isn't there a common political ground where the severance tax issue could by neutralized?

Adoption of a rational and coherent national energy policy, accompanied by more sensible environmental regulations, would go a long way toward defusing the severance tax issue. Current energy and environmental policies are working at cross purposes, and higher severance tax rates—especially in the western coal states—are a predictable outcome.

For example, some laws, such as the Powerplant and Industrial Fuel Use Act, mandate the use of specific fuels for specific purposes. In the case of PIFUA, only coal may be used as a boiler fuel in the future and existing gas-fired capacity must be converted by 1990. No interfuel substitution is permitted, even though for two years we have been adding to gas reserves at a rate faster than current consumption. While coal conversion is being mandated by energy policies, environmental regulations are putting a premium on low-sulfur, western coal. Because Montana and Wyoming account for more than two-thirds of the nation's low-sulfur coal reserves a large degree of monopoly power is conferred upon those two states. Facing a relatively inelastic demand curve for their prime natural resource, Montana and Wyoming are behaving in a completely rational manner by boosting taxes on coal production. In a similar vein, all environmental and other regulatory constraints on the development of nuclear energy confer some degree of monopoly power to fossil fuel producers.

The "solution" to the severance tax problem is to reduce the monopoly power of low-sulfur coal states and fossil fuel producers generally. Required are the complete and rapid decontrol of all energy prices, recission of federal laws and mandates pertaining to fuel use, the revival of our nuclear power program, and a modest relaxation of air quality standards so that eastern coal and lignite can be used more readily as boiler fuels. Such a program would ensure that all fuels were priced on a BTU equivalency basis, and no one state would be able to levy excessive production taxes for fear of losing business to other states and other fuels.

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[9] Southern States Energy Board, Annual Report 1980. Atlanta : Southern States Energy Board, 1980.

[10] Northeast-Midwest Institute, op. cit., pp. 11–12.

[11] For example, H.R. 6625, 6654 and S. 2695.

Senator SARBANES. Let me ask you about these figures. "Over the next 20 years, real personal income in 'stagnant' New York is expected to grow by $55 billion while 'booming' Nevada will post a mere $8 billion gain."

Now those figures aren't adjusted for population, are they?

Mr. WEINSTEIN. No, they weren't intended to be.

Senator SARBANES. In other words, you're telling us, I guess, that New York is going to do pretty well by growing $55 billion while Nevada only grows $8 billion, when New York has got 18 times more people than Nevada. What is the point that you're making there, in light of the gross disparity between the two States in population?

Mr. WEINSTEIN. The point that I'm trying to make is that too much of our focus is on rates of change and not absolute levels of income and wealth, that a slow growing State like New York can be relatively robust despite its slow growth and that a State like Nevada which is projected to grow in terms of population two- or threefold over the next 20 years in terms of total income compared with the slow growing large State like New York—it really doesn't compare—but I think the interesting trend, at least as projected——

Senator SARBANES. Given this figure of yours, aren't you going to do better significantly per capita if you're in Nevada than if you're in New York?

Mr. WEINSTEIN. The Bureau of Economic Analysis has also projected that population outmigration from the Northeastern States will slow down and inmigration to the Sun Belt States will also slow down. If you look at figure 4 on the last page——

Senator SARBANES. Let me get an answer to my question. n a per capita basis, aren't you going to do far better if you're in Nevada with an $8 billion growth in the next 20 years than if you're in New York with a $55 million growth?

Mr. WEINSTEIN. No. According to the ——

Senator SARBANES. Explain that to me.

Mr. WEINSTEIN. If you look at figure 2, which is a projection of per capita personal income in the year 2000, aind even 20 years from now, per capita income in New York will be above the national average. It will also be above the national average in Nevada, which is not surprising considering how fast Nevada is growing.

Senator SARBANES. What is it going to be in New York?

Mr. WEINSTEIN. In the year 2000?

Senator SARBANES. This is figure 2 of your chart.

Mr. WEINSTEIN. Figure 2.

Senator SARBANES. What's it going to be in New York in the year 2000?

Mr. WEINSTEIN. In dollar terms?

Senator SARBANES. On per capita personal income as a percent of the U.S. average, what's it going to be?

Mr. WEINSTEIN. It's going to be 102 percent.

Senator SARBANES. What is it going to be in Nevada?

Mr. WEINSTEIN. 107 percent.

Senator SARBANES. I repeat my question. Aren't you going to do better per capita in Nevada than if you're in New York?

Mr. WEINSTEIN. According to these projections, you will.

Senator SARBANES. You just told me that you wouldn't, and you told me to look at table 2.

Mr. WEINSTEIN. If you look at the country as a whole, half of the States are still going to be below the national average per capita income in the year 2000, including almost all of the Southern States.

Senator SARBANES. Professor Weinstein, you've got some good points in this paper but I don't know why you're giving us this junk about a $55 billion stagnant economy in New York and a booming $8 billion economy in Nevada, as though that proves that New York is booming and Nevada is stagnant, when you've got a gross disparity between the two stages in number of people to which this increase in real personal income must be referred. You know, some of these other points have got some rationality to it, but I don't think that one has any. I'm trying to find out what it is, and I haven't found it yet.

Mr. WEINSTEIN. The point, if I can summarize——

Senator SARBANES. My time is up. I'll come back to it and give Congressman Richmond a chance.

Representative RICHMOND. Thank you, Senator.

This is just to underline Senator Sarbanes' remarks. I worked that out arithmetically and your statement should say:

> Over the next 20 years, real personal income in the stagnant New York is expected to grow $55 billion, an amount of roughly 30 percent, while booming Nevada will post a mere $8 billion, an amount of 800 percent.

So, Professor Weinstein, I think you take us all to be fools up here.

Mr. WEINSTEIN. I'm trying to make the difference between rates of growth in absolute dollars.

Representative RICHMOND. I think you agree that wasn't a particularly good example. You're talking about one economy that you yourself say is going to grow 30 percent in 20 years and another economy that's going to grow 800 percent in 20 years.

Senator SARBANES. Cut your losses and agree with that statement, then we can address some of the other points.

Representative RICHMOND. In your prepared statement you say that the Northeast and Midwest, of which Mr. Rohatyn is one of our great protagonists, received back in Federal funds much more than it gives.

A recent study by the Advisory Commission on Intergovernmental Relations estimates that the revenues collected by the Federal Government between 1952 and 1976 from residents of the Northeast, the Great Lakes and the plains regions exceeded the amount expended by the Government in these regions. The reverse was true for the Sun Belt. Over this period there's been a tendency for the ratio of estimated Federal Government expenditures to expected Federal revenue collected to converge across regions.

Now the Great Lakes, for every dollar contributed by residents to the Federal Treasury, only 74 cents was expended in that region. Now there again in your own statement you made the remark that the South receives less dollar help from the Federal Government than the Northeast or the midwest. It's totally untrue.

Mr. WEINSTEIN. No, I didn't say that.

Representative RICHMOND. You said that in your prepared statement.

Mr. WEINSTEIN. I said if you look at Federal aid per capita, the mid-Atlantic region and the New England region receives more dollars on a per capita basis.

Representative RICHMOND. Sure, because they contributed more. That's why.

Mr. WEINSTEIN. In terms of Federal aid. Now if you want to look at the total fiscal flows of all revenues collected and all revenues expended, it's true that the Northeast and Midwestern regions get back less in total Federal spending than they sent to Washington and the South gets back more as a region.

Representative RICHMOND. Why didn't you say that in your statement?

Mr. WEINSTEIN. There's a simple explanation for that. The reason the Northern States pay more than they get back is because they have higher income levels and because our progressive income tax system takes more from wealthy individuals and wealthy States than it does from poorer individuals and poorer States. I think it's a very simple explanation for those kinds of disparities which really aren't disparities.

Representative RICHMOND. And what would it be in the South if it weren't for Federal aid to the Southern States? Do you know how little the average Southern State gives to support their aid to families with dependent children?

Mr. WEINSTEIN. Yes, I'm fully aware of it.

Representative RICHMOND. Did you know if it weren't for the Federal food stamp program the people down South would starve to death?

Mr. WEINSTEIN. I'm not prepared to comment on that.

Representative RICHMOND. The State of Mississippi gives roughly $120 a month to a mother of three children who is totally destitute. I'm sure you live on a lot more than $120 a month, don't you, Professor Weinstein?

Mr. WEINSTEIN. A little more.

Representative RICHMOND. Mayor Rusk, your presentation was excellent. You've obviously given it a number of times before because I notice you had it virtually memorized. I think what you have done in Albuquerque is most exciting and I think your statement was fair and well balanced.

Mr. RUSK. Thank you. We are not without our flaws, as we remind ourselves constantly at home.

Representative RICHMOND. I think you should be congratulated on what you're doing there and on your very honest and truthful and well-balanced statement.

Felix, why don't you extemporize a bit and tell us how we're going to save New York City and save the Northeast and what steps you feel we have to take in advance of your RFC. You're not only a civic leader but you're also a first-class banker. I'll tell you what. The chairman of this committee, Henry Reuss, came on a television program with you yesterday and enunciated a fantastic idea; namely, that the major financial countries of the world should have their central banks sit down together and work out one cooperative Eurodollar interest rate. He feels that would do more to stablize interest rates all over the world and keep money from running from country to country and he thinks that would be one of the most stablizing forces in the country. I was absolutely fascinated with his comments because I think it's so simple to just think of our Federal Reserve sitting down with the Bank of England, the Bank of France, the Deutsch Bank and a few others—the Bank of Japan—and all saying that once and for all we're not going to let interest rates go back and forth so there's no way to stabilize money. I think that would do an awful lot of good to every country's developmental program.

Mr. ROHATYN. I think before you can do that you have to probably orchestrate other economic policies between those countries. I don't think you're going to have any rational discussion on issues of that kind with the Europeans while we're charging $1.40 for gasoline and they pay $3.50. I think there are some issues that go beyond that.

I would like to just comment in general in conclusion on some of the things I heard here today. As you know, I think, and I say this as a businessman, I'm not an economist and I'm not a major and I'm not a newspaper editor—I run a private, highly capitalistic business and therefore I also sit on the boards of some large companies and I'm very skeptical of anything approaching an economic forecast and statistical extrapolations as to the future.

I think you really have to be living in a fairly high ivory tower not to look at this country and see its being divided into two very different regions and into classes of populations that are ultimately going to be warring with each other unless we are very careful, which will ultimately undermine everything that's been built here philosophically over the last 200 years. And I say this as an immigrant and as a refugee. You don't have to fool around with a lot of statistics—just walk around, whether it's in Cleveland, whether it's Bed-Sty in New York, whether it's the Southside of Chicago, or Detroit—to see what's happening to those cities, to see what's happening in the ghetto, to see what's happening to classes of population that have neither a now or a future, and at the same time having those parts of the country tied to industries that are in desperate shape.

And I think simply letting trends, when you can see the trend, a trend which is a very deeply flowing tide both economically and socially, going in directions that are highly destabilizing, I think the test of statesmanship is to do something about it before there is a crisis upon you.

There is no crisis upon us today like the New York City bankruptcy crisis. That doesn't mean there isn't going to be one, whether it's next year, 2 years from now, or 5 or 10 years from now. Just as in 1973 when OPEC quadrupled oil prices people said it won't make any difference; we're just going to recycle the money. We're still talking about recycling the money with the Third World in terrible shape, with no contributions to the economic problems we have in this country.

All I'm saying to you is I have no great hopes that anything is going to be done here reasonably soon, mostly because of the philosophies as stated by Professor Weinstein of let's let it work and see what happens. But if it doesn't work, then—I sincerely hope it works because, as I said, it would be the best thing for me, for my part of the country, and for my business, and for my family—but I don't think you can bet this country on its working. And if it doesn't work or if it doesn't seem to work or if these trends and tides continue to flow as they seem to be flowing, I think you have to be ready to do something about it.

Probably the first thing to try to do something about is to engage in a dialog among people who can talk rationally about what they can do in case this turns out to be the problem that I think it will be; and have a problem. But just as there ultimately has to be a dialog on recycling petrodollars rationally among the West, OPEC and the Third World, there ought to be—and probably this committee is about as good a place for it as any—the beginning of a dialog which ought to be really relatively unemotional about what happens if this thing does turn out to be the problem that at least some rational people seem to think it might become.

Because once these things get beyond a certain point, you can't reverse them. It isn't something where you can just at some point decide that you're going to do things a little bit different. You're going at very fundamental issues of American life, of social opportunity, of racial opportunity, and of philosophy. I think it's a serious issue.

I'm very grateful to have had the opportunity to appear before you and if I have done nothing else but at least hopefully continue to stimulate some dialog on this issue, I will be very grateful.

Representative RICHMOND. Thank you, Mr. Rohatyn.

Senator SARBANES. I just have a couple of comments.

First, Mayor Rusk, I think the point you make is a good one. I think probably to complete the analysis one would have to look at what the states do to recirculate money back to the localities within their jurisdictions, perhaps to compensate for the failure to permit the localities to expand their boundaries as you have been able to do in Albuquerque.

In other words, I think really to be able to draw a final, fair comparison, one would have to see whether Maryland does better at recirculating money to Baltimore, or New York State to New York City, than the State of New Mexico does to Albuquerque, because that's still within that geographical area.

Wouldn't you agree that's a central part of the analysis?

Mr. RUSK. Yes. I would note that the State of New Mexico has a school system equalization program. Basically the State collects taxes for all local schools. That has a major impact and in that way it has an equalizing effect around the State as well.

Senator SARBANES. I want to also say that I was in New Mexico last summer and heard repeatedly what a fine job the mayor is doing in Albuquerque. You don't always hear that at home but I did hear it, and I think I ought at least to tell you so here today. I commend you on that.

Professor Weinstein, I want to leave this thought with you. You say, "Others, including myself, believe that supply-side economic policies, as espoused by the new administration and the Joint Economic Committee, hold great promise for revitalizing all regions." I'm not sure that they espouse the same policies.

I think an important distinction has to be made between some of the recommendations which this committee has made and some of the recommendations which the new administration appears about to make In that regard I commend to you James Schlesinger's article in yesterday's Washington Post. If you have not seen it, I certainly encourage you to read it because it makes the very interesting point that the administration's supply-side economics is not new economics; it's the same old economics. It might be appropriate, but we need a proof-in-packaging requirement.

And, Mr. Rohatyn, I simply want to thank you again for a very thoughtful statement. I would hope that our other two panelists agree—I'm sure the mayor agrees and I would hope the professor agrees, too—with the concluding statement that America as we know it cannot survive half-rich and half-poor, half-suburb and half-slum.

The other thing that I always find encouraging in your testimony is the sensitive perception of the problems combined with a very imaginative and constructive way of dealing with them and, in particular, an appeal to America's strength, instead of its weakness—I find that where you say, "The United States is probably the only country in the world today whose biggest problems are also its biggest opportunities." In economic terms we have a tremendous chance to do some incredible things, if we would put our minds to it. We may well need that dialog you talked about, and I thank you for contributing to it.

Mr. ROHATYN. Thank you, Senator.

Representative RICHMOND. Thank you, Senator Sarbanes. Thank you, Professor Weinstein, Mayor Rusk, and Mr. Rohatyn. I think we have had a very exciting and interesting morning.

Mr. WEINSTEIN. May I make one more point very briefly in response to Senator Sarbanes' comments? I think it's interesting to note that this whole focus on regional disparities didn't really start until the mid-1970's and it was in the mid-1970's that our real economic growth rate started to slow down and we have been in a slow growth phase for 7 or 8 years now. That's why I feel it's extremely important to get the Nation moving again and I'm very concerned about the Northeast and Midwestern regions—don't misunderstand me—but I'm convinced that the first thing we need to do is get the national economy back on a real noninflationary economic growth pattern.

Representative RICHMOND. Professor Weinstein, we all agree with that, but I think accurate figures that are unclouded would help this panel much, much more than figures that are one way or another out of balance. I regret that your statement had far too many statements in it that were just totally incorrect and I think Senator Sarbanes' discussion with you and mine demonstrate the fact that your statement really ought to be amended. But be that as it may, thank you for coming.

This committee will reconvene this afternoon. Our witnesses this afternoon are Donald Hicks from the President's Commission for a National Agenda for the Eighties; and Tom Cochran from the Northeast-Midwest Institute. Thank you.

[Whereupon, at 12:10 p.m., the committee recessed, to reconvene at 1:30 p.m. the same day.]

AFTERNOON SESSION

OPENING STATEMENT OF REPRESENTATIVE REUSS, CHAIRMAN

Representative REUSS. Good afternoon, the Joint Economic Committee will be in order for further hearings on its 1981 economic report today with special emphasis on urban policy and the East-West problem.

We have with us today Mr. Tom Cochran, executive director of the Northeast-Midwest Institute here in Washington; and Donald Hicks.

Senior Professional Staff of the President's Commission for a National Agenda for the Eighties. Both of your prepared statements, under the rule and without objection, will be received in full in the record and would you now proceed, first, Mr. Cochran, to make an oral presentation.

STATEMENT OF TOM COCHRAN, EXECUTIVE DIRECTOR, NORTHEAST-MIDWEST INSTITUTE, WASHINGTON, D.C.

Mr. COCHRAN. Thank you, Mr. Chairman.

Mr. Chairman, I am very pleased to have an opportunity to appear before this distinguished committee for the purpose of discussing the urban policy recommendations made by a panel of the President's Commission on a National Agenda for the Eighties. As our Nation embarks on a new decade under the leadership of a new, and strikingly different Presidency, it is perhaps especially appropriate that we examine the basic assumptions concerning Federal policy toward the Nation's cities.

The Northeast-Midwest Institute, as I believe you know, Mr. Chairman, is a nonprofit, tax-exempt research organization formed in 1977 for the purpose of examining the impact on the older industrial regions of the Nation of Federal policy alternatives.

Before addressing the Commission's urban policy report specifically, I would like to offer a few comments about the Commission's entire report, for a number of its recommendations contained in other sections have important urban policy implications in and of themselves. While I have not had a chance to read the full Commission report cover to cover, I can tick off two major recommendations which illustrate how central so many different areas of Federal policy really are to the future of American cities:

First. The federalization of public welfare expenditures, as recommended by the Commission, would have a profoundly important and positive impact on the fiscal and social well-being of our cities; and

Second. A rigorous reexamination of our present plans to spend $80 billion of windfall profits tax revenue on the development of a narrow range of synthetic fuels—a reassessment the Commission urges strongly—would illustrate the essentially antiurban nature of the current Synfuels Corp. concept. I think such a reassessment of the present synfuels approach would also reveal a range of far more useful, economically efficient, and geographically equitable investments in energy independence which could be made with the windfall profits tax revenue.

It should be obvious, then, that when we make welfare policy, we are also making urban and regional policy; and when we make energy policy, we are also making urban and regional policy, and so on. I should add that our own work has demonstrated also that when we make business tax policy, and budget policy, and procurement policy, and defense policy, and a variety of other kinds of national urban policy, we also make urban and regional policy. The great tragedy continues to be that we often fail to understand the urban and regional implications of our actions in other policy fields. And the result of this persistent intellectual failure has been the development over the last

40 years or more perhaps of a corpus of Federal policy, much of which favors the development of newer, less densely populated areas and places.

These comments bring us directly to the Commission's Urban Policy Panel recommendations. I am very deeply concerned that neither the analysis nor the recommendations found in the report of the Urban Policy Panel to the Commission for a national agenda for the eighties appropriately addresses the problems of the Nation's urban dwellers, or of the cities themselves as physical and economic entities. The panel's draft report is replete with misleading statements, inconsistencies, omissions, and conclusions without analyses. Many of these problems are summarized in the letter of December 2, 1980, to Mr. Claude Barfield from HUD's then Assistant Secretary Robert Embry and Deputy Assistant Secretary Marshall Kaplan. Perhaps if the committee were willing, I would be happy to share a copy of that 8- or 10-page document with you and to provide it for your record.

Representative REUSS. We might at this time include in the record, without objection, the Embry-Kaplan letter.

Mr. COCHRAN. I will provide a copy to your staff.

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

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,
Washington, D.C., December 2, 1980.

Mr. CLAUDE E. BARFIELD,
Executive Director, President's Commission for a National Agenda for the Eighties, Washington, D.C.

DEAR CLAUDE: We appreciated the opportunity to read the section of the Commission's report concerning urban policy. It deals with many provocative issues. However, on balance, the document could be strengthened conceptually and analytically. Further, the text contains many regrettable inaccuracies and several misleading statements concerning current urban policies. Finally, numerous, often inconsistent, policy principles, described in the draft, would reduce the ability of the public and private sector to both improve the quality of life in this nation's urban areas and expand the choices open to the poor.

Our original intent was to provide you with a page by page critique. But, given your apparent time constraints, we have focused primarily on key problems with the text.

MISLEADING STATEMENTS—SETTING UP STRAWMEN

Numerous misleading statements are made throughout the text with respect to the primacy granted "place" in the national urban policy. Similarly, the document, erroneously, suggests that the national urban policy's focus is directed at aborting secular trends and generating an economic "renaissance" in older distressed communities.

Unfortunately, although the bibliography in the document lists both documents, the authors of the draft apparently read neither the 1978 or 1980 urban policy reports. If they did, they would have perceived that the urban policy, contrary to assertions in the draft, grants parity to "people" and "place" objectives and does not reflect a "berlin wall" mentality with respect to secular trends. Indeed, as noted in the 1980 Report:

> . . . Federal assistance must address both people problems . . . as well as place problems . . . Both were viewed as inextricably related (13–1):
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> . . . the policy rejected a massive Federal effort to abort secular or long term decentralization trends . . . mobility has lead to improvements in the lives of many Americans . . . (13–1);
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> . . . the urban policy is directed at helping communities adapt to anticipated economic and demographic changes . . . (13–4);
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> . . . while many of the traditional economic functions of declining urban communities—particularly older manufacturing based cities—*cannot be restored*, urban areas retain viable economic functions . . . (13–5);

. . . other proposed strategies aim at expanding job mobility opportunities for unemployed persons; that is, they are directed at expanding job choices for the unemployed in areas with growing employment (13–9);

. . . spatial mobility and neighborhood revitalization are not mutually enclusive policy options. . . . A quick and major break in the walls of urban ghettos is not possible . . . both spatial mobility and neighborhood revitalization will be necessary . . . (13–13); and

. . . improving the quality of social services will continue to be a major urban policy commitment. . . . Improvement in income support for poor people, while necessary . . . would not be sufficient . . . (13–16, 137–17).

Clearly, the national urban policy rejects extreme and unworkable options. For example, "it rejected a wait for market equilibrium to occur approach to the revitalization needs of older declining communities. To have relied entirely on the marketplace, as recommended by some, would exacerbate the economic and social problems faced by needy cities and towns . . . their ability and capacity to compete for industry, jobs, and tax base is severely strained. In a similar vein, the policy also rejected a massive Federal effort to abort secular or long-term decentralization trends thought harmful to older urban communities. To have attempted to reverse secular trends, as proposed by some, would have required Federal actions inimical to the nation's institutions and its political framework. Moreover, it would have disregarded the fact that mobility has led to improvements in the lives of many Americans and has helped increase the economic vitality of many once distressed areas."

Regrettably, as indicated above, the Commission's draft distorts the thrust of the national urban policy. In doing so, it obscures its own purpose and or objectives. To put it bluntly, the draft develops often logically inconsistent, many times simplistic alternatives to an inaccurate description of present urban policies.

CONCLUSIONS WITHOUT ANALYSES

Surprisingly, given the competence of the staff and the Commission's mandate, the draft contains relatively little in the way of serious analyses. This fact is significant because of the drafts findings or conclusions concerning: the marginal costs and significant benefits associated with urban sprawl; the absence of a systemic relationship between urban problems and poverty; the negligible results from place oriented economic development programs; the unalterable socio-economic trends negatively affecting cities; the wisdom of equilibrium as a policy: and the inconsistency between place oriented policies and national economic growth. Permit us to briefly comment on each:

Cost of Sprawl.—Without conclusive data or any effort at evaluation, the draft proclaims the virtues of sprawl. Undeniably, the literature on the costs of sprawl is complex and in need of re-evaluation. But, most independent analysts would agree that:

(1) Energy savings could be achieved thru relatively compact growth or more compact growth than now in evidence in most SMSA's;

(2) For certain types of air particulates, dispersed patterns may be beneficial; for other types of air particulates, more concentrated land use patterns seem preferable. Strategic use of now available or soon to emerge pollution control technology would permit the advantages of compact development without the disadvantages of dispersal;

(3) Primary agricultural land is vulnerable to sprawl type development: and

(4) Modest increases in density would achieve visible environmental and energy benefits;

The text, mistakenly, assumes that the only choice facing Urban America is one of extremes—either sprawl or high density development. Apart from the absence of definitions of both (i.e., sprawl and high density), no consideration is granted more modest and realistic land use alternatives. We would hope your staff could read chapter 9 of the biennial report prior to concluding its work. It provides a detailed quantitative analysis of the costs and benefits of various growth patterns.

Poverty.—The text presents a rather inconsistent view of poverty. On the one hand, although the analyses is sketchy, poverty is correctly viewed as changing in nature—e.g., increasingly linked to being minority, and female headed households; on the other hand, the authors fail to perceive the strong link between poverty and place or conversely the relationship between relative as well as absolute increases in the numbers of poor inhabitants and larger distressed communities. Indeed, in one part of the document, the report appears to suggest that poverty in distressed cities may be a natural phenomenon, almost predestined to occur and not at all related to the varied economic and social characteristics of the community.

Because of these analytical weaknesses, the paper offers sometimes inconsistent approaches to poverty. Simultaneously (in different sections), it calls for a reduction in Federal leadership and, by implication, assistance, and elsewhere increased assistance to the poor. Similarly, while calling for a "people" oriented approach, and acknowledging increased numbers of poor people in cities, it suggests approaches which could result in severe cuts in local services and further deterioration in the quality of urban life in many of the most needy cities. While recognizing the changing nature of the poor and the emerging structural character of poverty, the text focuses on mobility as its principle strategy to reduce the relative and absolute numbers of poor people. In this context, the Commission's emphasis on mobility, would be more convincing, if similar to the urban policy report, the draft supported its numerous generalizations with precise recommendations concerning: ways to eliminate disincentives and increase incentives associated with minority and low income household relocation to growing areas; ways to expand job opportunities of the long term or structurally unemployed—individuals who may not benefit from mobility; ways to improve the quality of local public and private services available to the poor, given the likely levels of available income support.

Failure of Economic Development Programs.—Contrary to implications in the text, place oriented economic development programs in cities are a rather recent phenomena. They do not dominate the Federal inventory or even recent growth trends with respect to that inventory. Their success or failure has yet to be thoroughly evaluated. Certainly, the initial results of economic development programs do not indicate the negative conclusions contained in the Commission's draft. The UDAG experience, particularly, suggests the probability of success, if measured by such conventional indices as tax base/job creation and the attraction of private investment.

Perhaps one of the reasons why the draft assumes the position it does relates to its mistaken attribution of uniform objectives to diverse Federal programs. None of the urban economic development programs now in place are directed essentially at re-attracting a declining manufacturing base. Most programs, including UDAG, are oriented more toward helping communities "adapt" to economic change (assumedly a Commission objective) and facilitate either the creation of new firms or the expansion and health of existing ones.

Historical Trends and the Role of Cities.—The draft strongly suggests that demographic and economic changes now affecting cities are immutable. More relevant from a policy perspective, it asserts that they affect all cities or at least most cities in a similar way. Accordingly, public and private actions aimed at reversing, retarding and/or influencing them would be relatively meaningless.

Unfortunately, the draft's pessimistic perception of the possible role of the public and private sector in responding to urban problems and its deterministic view of America's urban future is not warranted by the facts, even as presented in the text. For example, the role of all cities (and their economic viability) is not inextricably linked to age and stage of population growth. Cities like Minneapolis-St. Paul reached their half way population mark earlier than Detroit and/or New York, yet their status and condition (dissimilar to the rule suggested in the draft) are much different. New England mill towns have suffered both population and manufacturing job losses, yet many are now illustrating new economic and technological vitality.

Regrettably, the variations among and between this nation's cities defy simple generalizations and principles analogous to iron laws of gravity (or decline). Federal actions in the past have affected supposedly fixed migration patterns regarding industry and jobs; federal policies have facilitated achievement of differential regional growth patterns. The claim that the Federal government is a eunuch or that the public and private sector, working together, cannot respond to legitimate national objectives regarding urban areas appears premised more on ideological conviction than hard analyses of realistic options.

Relevance of Equilibrium.—The Commission's paper, in its suggestion that urban policy follow and reinforce trends; in its apparent positive perceptions of sprawl and decentralization, and in its acceptance of a constant adversial relationship between national and urban economics, seems to endorse reliance on market equilibrium as its "dominant" urban (or non urban) policy. Even the most classical economists would view the draft's judgments in a jaundiced manner. Both, national and local economies are complex; thus, it is often difficult to separate out the effect of diverse public and private activities on them. Indeed, as the text suggests, inadvertent Federal (as well as State and local) behavior has often negatively affected certain cities and positively benefitted others. Although, even a modest effort to neutralize this impact would have likely, economic and social payoffs, it would apparently run counter to the drafts abiding lack of faith in purposeful public behavior. Apart from waiting for negative externalities to affect demographic and economic trends (an unlikely event), the draft's only explicit option for those who live in troubled urban areas besides waiting, hoping, and we suppose praying, is not very well defined (either conceptually or programmatically).

Linkages between National and Local Economies.—The draft draws inconsistent conclusions concerning the relationship between cities and the national economy. First, it suggests that the health of troubled urban areas is inextricably linked to the health of the national economy. Subsequently it indicates that efforts to achieve healthier local economies may frustrate national economic objectives. A more sophisticated and policy relevant analysis would indicate that:

(1) Efforts to stimulate the national economy may have inadvertent negative effects on already troubled cities; may unless carefully structured have a marginal effect on productivity; and may unless extremely sensitive run counter to an (apparently Commission desired) industrial/or sectoral policy;

(2) The economies of different types of cities behave differently during different types of national economies. Clearly, a booming economy generally leads to improved local economies. But the relative disparities between distressed cities and their suburbs and cities in different regions may actually widen, reinforcing decentralization trends and related local urban problems. In a similar vein, fiscal and economic conditions in different types of cities respond differently to inflation, inflation/recession and/or recession prone economies; and

(3) efforts to help troubled cities retain healthy economies need not be inconsistent with national economic growth. Many economists argue that focused or place oriented policies, if successful, would be counter-inflationary; would reduce transfer payments; and would directly expand productivity. Some add that focused economic development minimizes substitution and displacement, phenomena often associated with macro economic approaches. Clearly as suggested in the Biennial Report, and the President's as well as the President-elect's economic revitalization programs, tandem efforts to achieve national and local economic growth rather than being inconsistent, are essential complements of one another.

RELEVANCE OF TARGETING

The Commission's text seems ambivalent concerning targeting. It faults the absence of perfection reflected in the formulas—although it offers only sketchy analysis of a limited number of formulas. More relevant, the draft's typology of distress, while beguilingly simple, mixes the causes of distress with impact factors. As a result, it fails to help clarify targeting options generated by the observed distinctions.

At one time or another, the text supports targeting if aimed at "adaptation;" seems against targeting, if directed at place problems; appears implicitly to support targeting if growing areas are helped; seems to favor targeting if assistance aids people (yet suggests that a focus on people would be geographically neutral—despite the increasing concentration of the poor in needy areas).

Regrettably, the draft report does little to clarify problems (political, institutional, data, indices) associated with current efforts to focus limited Federal funds on needy places and needy people. While the draft is correct in suggesting that diverse variables are used in targeting formulas, it neglected to state that, despite differences of emphases and focus, most government and independent analyses of distress (and related efforts to suggest targeting criteria) have generated similar lists of troubled communities. In a similar vein, the draft, alluding to the difficulties many earlier targeting efforts had in accommodating regional variations, failed to note the fact that both the analyses and variables used in the recent national urban policy report were sensitive enough to identify as distressed cities in different regions facing different kinds of problems.

RELEVANCE OF KNOWLEDGE

The draft correctly states some of the limitations of our knowledge concerning urban problems. Confusing and contradictory conclusions are drawn from this bit of candor, however. On the one hand, the draft seems to suggest that absence of complete information warrants minimal Federal intervention and supports Federal policies which buttress existing trends; on the other hand, the draft, while acknowledging an absence of information, willingly urges Federal intervention with respect to mobility, aid to growing areas, industrial policy, systemic economic planning, etc. Surprisingly, the draft, even when the author feels adequate knowledge is available (negative impacts of non urban policies), is hesitant to endorse Federal action to benefit distressed cities and their residents.

Neither the Federal government nor any other level of government has or will have complete knowledge relative to the causes and effects of urban ills. Yet we have made great strides in improving our understanding of cities and how they function. In this context, absence of absolute certainty provides no excuse for absence of a willingness to respond to problems or opportunities, particularly where knowledge relative to probabilities exists and/or where legitimate public opportunity costing suggests that potential economic and social benefits outweigh costs. Because of the text's recommendations concerning macro economic and sectoral policies (areas of concern where the knowledge gap concerning what works and what doesn't is quite visible), the text's hesitance regarding urban policies seem based more on the author's value set than on hard analysis.

REAPPRECIATING THE ROLE OF THE STATES

We agree on the need to "reappreciate" the role of the States. But we are disappointed that the Commission's text chose to limit the reappreciation to a scant three pages and its analyses to a set of thin conventional wisdoms. At a minimum, analyses relative to the differences among States (institutionally, politically, fiscally) would seem warranted given your desire to stimulate State activity. In addition, the variations in present and anticipated State finances would have been an appropriate subject for discussion.

Clearly, as indicated in the urban policy document, the once myopic view of the Federal system no longer is valid. To secure needed changes, however, will require more than a wish list. Why should States agree to assume more responsibility? What are the incentives? The disincentives? Should State action merely reinforce trends; a course of action suggested in the draft for the Federal government. Or should State programs be focused differently? What specific types of State action is required re "service responsibilities of local government?" Is there a justification for Federal incentives given the adequate fiscal condition of some States? These questions require attention lest the Commission's work to be regarded as proposing, not a rational shift of functions and responsibilities, but a defacto abandonment of them.

TOWARD A NEW FEDERAL POLICY

The marginal nature of the document's conceptual and analytical base is reflected in the tone and content of the final policy chapters. While the reader has been warned that knowledge with respect to urban areas and problems is at a premium, and as a result, the Federal government, indeed all levels of government, should be wary of affirmative policies; and while the author has reminded us in an iterative manner that (unidentified) trends shaping our nation's development patterns are immutable to change, the text's recommendations are often open ended and undefined (e.g., "a positive government-business partnership to develop policy for the nation's industrial sectors . . . a system of national economic planning and a national science policy . . .). In a similar vein, although the text suggests that the Federal government bow out of a leadership role, and although it questions successful recent efforts to target Federal programs and administer them in a manner which avoids inadvertent negative urban impacts, without a strong rationale or any real analysis, it opts for a new super agency to house and coordinate unidentified "scattered" development assistance efforts.

Policy principles presented in the final pages are neither well formulated nor premised on solid study. Unfortunately, as indicated earlier, the urban policy choices facing the public and private sector are not as simple as people vs. place, sprawl vs. high density, deconcentration and dispersal of jobs/people vs. concentration. Indeed, the either or choices posited by the draft are often logically absurd, and substantively weak. Clearly, several questions remain unanswered in the draft; among them: if the nature of poverty is changing (becoming structural), should mobility be suggested as the principal option to ameliorate poverty, particularly in the short run? To put it another way, what evidence is there that growing economic areas can and will provide jobs for the structurally unemployed? If spatial mobility is to be extended among low income, and minority households, how does the author of the text propose to reduce discriminatory practices in job and housing markets, assuming implementation of the draft's proposals concerning minimal Federal urban policy leadership? If the threshold level of income is set within the range of present welfare programs, how can or will proposed income support programs foster a better life for the poor without attention to the quality of public services? Why should the Federal Government inadvertently reinforce decentralization if its benefits are not clear, and its (economic and social) costs are measurable? Finally, what hard evidence is available to suggest that the nation is helpless simultaneously and positively to influence the health and vitality of its urban areas and the well being of their residents?

We are surprised that neither members of the development profession nor representatives of a cross section of State and local government officials reviewed and participated in the development of the draft. We are also concerned about the absence of a review process involving representatives of public interest groups.

We would welcome an opportunity to discuss our comments and the document with you further at your convenience. We would also like to present our views to the Commission.

Sincerely,

ROBERT C. EMBRY, Jr.,
Assistant Secretary.
MARSHALL KAPLAN,
Deputy Assistant Secretary for Urban Policy.

Mr. COCHRAN. Our own review found several other very serious problems as well.

First, the report gives little, if any, attention to the fact that for the nearly 50 years since F. D. R. first declared that southern economic and social development were national challenges requiring concerned Federal attention, a wide array of Federal policies and programs has actively encouraged the development of noncentral city areas and the entire Sun Belt region.

For example: TVA; rural electrification; interstate highways; water policy; port development patterns; military base and civilian facility siting policies and practices; and many aspects of the corporate taxation system, have all encouraged development in new cities and regions—active intervention, in other words, by the Federal Government in the development patterns of the Nation.

The initiatives of Presidents Johnson, Nixon, Ford, and Carter in the urban policy field have only begun to restore a degree of urban and regional balance to Federal spending, taxing and regulatory policies. In effect, a thin overlay on the large body of existing and continuing Federal policy much of which I believe is tilted in the other direction. And I don't believe for a moment that a reasonable balance has yet been achieved; to this day, Federal policy in large part remains substantially titled toward the development interests of the Sun Belt in general, and of noncentral city areas of the Sun Belt in particular.

Second, the urban panel seems to have paid no attention to the enormous but often hidden public and private costs of the rapid job and population shifts of the last decade, shifts the Commission's panel seems to want to accelerate in the 1980's. For example, schools abandoned due to falling enrollment in northern central cities—and the suburbs I might add—have to be built anew, at rapidly escalating construction prices, in Sun Belt suburbs. The same is true with respect to many other forms of public capital including streets, bridges, sewerlines, and water mains. Yet, a recent GAO study found that the costs of maintaining and rehabilitating existing municipal water systems are one-third to one-half of the costs of installing new water systems. In effect, the development patterns we are witnessing, and that the Federal Government already is encouraging, may be "double-billing" or "triple-billing" the public for these capital items.

Third, there seems to be little understanding in the panel's report of the serious constraints on further rapid development in the Sun Belt. Severe limitations on such essential resources as water already are a source of major concern to thoughtful leaders in many parts of the South and Southwest. The fact many people miss about the Sun Belt economy and the life style of sprawl which characterizes much of the region is that it is extremely energy intensive. Yet, the region has been slow to adopt energy, and I might say other forms of conservation, even though it is highly dependent on energy resources which are nonrenewable and, in many cases, will run out within our lifetimes. Other problems of rapid growth—including racial friction, rapid wage inflation, and lack of public services—also are of increasing concern to Sun Belt leaders.

Fourth, and perhaps most disturbing, is the panel's emphasis on moving poor, unemployed and perhaps underemployed people from older central cities to younger, economically growing areas of the South, Southwest, and West. The report bases this recommendation in part on the experience of individual European nations which, it is claimed, have used such incentives successfully within their borders. To draw an analogy between the experience of individual European countries and the United States as a whole seems very silly. Most nations in Europe are the size of one or two individual States in the United States and they also have relatively homogeneous cultures and populations.

A more appropriate analogy might be the deplorable practice of highly developed, wealthy European nations of importing large numbers of workers from poor countries such as Turkey when their need for low-paid workers is high, and sending them home when demand slackens. While I'm sure that there would be no organized effort in the United States to send workers back to Northeastern and Midwestern urban centers if demand for their services slackens, won't that be the actual result if Sun Belt States continue their current policies of providing low medical assistance, welfare and unemployment compensation, and other kinds of benefit levels?

In addition, as former Assistant Secretary Bob Embry and former Deputy Assistant Secretary Marshall Kaplan recently stated in a New York Times Op Ed piece:

> Fear will prevent many families and individuals from changing their locales. Minorities' poverty rates remain high in the Sun Belt. The ability of minority female headed households and teenagers to find work will be only somewhat better in Houston and Dallas than in distressed urban areas.

I might add, by "distressed urban areas," I think they were referring to distressed urban areas in the Northeast and East primarily.

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Embry and Kaplan made another vital point concerning this mobility question as well:

> Because Sun Belt industry is increasingly technical, poor people who have been unemployed for long periods of time in needier cities are likely to remain unemployed in growing areas.

I also thought it was curious that, in drawing its international comparisons, the Commission's urban panel ignores completely the fact that the European nations have made much heavier use of place-specific development policies than the United States. What makes one policy worth transferring while the other is ignored? We see no answer to that question in the panel's report.

The urban panel's report suggested that we must choose in a simplistic fashion between place-specific and person-specific strategies for dealing with the tragic problems of structural unemployment experienced persistently by the "underclass." Yet, I think we all know that we must seek a prudent, effective mix of both types of policy. Both people, as individual citizens, and their living and working environments are important, legitimate concerns for Federal policymakers.

The Federal approach to urban policy I recommend was summed up well 2½ years ago by the then president of the University of Arkansas, in his role as a leading member of the Advisory Committee to the White House Conference on Balanced Growth. He said, in part, that:

> High priority in federal policy and actions should be directed toward areas and communities in distress, declining central cities, rural areas of high poverty concentration, and areas suffering from acute economic dislocation.
>
> The Federal Government should consider a full range of incentives to stimulate job creation in such areas, including investment tax credit differentials, front-end financing, purposeful location of Federal facilities, procurement policies, special training, and provision of the necessary infrastructure.

The speaker was Charles Bishop, now president of the University of Houston and the man who served as chairman of the Urban Panel of the President's Commission for a National Agenda for the Eighties. I just wish he's stuck to his guns.

Thank you once again for this opportunity to appear before you today. I'd be happy to try to answer any questions you or your colleagues may wish to put to me, but I might add that I understand that an exchange on the State severance taxation occurred in this morning's session and, as you may know, Mr. Chairman, this is an issue my organization has been studying for some time and I'd be happy to address questions on this area as well. Thank you very much.

Representative REUSS. Thank you very much.

Mr. Hicks.

STATEMENT OF DONALD A. HICKS, SENIOR PROFESSIONAL STAFF, PRESIDENT'S COMMISSION FOR A NATIONAL AGENDA FOR THE EIGHTIES, WASHINGTON, D.C.

Mr. HICKS. Mr. Chairman, distinguished members of the committee, I am delighted to be here this afternoon as you consider the topic of regional balance and economic growth.

I have a prepared statement for the record, and in my comments this afternoon I will briefly summarize a few of its major points.

On January 16, the final report of the President's Commission for a National Agenda for the Eighties was presented to President Jimmy Carter and the Nation. The culmination of a year's work by 45 commissioners and appropriate staff, the report attempts to draw attention to a decade of difficult choices facing the Nation. Viewed within the context of carefully selected unifying themes, the report summarizes the separate efforts of nine panel study groups, each designed to focus on a specific substantive policy domain. While these reports are not intended to be viewed as independent of one another, there are implications that can be drawn from several of them, particularly the urban panel report, that I believe have relevance for the work of this committee.

I would like to ask you to keep in mind that the full Commission report is the only 1 of the 10 reports produced by the President's Commission that has the approval of the entire body of commissioners. While most of the implications that I will draw out this afternoon can be considered to be consistent with the opinions of the majority, though not all, of the commissioners, I will also offer observations of my own for which I do not claim majority support.

Technological, economic, demographic, and lifestyle changes have been building in this Nation throughout the 20th century. Their multiple and reinforcing implications became inescapable during the past decade or so as the social and economic realities of our changing world outpaced our political capabilities for dealing with them. A shifting international economic order increased our dependence on other nations. Structural changes in our domestic economy reflecting changing technological developments and possibilities slowly modified the geographical distribution of capital and the jobs it creates, people and the incomes they command, political power and the allegiences they reflect, and even the capacity for industrial innovation itself.

In general, the Commission has recommended that the Nation respond to the transformation by promoting strategies of anticipation, accommodation and adjustment, rather than resistance. This applies to both the policy tools we employ and the political rhetoric we employ to justify their use. On balance, the restructuring of local and regional economies, the shift to lower density settlement patterns, the thinning out of older central cities, the deconcentration of larger metropolitan areas, the reconcentration in peripheral areas, and even the uneven growth rates across entire multi-State regions may well be beneficial to the entire Nation as a whole. We must be open to that possibility, even though there continue to be undesirable transitional costs imposed on specific settlements and regions experiencing rapid growth or shrinkage in population and employment—developments that make orderly adjustment difficult.

In America today both people and places suffer as the economic geography of the Nation transforms. The Commission recommends that the Federal Government allow for and even facilitate the transformation of places and principally seek to insulate people rather than places from the trauma of change. In a decade of difficult choices, the best urban and regional policy may not be an urban or regional policy at all. This may be especially true given the fact that gradually the notion of a "national urban and regional policy" has come to be associated with reversing trends defined as undesirable, rebuilding what is thought to be falling apart, and revitalizing what is thought to be dying.

There are sound reasons for believing that our older central cities are not dying; rather they are transforming to accommodate new modes of production, new technological capabilties and new relationships with surrounding settlements. Likewise, our older industrial regions, particularly the Northeast and upper Midwest, are not dying; rather, they too are just reflecting the same processes as mentioned above but on a larger scale. Such transformations as these, driven as they are by such powerful dynamics that have been unfolding for decades, most often yield results that are not only unavoidable, but perhaps even worth waiting for.

To the extent that the notion of a "national urban policy" has come to be associated with addressing the problems of distressed places and political jurisdictions, the emphasis should perhaps be shifted from local economic and community development efforts and toward national economic policies that have as their aim the creation and maintenance of an attractive investment climate conducive to steady and long-term economic growth, high rates of job creation, and low rates of unemployment, inflation, and dependence.

To the extent that the notion of a "national urban policy" has come to be associated with urban poverty and distressed people, the emphasis should perhaps be shifted from policies that may inadvertently reinforce the hold of distressed places on distressed people and toward policies that promise to loosen that hold. The Commission recommends that the contemporary reliance placed on jobs-to-people policy strategies for linking those who can work to opportunities for work be relaxed in favor of people-to-jobs policy strategies. Improving the access of people to economic opportunity should proceed not only by training the unskilled and retraining the displaced so that they come to possess the skills that will make them relevant to a transforming economy, but also by removing the barriers to mobility that prevent people from migrating within or between metropolitan areas in pursuit of new opportunity.

For those who cannot work and for the "working poor," the Commission recommends the federalization of welfare via a "minumum security income." These policy choices are meant to be considered in concert with the adoption of a universal, comprehensive health insurance program building on the strength of the private sector, shifting more responsibility for myriad functions that have floated up to the top of the Federal system to State and local governments, consolidation of Federal grants, more reliance on long-term growth and less on fine-tuning adjustments of the economy and greater emphasis on short-term energy conservation.

In the end, the Federal Government should place priority on the development of a blend of economic and social policies that nurture the health of the Nation as a whole and all of its citizens regardless of where in the Nation they might live. People-oriented national social policies that aim to aid people directly wherever they may live should be accorded priority over place-oriented national urban policies that attempt to aid people indirectly by aiding places directly. People acquiring new skills and taking advantage of economic opportunities in the same or different communities constitutes the best anti-distress policy we can devise.

Like it or not, embarking on an explicit program aimed at national economic revitalization will have the tendency to conflict at times—though not always—with a program of local and regional "revitalization." This is particularly likely since such revitalization has come to be associated with a need to rebuild and restore rather than to guide and plan for our passage into an era wherein the functions of cities and relationships among regions are being redefined. The inevitable conflict can be lessened if we redefine urban and regional revitalization to mean less the rebuilding of urban America according to historical social and economic blueprints and more the successful transformation and adjustment of local and regional economies within a coherent national economy.

The best thing we can do for all of urban America—that portion confined within the borders of our central cities and that which has spilled out into and beyond suburbs and even metropolitan areas—is to restore steady growth in the national economy and slowly, but surely, unravel the factors that support an inflation which has itself become institutionalized. More realistic, if accelerated, depreciation schedules; business tax cuts that facilitate the accumulation of capital necessary for investment and innovation, stimulated research and development to enable those industrial sectors—and specific industries within those sectors—to maintain and enhance their comparative advantages vis-a-vis other nations; all have the capacity for hastening the transformation of localities and regions in the Nation. However, given that the health of all places is ultimately dependent on the health of the national economy, economic policies that entail inadvertent and unavoidable antiurban impacts or impacts that hasten the trend of regional convergence may be preferable to those which make the strength of the national economy secondary to that of specific local and regional economies.

During the past decade a new sectionalism has flared in response to concern over the regional consequences of this shifting geography of inequality. With multistate units serving as units of analysis, patterns of long-term regional change—responding to major structural changes in our Nation's economy and the role of our economy in an international marketplace—have heightened passions about the relative fate and fortunes of differing regions. A largely economic and technological phenomenon has come to be viewed as a political one. The major issue has become what role the Federal Government should play in response to these long-term dynamics.

The role of the Federal Government in aiding and abetting the patterns of regional change may well be overstated. This overstatement reflects not only a fixation on the fact that the Federal Government has gotten bigger and busier in the World War II era, but also the fact that we may misunderstand the role of National Government in nation-building. It is undeniably true that throughout our national history, the Federal Government has played a major role in penetrating successive frontiers and facilitating, in turn, migrations of people and jobs from East to West, countryside to city, South to North, the Northeast and Upper Midwest to the South and West, and city to suburb and beyond. However, much of these "spatial tilts" favoring one region over another, or even one kind of locality over another, are largely the inescapable consequences of the role the Federal Government plays in the national economy. Further, once the historically disadvantaged regions were on their way toward social and economic convergence with the historically advantaged regions, the process became largely irreversible. As the once peripheral economies attracted and retained increasingly diversified populations, growth became self-sustaining. Historical patterns of regional dominance were bound to change, and it is likely that rewiring federal funds to achieve spatial (regional) goals would be ineffective, even if it were wise.

It may be worthwhile examining whether or not building a regional sensitivity into Federal policies by design is a wise thing. To some extent the very motion of "region" is contrived and artificial; it involves grouping States which share many characteristics and differ on at least as many others. "Regions" have become politically manufactured symbols interjected into the political process and may not be wise criteria for guiding the intentions of government policy.

It is unclear that the principal responsibility of a national government is the compensation of regions for ebbing and flowing fortunes, especially if those changing fortunes are comprehended in terms of relative growth rates. Surely, Federal policies in pursuit of important functional goals; for example, reduced energy dependence or job creation, cannot help but result in regional consequences. At a time when the productivity of the national economy is of such special concern, too great an emphasis on the principle of compensation via regionally sensitive Federal policies may delay the necessary adjustments that our national economy must make in order to stay vibrant and compete in an international setting.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Hicks follows:]

Prepared Statement of Donald A. Hicks

Place-Sensitive Public Policies in the Eighties

Introduction

On January 16, 1981, the final report ("A National Agenda for the Eighties") of the President's Commission for a National Agenda for the Eighties was presented to President Jimmy Carter and the nation. The culmination of a year's work by 45 commissioners and appropriate staff, the report attempts to draw attention to a decade of difficult choices facing the nation. Viewed within the context of carefully selected unifying themes, the report summarizes the separate efforts of nine panel study groups—each designed to focus on a specific substantive policy domain. While these reports are not intended to be viewed as independent of one another, there are implications that can be drawn from several of them—particularly the urban panel report ("Urban America in the Eighties: Perspectives and Prospects"—that I believe have relevance for the work of this Committee as it considers regional balance and economic policy issues.

You will note that what follows elevates perspectives over policies and suggests that how we come to perceive and define what is happening to us is prior to what we choose to do or not to do about it. Further, I would ask you to keep in mind that the full commission report is the only one of the 10 reports produced by the President's Commission that has the approval of the entire body of commissioners. While most of the implications that I will draw out this afternoon can be considered to be consistent with the options of the majority, though not all, of the commissioners, I will also offer observations of my own for which I do not claim majority support.

REGIONAL CHANGE: INTENTIONS AND CONSEQUENCES

Technological, economic, demographic and lifestyle changes have been building in this nation throughout the 20th century. Their multiple and reinforcing implications became inescapable during the past decade or so as the social and economic realities of our changing world outpaced our political capabilities for dealing with them. A shifting international economic order increased our dependence on other nations. Structural changes in our domestic economy reflecting changing technological developments and possibilities slowly modified the geographical distribution of capital and the jobs it creates, people and the incomes they command, political power and the allegiances they reflect, and even the capacity for industrial innovation itself.

There is nothing novel in these dynamics; they have always been the building blocks of economic development and social change within and between the nations. Though our national history is relatively short, and our urban history even shorter, the discovery and development of our nation, region by region, and the emergence of our national system of settlements are the results of just such dynamics. What makes the intraregional and interegional metabolism so remarkable today is that for the first time in a century or more, the hegemony of an essentially 19th century economic order and the regions to which it has been anchored have been challenged by the emergence of a vigorous and new 20th century economic order with new and unfamiliar possibilities for how people, their settlements, homes and workplaces arrange themselves in space. Gradually, the older industrial urban economies have lost the capacity to compensate, through new innovation and self-sustained growth, for the outmigration of people and jobs.

This historical transformation marks the passage of this nation into an essentially postindustrial era, a time in our history that requires a certain skepticism about the conventional wisdom and comfortable images we employ when examining urban and regional issues.

A FEDERAL URBAN-REGIONAL POLICY ROLE FOR THE EIGHTIES

It was the ongoing task of the urban panel—and later the larger Commission—to seek to suggest what might be an appropriate federal role in response to the urban and regional growth and development issues that this historical transformation has left in its wake. Such judgments must always be made in the context of other factors impinging on the times. Despite the fact that the national government has shown that it can do many things well, the decade ahead is not one in which we can proceed on all fronts at once. Hard choices—harder than they have even been before—will have to be made. It is essential that we understand fully the process of transformation that we are living through; in the end, what the government should refrain from doing is every bit as important as what it should continue or begin to do.

In general, the Commission has recommended that the nation respond to the transformation by promoting strategies of anticipation, accommodation and adjustment, rather than resistance. This applies to both the policy tools we employ and the political rhetoric we use to justify their use. On balance, the restructuring of local and regional economies, the shift to lower density settlement patterns, the thinning out of older central cities. the deconcentration of larger metropolitan areas, the reconcentration in peripheral areas, and even the uneven growth rates across entire multistate regions may well be beneficial to the entire nation as a whole. We must be open to that possibility, even though there continue to be undesirable transitional costs imposed on specific settlements and regions experiencing rapid growth or shrinkage in population and employment—developments that make orderly adjustment difficult.

In America today both people and places suffer as the economic geography of the nation transforms. The Commission recommends that the federal government allow for and even facilitate the transformation of places and principally seek to insulate people rather than places from the trauma of change. In a decade of difficult choices, the best urban and regional policy may not be an urban or regional policy at all. This may be especially true given the fact that gradually the notion of a "national urban and regional policy" has come to be associated with reversing trends defined as undesirable, rebuilding what is thought to be falling apart, and revitalizing what is thought to be dying.

There are sound reasons for believing that our older central cities are not dying, rather they are transforming to accommodate new modes of production, new technological capabilities and new relationships with surrounding settlements. Likewise, our older industrial regions—particularly the Northeast and Upper Midwest—are not dying, rather they too are just reflecting the same processes as mentioned above but on a larger scale. Such transformations as these, driven as they are by such powerful dynamics that have been unfolding for decades, most often yield results that are not only unavoidable, but perhaps even worth waiting for.

To the extent that the notion of a "national urban policy" has come to be associated with addressing the problems of distressed places and political jurisdictions, the emphasis should perhaps be shifted from local economic and community development efforts and toward national economic policies that have as their aim the creation and maintenance of an attractive investment climate conducive to steady and long-term economic growth, high rates of job creation, and low rates of unemployment, inflation and dependence. While there are undoubtedly opportunities for restoring vitality to a wide variety of economically distressed local communities treating each as a self-contained entitly, in a decade of hard choices facing the federal government, these opportunities may best be left to states and localities.

To the extent that the notion of a "national urban policy" has come to be associated with urban poverty and distressed people, the emphasis should perhaps be shifted from policies that may inadvertantly reinforce the hold of distressed places on distressed people and toward policies that promise to loosen that hold. The Commission recommends that the contemporary reliance placed on jobs-to-people policy strategies for linking those who can work to opportunities for work be relaxed in favor of people-to-jobs policy strategies. Improving the access of people to economic opportunity should proceed not only by training the unskilled and retraining the displaced so that they come to possess the skills that will make them relevant to a transforming economy, but also by removing the barriers to mobility that prevent people from migrating within or between metropolitan areas in pursuit of new opportunity.

For those who cannot work and for the "working poor," the Commission recommends the federalization of welfare via a "minimum security income." These policy choices are meant to be considered in concert with the adoption of a universal, comprehensive health insurance program building on the strength of the private sector, shifting more responsibility for myriad functions that have floated up to the top of the federal system to state and local governments, consolidation of federal grants, more reliance on long-term growth and less on fine-tuning adjustments of the economy and greater emphasis on short-term energy conservation.

In the end, the federal government should place priority on the development of a blend of economic and social policies that nurture the health of the nation as a whole and all of its citizens regardless of where in the nation they might live. People-oriented national social policies that aim to aid people directly wherever they may live should be accorded priority over place-oriented national urban policies that attempt to aid people indirectly by aiding places directly. People acquiring new skills and taking advantage of economic opportunities in the same or different communities constitutes the best anti-distress policy we can devise.

NATIONAL ECONOMIC REVITALIZATION AND URBAN REVITALIZATION: CONFLICT AHEAD?

Like it or not, embarking on an explicit program aimed at national economic revitalization will have the tendency to conflict at times—though not always—with a program of local and regional "revitalization". This is particularly likely since such "revitalization" has come to be associated with a need to rebuild and restore rather than to guide and plan for our passage into an era wherein the functions of cities and relationships among regions are being redefined. The inevitable conflict can be lessened if we redefine urban and regional revitalization to mean less the rebuilding of urban America according to historical social and economic blueprints and more the successful transformation and adjustment of local and regional economies within a coherent national economy.

The best thing we can do for all of urban America—that portion confined within the borders of our central cities and that which has spilled out into and beyond suburbs and even metropolitan areas—is to restore steady growth in the national economy and slowly, but surely, unravel the factors that support an inflation which has itself become institutionalized. More realistic, if accelerated, depreciation schedules; business tax cuts that facilitate the accumulation of capital necessary for investment and innovation; stimulated research and development to enable those industrial sectors (and specific industries within those sectors) to maintain and enhance their comparative advantages vis a vis other nations; all have the capacity for hastening the transformation of localities and regions in the nation. However, given that the health of all places is ultimately dependent on the health of the national economy, economic policies that entail inadvertent and unavoidable antiurban impacts or impacts that hasten the trend of regional convergence may be preferable to those which make the strength of the national economy secondary to that of specific local and regional economies.

TOWARD A PROPER FEDERAL ROLE IN RESPONSE TO REGIONAL CHANGE

Our nation, like any other, always has been—and probably always will be—characterized by a geography of inequality. Ultimately, this unavoidable characteristic is tied to differential resource endowments throughout our nation. Wave after wave of technological change may not only alter the original distribution of those endowments, but may also enhance or diminish their value to our overall national economy. The distributions of economic growth and population are influenced greatly by the distribution of these resources and, in turn, further enhance or diminish their value. Consequently, this geography of inequality is constantly shifting over time as technological change, economic development and population change unfold in response to it. The history of the settlement and the development of our nation is a history of these linked processes.

During the past decade a new sectionalism has flared in response to concern over the regional consequences of this shifting geography of inequality. With multistate units serving as units of analysis, patterns of long-term regional change—responding to major structural changes in our nation's economy and the role of our economy in an international marketplace—have heightened passions about the relative fate and fortunes of differing regions. A largely economic and technological phenomenon has come to be viewed as a political one. The major issue has become what role the Federal Government should play in response to these long-term dynamics.

The role of the Federal Government in aiding and abetting the patterns of regional change may well be overstated. This overstatement reflects not only a fixation on the fact that the Federal Government has gotten bigger and busier in the World War II era, but also the fact that we may misunderstand the role of national government in nation-building. It is undeniably true that throughout our national history, the Federal Government has played a major role in penetrating successive frontiers and facilitating, in turn, migrations of people and jobs from east to west, countryside to city, south to north, the Northeast and Upper Midwest to the South and West, and city to suburb and beyond. However, much of these "spatial tilts" favoring one region over another, or even one kind of locality over another, are largely the inescapable consequences of the role the Federal Government plays in the national economy. Further, once the historically disadvantaged regions were on their way toward social and economic convergence with the historically advantaged regions, the process became largely irreversible. As the once peripheral economies attracted and retained increasingly diversified populations, growth became self-sustaining. Historical patterns of regional dominance were bound to change, and it is likely that rewiring Federal funds to achieve spatial (regional) goals would be ineffective even if it were wise.

For instance, much is made of the fact that in recent decades federal dollars spent on defense have gone disproportionately to the South and West thus aggravating the relatively slower growth rates of the Northeast and Upper Midwest. This outcome may well reflect the fact that twenty years ago the West, in particular, offered the business climate most suitable for spawning the kinds of science and high-technology-based industries (aerospace and computers) that have thrived so well there. As the nation's defense came to rely increasingly on ever more sophisticated military technology, economic development, population shifts and patterns of federal spending were influenced. These patterns, and this logic with which to understand them, can be seen to apply across many industries.

It may be worthwhile examing whether or not building a regional sensitivity into federal policies by design is a wise thing. To some extent the very notion of "region" is contrived and artificial; it involves grouping states which share many characteristics and differ on at least as many others. It may be logically akin to suggesting that since the daytime and nighttime populations of a place, such as a central business district, differ substantially, this justifies some sort of compensatory behavior on the part of government aimed at achieving equity based on the diurnal cycle. "Regions" have become politically manufactured symbols interjected into the political process. Regional patterns may be useful for anticipating and understanding the consequences of change, though they may not be wise criteria for guiding the intentions of government policy. They may well have the effect of clouding issues and shifting essential political debates to inappropriate terrains.

While no federal policy should have as its principal goal the deliberate hobbling of any single community or region, it is unclear that the principal responsibility of a national government is the compensation of regions for ebbing and flowing fortunes, especially if those changing fortunes are comprehended in terms of relative growth rates. Surely, federal policies in pursuit of important functional (e.g., reduced energy dependence or job creation) goals cannot help but result in regional consequences. But, perhaps, these regional consequences may be necessary prices to pay for national intentions. And at a time when the productivity of the national economy is of such special concern, too great an emphasis on the principle of compensation via regionally sensitive federal policies may delay the necessary adjustments that our national economy must make in order to stay vibrant and compete in an international setting.

For many, the "balance-of-payments" deficits that certain regions experience because they pay more in taxes than they receive constitute prima facie evidence of regional discrimination. There may be another interpretation, however. It is a fixed principle of federal governance in this country that when it comes to taxation, those who have more money pay more. The underlying inequality in the distribution of income is the focus of that principle.

If we impose a regional grid across a map of the nation, we find that incomes are lower and poverty is more prevalent in certain regions than others. Responding to income inequality is a primary government intention; the regional implications are largely incidental consequences.

In the end, the public resources which the Federal Government commands are limited. The historical transformation of our economy and the regional consequences it occasions should be viewed differently than they have come to be in the past decade. People principally, not places or regions, should be insulated from the distress occasioned by these changes.

A "PLACE-ORIENTED" NATIONAL URBAN POLICY: A STRAWMAN?

It has been suggested recently that to challenge our nation's explicit National Urban Policy as being essentially "place-oriented" is unfair because such a challenge would gain its momentum and impetus by first setting up a series of "straw men" with whom argument can proceed relatively effortlessly. An examination of "The President's National Urban Policy Reports" (1978 and 1980) offers little to deflect any such challenge.

The 1980 Report, a much more ambitious document than the 1978 version—is nothing short of excellent in its ability to examine in some detail numerous issues across the "urban" spectrum. The work is encyclopedic, definitive on many issues, and very often a useful guide to governmental action. To its credit, the 1980 Report offers a more evenhanded treatment of the potential beneficial consequences of allowing and even encouraging the contraction of localities and of increasing the mobility of distressed workers. In that respect, it offers a rather noticeable break with the past.

The report of the President's Commission and the 1980 "President's National Urban Policy Report" both pay attention to the option of breaking the linkage between distressed people and distressed places, it is true. However, the 1980 Report adds this relatively new emphasis to the intellectual tradition that preceded it. The Commission report chooses to give this point far more relative emphasis in contradistinction to that tradition.

Our differences with the 1980 Report would appear to run deeper. As was conceded on occasion by some of those who had a hand in its preparation, the 1980 Report sanctions so many options that it fails to help the nation prioritize and ultimately choose from among them. As a background document on countless topics, it is superb; as a political document, it slights no one interest or point of view; as a statement of national urban policy, however, it defers the difficult choices.

Page after page in the final chapter of the 1980 Report presents an inventory of worthwhile tasks which a federal government with relatively boundless resources and an unambiguous mandate could undertake. The probability of the success of each possible policy action undertaken independently, or in concert with others, is not given the same attention. So, the urban panel of the Commission came away mindful of the many policy levers that could be inventoried and even pulled with the intention of affecting urban America. What is absent from the 1980 Report is a rationale for deciding which among these many levels should be pulled. Once pulled, all would doubtless have consequences for urban America; however, there lingers a healthy skepticism concerning their ultimate ability to influence significantly the prospects facing the nation in the 1980s.

The "President's National Urban Policy Report" (1980) aside for the moment, what is our justification for directing so much of our energies toward criticizing the "place" bias in our federal urban policy activities as reflected especially in the National Urban Policy? What the panel report proposes to offer is a statement about how the explicit federal urban policy role has evolved in this nation in past decades. That expectations are raised about the federal government's ability to forestall multiple distresses through the nation's adoption of and commitment to an explicit National Urban Policy may not be a propitious development. There is probably not much reason to believe that the act of governing can do much more than marginally assist localities anticipate and adjust to dominant social and economic trends. Public dollars are numerous indeed, but they are often no match, and or even much of a decisive lure, for private dollars in determining what will happen to our nation's cities in the years ahead.

The "place" bias we criticize is not that which was at the heart of the criticism in the 1960s and 1970s of the "bricks and mortar" mentality reflected in federal programs like urban renewal. Rather, it is a criticism of the perspective that results from endeavoring to limit somewhat our perception to that which is transpiring with local political jurisdictions—within the nation's cities (especially its largest and oldest ones in the Northeast and Upper Midwest). The urban panel report, then, attempts to do the broader task that it was assigned to do; namely, to say something about what will be happening in the nation's metropolitan and nonmetropolitan areas and what a realistic and pragmatic response by the federal government might look like. To do this requires that the reader begin to think of the intellectual and policy traditions that have accumulated at the federal level over the past decades. Then, a judgment must be offered about the kind of mesh that exists between the changing problems that face a transforming urban America and the understanding and the capability that the federal government is in a position to bring to this policy arena.

As we know, the history of the notion of a "national urban policy" is an interesting one. The formation of the Urban Affairs Council in 1969 was itself a response to the phenomenon of distress (social, economic and fiscal) piling up in cities while instruments that traditionally relieved that distress (tax base, capital, jobs, school quality, the presence of the middle class) had for some time been taking leave of them. From that beginning, efforts to effect an urban policy have been driven largely by imagery ("death of the city;" urban decline, etc.) denoting the new circumstances found within political jurisdictions. At the same time there has been a systematic blindness to and lack of recognition of the tremendous vitality that has been relocating in areas peripheral to the nation's cities and in regions that had been traditionally underdeveloped.

The new urban America has not lost the vitality; the nation's older cities had. Unfortunately, there has been little political support forthcoming for the greater appreciation of that point. To illustrate the potency of the imagery we have used to symbolize what has been happening to scores of cities for a decade or more, consider the rhetoric of at least two major candidates for President as they called for massive efforts to "rebuild our crumbling cities."

The broad coalitions that it was possible to build in the past decades to take actions that had derived their impetus from our perceptions of those localized circumstances were made possible largely by using political jurisdictions as building blocks. With the exception of the Model Cities program, perhaps, increasingly the goal was understood and communicated in terms of remedying—via Federal aid to local governments—the dysfunctioning of the city as a system that was no longer able to generate sufficient jobs, safety, services—indeed the full range of amenities and opportunities that we had come to associate with life within central city boundaries during the first half of the century. Henceforth, the Federal Government channeled aid to cities for all sorts of purposes.

A major goal was to "fix" the cities. This is the understanding of the Federal urban policy presence, illustrated by the common perception of the National Urban Policy, about which the Commission report seeks to stimulate debate. If the city is to be "fixed," it will likely be fixed as a consequence of the same economic and demographic forces that led to its contemporary problems. The efficacy of the Federal role in that process is too easily overstated, oversold and ultimately believed.

Throughout the past, many of the intended recipients of Federal assistance were undeniably the local residents who exhibited multiple forms of distress. Nonetheless, much Federal aid—soon to be rationalized, verified and labeled a National Urban Policy—was packaged for local governmental officials who increasingly found themselves presiding over urban "systems" that had political boundaries which were unable to embrace the economic and social dynamism that spilled out beyond their domains. The form of that aid may have varied over the years, the amount may have been thought to be pitifully insufficient, but the arrangement was sufferable if only because the problems facing mayors were often equated with those facing city residents and the nation.

So, early explicit urban policies may have been understandably politically rational, albeit increasingly socially and economically irrational. Unavoidably, local government as an institution reflects the very problem it faces—an inability to adapt politically to what is happening socially and economically—as is witnessed by its fragmented, overlapping and often obsolescent structure. And this leaves aside for the time being the problems with state governments.

The continued and increasing preoccupation with the problems facing legally bounded local jurisdictions—"places," if you will—is illustrated by the report issued in 1978 by the President's Urban and Regional Policy Group. The intellectual focus is clearly on cities—on circumstances within specific locations bounded by political or administrative borders. The larger demographic and economic trends were discussed, but largely for the purpose of noting their undesirable localized side-effects and not for the more neutral purpose of acknowledging that opportunity and vitality need no longer be tied to specific locations and places.

The discussion in the late 1970's grew increasingly sophisticated. Much was being said about the importance of having a "balanced concern for people and places." Curiously, the problems of people were still largely viewed as those of the problems of people in specific places; predictably the search for solutions to those problems was undertaken in ways that often (not always) linked the fortunes of people to the aid received by places. Distressed people were often judged to best receive aid "in place." Only in this way, it was often assumed, could any advances made by people redound to the benefit of local jurisdictions. There was little enthusiasm for remedies that attempted to break that linkage. In the words of the Urban Policy Group's ninth recommendation, "[T]he Federal Government will help make troubled central cities attractive places to live and work. . . . Federal programs will encourage the middle class to remain in or return to central cities."

Nowhere is there any great optimism inspired over of the possibility that the urban America that was spilling out beyond city boundaries was one that perhaps should not be contained by historical local governmental boundaries. Nowhere was it stressed that the decentralization of urban America possibly served the nation as a whole exceedingly well even though very real distress did accompany the transition. Nowhere was it elaborated upon that the interests of the nation—rather than those of subnational units—might best be served by a federal urban presence that did not unwittingly tie people with problems to places with problems. After all, trying to aid people with their problems indirectly by channeling aid to specific local jurisdictions generates political capital to a degree that aiding people apart from where they may live cannot do. The logic was predictable, compelling and probably "right" given the political conditions that defined those decades: that the recounting of it may sound a bit conspiratorial given contemporary political conditions is largely unavoidable and entirely unintentional.

More recently, the proceedings of the White House Conference on Balanced National Growth and Economic Development likewise reflected a heightened spatial sensitivity. The principal policy recommendations were those which stressed federal efforts that gave priority to targeted subnational economic development, jobs-to-people linkages between the unemployed and economic opportunity, and the inadvertant anti-city biases of much federal activity that is not specifically urban-oriented. Finally, the 1978 President's National Urban Policy

Report is replete with suggestions for helping revitalize distressed places and assisting distressed people "in place."

With the 1980 Report, there is seen an evolution in the intellectual approach to defining what our urban "problems" are and how they may best be managed. For the most part, these newer perspectives have been added to the more traditional ones, and little assistance is offered to help the Report serve the nation by deciding where to place the emphasis and where to direct ever, and increasingly, inadequate federal resources. In a sense, the "President's National Urban Policy Report" (1980) cannot be equated with the nation's "national urban policy"—the aggregate consequence of the federal policy presence on urban America.

The report of the President's Commission implies that the notion of the nation having a National Urban Policy as being quite distinct from having a report (1980 Report) by the same name. Both, by their very existence, raise expectations concerning what government can ultimately be expected to do. It is certainly open to conjecture whether or not many of the undesirable conditions and characteristics that define this nation's urban places and the lives their residents lead are amenable to purposive governmental action.

CONVENTIONAL WISDOM AND AN AGENDA FOR DEBATE

The full Commission report and the urban panel report offer their conclusions and recommendations with the support of logical analysis often not accompanied by reported empirical domumentation. This format was dictated in part by the firm resolve on the part of the panel members that the final panel report not exceed 100 pages, that it knit together a diversity of issue areas within a few short pages, and ultimately that many of the issues teased into the forefront would be those for which empirical analysis often does little more than narrow the terrain of debate to methodological complexities, incompletely specified models, measurement flaws, or misinterpretation of the data. However, the goal was to present an array of items for a public agenda and to stimulate debate rather than foreclose it.

There was considerable support for the view that resolution of the question concerning what the federal role in urban policy should be is ultimately only partially aided by empirical inquiry. Even the most sophisticated "scientific" evidence—of which we reviewed an enormous amount—is seldom untainted by prior conceptions of urban and regional phenomena which guide the choice of questions explored, the comparisons set up within research designs and the context within which sense is made of the results.

Of more importance, perhaps, are the valuative analyses that do not lend themselves to quantification. Unsurprisingly, there is such a wealth of and diversity among "facts" that values need be articulated more, rather than less, carefully. In the end, it was decided that any issue for which there was a respectable viewpoint that was being systematically eclipsed by conventional wisdom or the traditional political process was one that should be offered to the nation for critical review and debate in the decade(s) ahead.

For instance, while the panel unequivocably recognized the inevitability of spatial tilts in federal policies, it was somewhat more skeptical of contemporary thinking about what we should do about them. While the 1980 Report recommends that the federal government "[r]evise tax policies that inadvertantly harm urban areas . . .," the panel report suggests that the mere "suggestion of negative impacts on urban economies" that lead to decentralization not be considered sufficient reason to rewire a spate of federal tax provisions, environmental regulations or procurement policies. In such instances the vitality of the larger national economy should be the prior concern of the national government.

For many of the same reasons the panel report cautions the nation against the presumed obviousness of the wisdom of rebuilding public infrastructure in shrinking central cities, and the presumed energy profligacy and inefficiency associated with lower density growth, development and reconcentration away from central locations. Further, evidence is coming to the fore that seriously questions the notion that there has been a net loss of prime agricultural land through the encroachment of urban land uses at the periphery. In the end, it appears that the panel report views with far more confidence the ultimate net consequences of the thinning of urban America and the trend toward reconcentration in newer, noncentral locations than does the 1980 Report.

And on yet another point, we do grant that there are policy successes in the area of local economic development that need to be recognized. (Certainly the

UDAG policy mechanism—at least when there is private money available to leverage—may make much sense in certain localities under certain circumstances.) Several questions about such strategies merit the benefit of continued finer analysis of the kind that is being routinely provided by federal agencies and others. However, the panel report notes that even the most ambitious and effective local economic development strategies may provide little respite for a certain proportion of the nearly permanent urban "underclass." The aid that will assist these people is probably best directed to individuals rather than to institutions . . . including the private sector and local governments. Most current federal programs directed at relieving urban distress are focused on problems associated with institutions rather than individuals; in the years ahead this spatial sensitivity may be unwisely allowed to displace a social sensitivity that, too, took long years to develop.

CONCLUSION

Over the long run the demographic, economic and technological forces that shaped our cities have the look of inevitability from a contemporary perspective. Indeed, the panel report acknowledges that purposive governmental actions in the very recent past have had an influence on how cities have grown and regions have developed. It is likely, however, that the majority of those influences were unintended and tied to the pursuit of narrower primary goals (improved housing, transportation, or greater efficiency in the production of government services), and it is also probably true that not explicitly urban policies have had far greater urban influences than have explicit urban policies. But does it follow that even a thorough rewiring of the federal presence to "correct" for inadvertant "anti-city" biases of the past can promise much in the way of relief from current economic and demographic trends? Probably not.

Beyond the limited utility of efforts to blunt long-term development trends probably no conceivable federal presence can promise the eradication of poverty, the end of inequality, the abolition of discrimination or even the necessary compensatory relief from all of these societal ills. Yes, there is some acknowledgment that these circumstances are most visible in cities. Yes, it is certainly true that no large-scale trends will unfold across all cities in a uniform manner. So much more important, then, is the admission that the various institutional distresses that afflict localities cannot be expected to be remedied or even largely allayed by centralized urban policy machinery as it is now conceived.

Whether or not the technological, economic and population trends are immutable is certainly open to conjecture; however, the evidence that exists from a dozen or more European nations lends some credence to the fact that they do at least reflect an underlying dynamic unfolding in First World nations. They certainly do not stem solely from past policy decisions; they will not be defused by future policy decisions. It is probably safe to say that that realization is not widely appreciated by the nation today, and the nation's perception of a "national urban policy" (again, as distinct from the recently released 1980 Report) is still largely founded on the impression that increasingly the cities don't work and all we need are the will and the money to turn things around.

Finally, throughout the year there were many times when Commissioners were urged to look beyond the secondary questions of what could be done and how energetically could we be about the business of doing these things, and instead ask the prior questions involving how to choose from among options and whether or not purposive government action could ultimately be expected to have significant results. These are matters that relate to our nation's often demonstrated inability to anticipate, recognize and distinguish desirable from undesirable outcomes and our uncertainty about what it is that constitutes "success." These very basic questions were considered the principal focus of the urban panel report. Ultimately, as a statement on urban America, it was deemed important to say that the federal government may at times be severely limited, if not largely impotent, in its ability to determine what happens to urban America. These are not criticisms of government, rather they are only statements of its probable limitations.

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5. President's Commission for a National Agenda for the Eighties. Report of the Panel on Policies and Prospects for Metropolitan and Nonmetropolitan America, "Urban America in the Eighties: Perspectives and Prospects, 1980.

Representative REUSS. Thank you very much.

You gentlemen certainly present—and I congratulate the staff for having arranged this—a sharp conflict in policies. Mr. Hicks is very much in favor of people oriented programs, move people to the jobs, move them out of the Cold Belt where they are unemployed to the Sun Belt where they can find jobs, and against place-oriented policies; that is, try to do something about the condition of the Cold Belt areas.

Just the contrary, Mr. Cochran is very long on place oriented policies, which would presumably—and I would agree—have us see if some of the military contracts can't be put into Cold Belt areas. This approach would see if some of the synfuel independent money couldn't more effectively be spent on weatherization or coal generation programs in Cold Belt areas and thus achieve more independence per dollar, and Mr. Cochran finds very disturbing bringing the unemployed to where the jobs are in the Sun Belt proposition put forward by Mr. Hicks.

Aren't you both right and both wrong? Wouldn't it be a perfectly sensible policy to do whatever we can to bring people where jobs are, and to bring jobs where people are? What's inconsistent about pursuing both ends of that?

I point out that we knocked ourselves out bringing people where jobs are in the case of the Hungarian refugees in the 1950's and the Cuban refugees in the 1950's and late 1970's, of the Southeast Asians more recently. Tailormade programs were provided for them and when they arrived in the promised land there was a job and home and neighbors and everything waiting for them.

Why can't we do as much for our own? Equally, though, it seems to me that the enormous capital investment and the enormous human interest in keeping the older and colder cities of the Northeast and Midwest alive argues against the call for eliminating a national urban policy which in the last 4 years we have been in such pains to see put into place.

So my point is, why do you need to go kicking the other fellow's dog around? Why can't you put together the best of your respective fetishes and make a pretty good national program?

Mr. COCHRAN. Do you want to answer that, Mr. Hicks?

Representative REUSS. Let's start with Mr. Cochran. You make very capably the case for place oriented policies and I accept your position. I have no difficulty with it, but why do you need to come down so hard against a humanely conceived Federal program of setting up, for instance, a computerized national job information system so that somebody in Cleveland might per chance find out if there were a job in Phoenix that he could take. What's so wrong about somebody making a study of the cost-effectiveness of doing unto the down and out Clevelander what we did to the town and out Cambodians, Hungarians, Cubans, et cetera?

Mr. COCHRAN. Gee, I hope my statement wasn't taken as meaning that we shouldn't set up a national job bank or do a cost-effectiveness study or any number of other things which would be essentially neutral, and which would assist the labor market to do its job better and more rapidly.

I think that when we talk about more positive and more interventionist efforts to relocate the structurally unemployed we run into a variety of problems having to do with major shifts in cultural environments and so on.

You mentioned the Hungarian, Cuban and other refugee experience, and I think those are interesting, but I do think they are distinguishable in important ways from the problem we face internally. Many of the folks that you're referring to were in fact highly skilled individuals, relatively easily placed in reasonably skilled jobs. Not all of them and in fact many of those who are left over—those less skilled Cubans, Haitians, Cambodians, Vietnamese and so on—are in fact having very substantial difficulties being placed now. I am familiar with one family from Vietnam, actually with fairly high skill levels who has been relocated in Houston as a matter of fact, who are encountering virtually all the same difficulties in getting productively employed that they would encounter in New York City.

I do think we need to distinguish between kinds of people and particularly their skill levels.

Representative REUSS. Yes; although the kinds of people in the case of the individual can be changed if he or she is given the proper education and training, and I take it that the President's Commission on the Eighties isn't entirely and totally talking through their hat. I take it that they seriously believe that a program could be put together of job information, travel assistance, special education, smoothing out the bumps when you get there, which could work; and if I were a mover and shaker of a coalition, which I once was, I would want to call the bluff of the Sun Belters on that one and say, all right, let's have such a program; see that it's at least as good as the German program where they got all kinds of Turks from the mountains who had never seen a machine before and who were operating machinery at Mercedes very shortly thereafter and they weren't sent back when times grew tough. New ones were prevented from coming in. And they were accorded complete social security and educational and housing and other parity with German workers.

So I think it would be much more profitable for us Cold Belters to accept the challenge and say to our tormentors, all right, let's see you start a small but immediate program of helping the people to get to where the jobs are, and meanwhile—and now I turn to Mr. Hicks—how about you coming down off your high horse and recognizing the fact that every one of the $88 million of synfuel expenditures to dig up more of Wyoming—and I voted for it—every one of that $88 million hasn't been subjected to a cost-benefit study as to whether we couldn't, dollar for dollar, obtain greater energy independence by putting on storm windows in rental housing in Cleveland or grubstaking coal generation in Buffalo, for example.

Would you object to that?

Mr. HICKS. Of course not.

Representative REUSS. I mean, would you let your lack of enthusiasm about "place" oriented programs lead you to oppose such an exploration?

Mr. HICKS. The high horse that I may appear to be riding, Mr. Chairman, is an illusion. I agree with some of the things that Tom has just said and certainly with many things you have just said.

The Commission found it very important to not consider this issue in dichotomous terms—people versus "place." It did, however, consider it important—and said so explicitly in the urban panel report and the full Commission report—that it's a matter of emphasis.

To some extent in the past 20 years, our national urban policy effort has been understood to be "place" oriented. Perhaps this is a side effect of the fact that it was put together by people who represent particular places with boundaries and jurisdictions. This "place" emphasis is tending to cloud, the commissioners felt, the fact that there is a historical decline of the significance of place in our culture—in our society.

By that, I mean—think of one major technological development in the 20th century that has done anything but loosen the bonds between what we do and where we do it, be it transportation or telecommunications or anything else. So we only ask that we have our political discussions catch up with what's happening to our technology and realize that if anything has to be insulated from this wrenching transformation we're going through it's people, not places.

Representative REUSS. Well, I must confess I am made uneasy by some of your phraseology. For instance, in your prepared statement you say, "In this decade the best urban policy may not be an urban policy at all."

Well, you know, that's really quite a mouthful. An urban policy shouldn't be monolithic. It should be multifaceted, different cities, different solutions; but that we should muddle ahead for the next decade I don't find very comforting.

Then on that same page you say, "The Commission," meaning the President's Commission on the Eighties, "has recommended that the Nation respond to the transformation"—by that you mean the coming of age of the South and the West—"by promoting strategies of anticipation, accommodation, and adjustment rather than resistance." That's sort of relax and enjoy it to the rest of the country, and I really am disappointed. I don't think that's enough. I think you need to promote strategies of anticipation, accommodation, and adjustment, plus strategies of humane and energy and cost-saving conservation of what we have.

What's wrong with having an urban policy that takes care of both parts of the country instead of just the Sun Belt?

Mr. HICKS. Again, there's nothing inherently inhumane about adjustment or anticipation or even accommodation. It merely suggests that a recognition that the factors that we're facing that tend to be pulling all the levers or at least a large number of them tend to be economic and tend to be technological, and I would think it's the height of humanity to recognize that some policy levers don't seem to work in that kind of environment.

Furthermore, the kind of transformation we're talking about is not the transformation solely of the so-called Sun Belt. It is also certainly

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transformation of the so-called Frost Belt in the cities that anchor urban economies in those regions.

A study group went into Pittsburgh about 20 years ago and recommended to the people there some steps that could be taken to supposedly make Pittsburgh a better place in which to live. You recall 20 years ago Pittsburgh had some real dire problems, and the 2 principal recommendations that Pittsburgh was presented were these: First of all, the internal urban central city based economy has to restructure. Second, there have to be fewer people there. Those were policies that the city of Pittsburgh had very little control over and those are the kinds of developments that have indeed made Pittsburgh a much better place to live.

And I think it is misleading to couch urban policy debates in terms of Sun Belt versus Frost Belt. It reads very well in the press, but it clouds some very important issues and one of those issues tends to be that urban America may be alive and well. It's no longer simply or solely in cities. To some extent, even traditional rural America has become urbanized. All of America, it would appear, offers the opportunities to a greater or lesser degree to share in an urban existence and to live an urban life. That's why I put it the way I do.

To say urban does not suggest a subset of specific distressed conditions that are endemic to city life. Unemployment and inflation and poverty and malnutrition are characteristics of life anywhere, all places.

Representative REUSS. Thank you, Congressman Richmond.

Representative RICHMOND. Thank you, Mr. Chairman.

Mr. Hicks, you mentioned Pittsburgh, a city with which I was familiar for 30 years. You neglected to mention the reason Pittsburgh has had this incredible renaissance is because of two individuals. Dick Mellon and Mayor Lawrence decided the city was filthy, offered very little to improve the quality of life, and no art forms, very few hotels, very few amenities, and their individual leadership, beyond a doubt, is the reason that Pittsburgh is now a clean, vital, vibrant city.

I think in both your presentations you have forgotten that it's usually a couple of key people in every city itself. It's Dick Mellon and Mayor Lawrence of Pittsburgh who are principally responsible for reorganizing the city. If we hadn't had Mellon and Lawrence, Pittsburgh would still be a filthy, dirty city. I can remember going to Pittsburgh for a day and having to take an extra shirt because by noontime your shirt was black and you had to change your shirt for lunch. Now you can go to Pittsburgh and it's ecologically just as clean as any city in the United States. Individual leadership is something this country has and really must develop, and you two gentlemen ought to emphasize much more of that in your reports. That's just a statement of mine.

Another thing I haven't noticed in either one of your reports—Mr. Cochran, I didn't hear your report, but I read it before you gave it—the efficiency of our inner cities which are in the Frost Belt. New York City which has all the problems in the world—you hear about its terrible subway system, its terrible this and that, its terrible crime rate. As you know, we are nowhere near top in crime rate. We are down to seventh in the United States. New York still has the most efficient, largest subway system in the world. It happens to be the oldest system. It's 83 years old, and it's going to require $80 million to modernize it. But because of our subway system, because we are close in, verticalized instead of horizontalized, we have been able to run New York City and the people living in New York City are living under a considerably lower rate of inflation than most other cities in the United States. Whenever the average inflation rates has come out every quarter, we find invariably New York City is well below the national inflation rate. And Los Angeles which is spread out, is well above the national inflation rate.

Why is that? It's because the inner city is basically a heck of a lot more efficient entity to operate.

Mr. HICKS. That very well may be true. New York City offers a chemistry of a lot of these different factors.

Representative RICHMOND. But you also have Boston and Philadelphia.

Mr. HICKS. However, there are arguments that can be made that beyond a certain size, energy, gasoline, time efficiencies tend to be eroded and there are arguments that can be made that the new kinds of organizations that are appearing in less densely settled Southern and Western cities—but will appear in other more peripheral areas in the Northeast and upper Midwest in the years to come without a doubt—are just as energy-saving as possible.

The Commission wanted to make simply this one point, and that is that it should not be part of our conventional wisdom in this Nation that concentration is always and in every instance good and deconcentration is bad.

Representative RICHMOND. Concentration tends to reduce inflation and certainly add to energy conservation tremendously. The great flaw we have in the United States is our suburban sprawl. As you know, it's much more difficult to administer a suburban entity than it is an urban city per capita because of the power lines, the water lines, the sewer lines, the school buses involved which you frequently don't have in the inner city atmosphere.

Neither of the reports mentions the fact that one of the greatest things the United States could do would be start looking inward and looking toward revitalizing all of our inner cities throughout the United States, be they Houston or Philadelphia or Baltimore, because that would probably be the single most efficient thing we could all do. That would create jobs, conserve energy, and it would seem to me that neither of you have even thought of that idea of understanding that probably the worst enemy we have in the country today is sprawling suburbia.

Mr. HICKS. The Commission does not agree with that position. Sprawl by its very name is pejorative. It suggests a negative set of circumstances and conditions.

Representative RICHMOND. But it's wasteful.

Mr. HICKS. Not necessarily so.

Representative RICHMOND. But it has to be wasteful because it costs you much, much more to administer than it does in a close group of people. In Europe you know the average city is vital, has an excellent quality of life, and people live within the city limits.

Mr. HICKS. That is not necessarily so either. In a dozen or so advanced European countries we are seeing the same kind of deconcentration affecting urban centers. An article that came to my attention about the city of Paris, something we all key on mentally as the best sort of urban environmental set of circumstances we could possibly live in, is experiencing a tremendous outmigration of people and jobs.

Representative RICHMOND. Take the city of London.

Mr. HICKS. Same kind of situation.

Representative RICHMOND. London is improving itself constantly because of their 25-mile ordinance, the fact that within 25 miles of the circumference of London everything is urban. Outside of 25 miles they have a green belt and people tend to live within that 25-mile area and it's a heck of a lot cheaper to administer a city on that basis than a city that sprawls like Los Angeles to the end of nowhere.

Mr. HICKS. Again, that is not necessarily the case, the Commission believes. Certainly there are efficiencies that relate to concentrated living and working, but when——

Representative RICHMOND. Such as efficient mass transportation.

Mr. HICKS. That's certainly one of them. That's certainly an option for some areas. That is not an option for others. But there are a tremendous number of inordinate costs associated with trying to replace infrastructure in very concentrated settlements, to try to adopt land to new uses as land prices are artificially high.

Representative RICHMOND. They must be replaced. We are not presiding over the dissolution of the inner cities in the United States, are we? So whether we like it or not, we have to replace the aging sewerlines and transportation lines we have now. Since we are going to replace them, let's also think of attracting people back into those cities, into the excellent housing slots we have and the excellent quality of life we have in many of these inner cities. It could be vastly improved if we could get more middle-income people to move back in.

Mr. HICKS. It's not necessarily the case that people will be moving back in. There's very little evidence that middle-class people are coming back with their incomes.

Representative RICHMOND. On the contrary, there's great evidence middle-class people are coming back. You see in the paper last weekend, in Baltimore that an entire area is being converted into a middleclass area.

Mr. HICKS. Most of the housing stock improvement one sees tends to result from people who are already dwellers of a particular city and redeveloping a particular area. Only perhaps one percent of all housing stock has experienced such improvement.

Again, the Commission believes there's very, very little evidence to date and very little expectation in the future that we are going to see the kind of justification that has been talked about so often in the press with regard to rebuilding infrastructure, be it mass transit or water or sewer lines.

Representative RICHMOND. Which we have to rebuild anyhow.

Mr. HICKS. No, that does not necessarily have to be the case.

Representative RICHMOND. Mr. Hicks, obviously they have to be rebuilt. An 83-year-old subway can't exist if it's not rebuilt. If New York City is populated by 1 million people, you still need that subway.

Mr. HICKS. The Commission believes on the basis of the evidence that they marshaled from many sources in the course of a year that it's very likely these major urban centers will continue to lose population, although not at the same heady rates that we have in the past, and if it is the case that a city has to provide services for a reduced number of people, then the city is well advised to think about restructuring that service package and perhaps rebuilding it in such a way that it's smaller and much closer to the people who remain.

So the Commission would offer as advice to people who would plan to rebuild the city that planned investment be balanced with a concern for planned disinvestment. Cities learning how to shrink.

Representative RICHMOND. All over Europe right now, mostly in the major cities, you know what they're doing? They are building more and more mass transportation. They are making their inner cities more and more attractive for people to move in because they know that's the most efficient way to run a country. It gives you more land outside for agriculture. It gives everybody a much better quality of life.

Mr. HICKS. Building of a mass transit system is a fine political response when you've got population trends that tend to pile up people in dense areas, but if that does not happen to be the case, given the liberating kinds of technology that the cities of the South and West in this country have, building mass transit systems doesn't make much sense in most cases. Certainly not the heavy traffic intensive mass transit systems that work and should be kept up in our older industrial areas.

Representative RICHMOND. Mr. Cochran, you have done a lot of study in this area. You know New York City suffers from unemployment, right? You also probably know that we have almost as many unfilled jobs in New York City as we have unemployed people. So shouldn't the whole trend of your argument be that government must start training unemployed people for open jobs and not worry about moving them to the Sun Belt or Frost Belt or anywhere else?

Mr. COCHRAN. Yes, Mr. Richmond.

Representative RICHMOND. There are now 300,000 jobs in New York City. You cannot find a competent bookkeeper, secretary, computer operator in New York City who's unemployed.

Mr. COCHRAN. I think that's in large part the answer to the chairman's earlier remarks about the need to provide for perfect matching, nationwide. I think that it would be ideal to have a system in which people could be matched, retained, perhaps even given mobility allowances as a last resort, in order to obtain jobs. However, the fact is that our training and educational institutional arrangements are so bad at present, throughout the country——

Representative RICHMOND. Why don't we call for better training and better institutional methods and why don't we call for the private sector to involve itself in the training programs and give them tax credits. Wouldn't that solve an awful lot more of our problems than moving people from the Frost Belt to the Sun Belt and so forth?

Mr. COCHRAN. I think that's right.

Representative RICHMOND. If every corporation in the United States were required to train let's say 10 percent of the amount of personnel it hires, because most corporations have a 10-percent turnover of unemployed people and give them tax credits for that 1-year training period, just think what that would do for the unemployment problems in most of our inner cities.

Mr. COCHRAN. The fact is, I agree with everything you have said and I would go on to say that we have begun to make a few small and I think useful initiatives in that direction of the private sector program in the CETA area, the PIC program, the "Targeted Jobs Tax Credit" which we believe to be seriously flawed at present but which is a useful concept—all should be helping areas provide a better match between their structurally unemployed and their rather large set of jobs openings which, as you suggest in New York City is a very clear mismatch just within the metropolitan area. I have no quarrel with what you have said and endorse it fully.

Representative RICHMOND. It must be done with tax credits and through the private sector. I think we've seen government training programs by and large are not terribly effective.

Mr. COCHRAN. Particularly if we remember government training programs, broadly conceived, include our schools, our vocational and technical systems, our county colleges and so on.

Representative RICHMOND. I meant our Government training programs for the unemployed. I'd rather see private corporations endeavor to train the unemployed because they have the open jobs. In other words, every corporation right now knows exactly within a couple percent who's going to be leaving a year from now, and what I'd like to see is them hire those replacements and give them 1 year of training and get a tax credit for it because then those people they're training would be positively sure of going into a job that was already there.

Mr. COCHRAN. I endorse those notions, but I think our failures and the size of the public expenditures allocated to those failing systems are much more enormous than we usually think of. We usually think of CETA as the major public failure to train people adequately for available jobs, but in fact I would argue that our entire public education and even parts of our higher education system as well as CETA and the other Government programs—Federal Government programs—are indeed failing and they are failing in Houston and they are failing in Shreveport just as badly and some would argue more badly than they are failing in New York City and New Brunswick and Flint and Rockford.

Representative RICHMOND. Let's not talk about moving people from the Frost Belt to the Sun Belt and vice versa. Let's talk about training people where they live and improving the quality of life in the inner cities.

Mr. COCHRAN. I have no argument with that, whatsoever.

Representative RICHMOND. Thank you.

Representative REUSS. Mr. Hicks, before you became senior professional staff for the panel on metropolitan America in the eighties, what was your position?

Mr. HICKS. I was an associate professor of sociology and political economy in the University of Texas at Dallas.

Representative REUSS. In late November of this year the draft report of the President's Commission on the Cities somehow leaked to the press, or at least it appeared in the press. Can you enlighten us at all on how that leak occurred?

Mr. HICKS. No, Congressman, I don't know how that premature disclosure occurred.

Representative REUSS. Apparently a couple of officials within the Carter administration, officials who had been leaders in setting up a national urban policy several years before, saw that prematurely disclosed copy and wrote a letter on December 2, 1980, to Mr. Claude Barfield, Executive Director of the President's Commission for a National Agenda for the Eighties. Are you familiar with that letter?

Mr. HICKS. I am familiar with the letter and I must say with regard to those two individuals who received a copy, we gave them a copy.

Representative REUSS. What was done by the Commission for a National Agenda for the Eighties or its staff after the receipt of that letter from Mr. Robert C. Embry, Assistant Secretary of HUD; and Mr. Marshall Kaplan, Deputy Assistant Secretary for Urban Policy of HUD?

Mr. HICKS. You'll have to remind me, sir, what the date of the letter was.

Representative REUSS. The date was December 2.

Mr. HICKS. December 2. We certainly read it very carefully and then read parts of it in the newspaper not too long afterward. With regard to its effect on the——

Representative REUSS. Are you suggesting there was another unauthorized disclosure?

Mr. HICKS. Perhaps; it's been a very confusing world for me personally in the last month, but with regard to its substantive impact on the schedule of the preparation, completion, pulling together, and dissemination of the report to the Commissioners, and later to the President, the report was already in cement by the date of the receipt of that letter and so it had very little substantive impact at that point. We were, however, aware of the kinds of objections and perspectives that we were likely to receive either from those two individuals or from others, and the Commissioners thought very hard and long about the quality of those objections and their substance, and while they chose in many instances to take a different tack to stress different emphases, those perspectives certainly were taken into account. Certainly the perspectives emphasized in that letter were shared by many other people and spokesmen for groups that came before the Commissioners in various settings, and so we had a lot of practice in handling some of the arguments.

Representative REUSS. With respect to the specific criticisms of the report of the Commission on a National Agenda for the Eighties contained in the letter of December 2, 1980, by Mr. Embry and Mr. Kaplan, a letter which consists of eight single-spaced, typewritten pages, were any changes made in the final report as a result of that letter?

Mr. HICKS. Again, let me differentiate. We released 10 reports. The urban panel for which the senior professional staff had one of the panel reports and then our work was reflected and insinuated in the full Commission report.

Representative REUSS. Yes.

Mr. HICKS. With regard to the panel report, no changes were made. There might have been a word or two, but certainly not more than simply a word or two. There were no substantive changes made and I don't believe there were any substantive changes made either in the full Commission report that dealt with this particular earlier urban policy.

Representative REUSS. Now the panel report entitled "Urban America of the Eighties, Perspectives and Prospects" is 112 pages long. I'm reading from it and it's entirely about urban America in the eighties. The Commission report, as I recall—I don't have a copy of it in my hand—has just a few pages on urban affairs. That is to say, it had 10 subjects to consider and urban affairs was just one of them. So that I'm right, am I not, that there are just a few pages?

Mr. HICKS. That's correct, possibly eight or nine pages.

Representative REUSS. And you say that as a result of the Embry-Kaplan letter of December 2, 1980, no substantive changes were made in either 112-page panel report nor in the overall President's Commission report?

Mr. HICKS. That's correct. May I go on and say that the Commission prided itself from the very beginning that it would be, shall we say, separate from the political institutions that surrounded it. It was certainly open to any information possible, but in a fashion befitting a Presidential Commission, it tried not to be influenced by either the present administration, then present administration, or any of the contenders. We had no Commissioners who were elected officials. We made every use of administration materials and I'm pleased to say that at no time did the administration try to bend the Commission to more narrow purposes.

Representative REUSS. Incidentally, I now have a copy of the overall President's Commission report, and you're quite right. The urban America section of it occurs on pages 64 to 71, so it is just about 7 or 8 pages that you suggested.

Embry and Kaplan, at the end of their letter to the Commission, of December 2, 1980, said, "We would welcome an opportunity to discuss our comments and the document with you further at your convenience. We would also like to present our views to the Commission."

Were they given an opportunity to discuss their comments and the document with the staff?

Mr. HICKS. With the staff?

Representative REUSS. Yes.

Mr. HICKS. We had a meeting at HUD. Mr. Barfield and myself had a meeting at HUD approximately in October and it was decided upon receipt of the letter that those objections had been heard once before. The mere fact, or the fact that the Commission report was the product of Commissioners and, on some issues, came down in the initial areas to views that were in some sense out of step with Mr. Kaplan and Mr. Embry's views did not seem to be a reason enough to rewrite the report.

Certainly the views were considered. There were no one-on-one meetings after the receipt of the letter. There were, however, telephone calls and an expression of views, but these two gentlemen were reminded that the report was in concrete at that time and the Commissioners were not about to change their views.

Representative REUSS. Who reminded them of the concrete nature of the report?

Mr. HICKS. I think there was certainly a common enough known fact among the people who worked on the Commission that it was really out of our hands by the date of the receipt of the letter that I know I mentioned it and I'm sure that Mr. Barfield did the same.

Representative REUSS. Can you fix the date of the October meeting held by you and other members of the Commission staff with Mr. Embry and Mr. Kaplan of HUD?

Mr. HICKS. I could, but I suspect it's on my calendar. It might even have been late September.

Representative REUSS. Late September?

Mr. HICKS. Or some time in October, although I think it was October. It could have been late September.

Representative REUSS. Well, it was in late September or early October?

Mr. HICKS. I can't say. Certainly 4 to 6 or 7 weeks before the report was locked in.

Representative REUSS. That meeting was 4 or 6 weeks before the report was completed; is that correct?

Mr. HICKS. That's my understanding; that's right—at least.

Representative REUSS. Was Mr. Embry or Mr. Kaplan shown a copy of the draft report at that September or October meeting, or didn't the draft report exist at that time?

Mr. HICKS. A draft report existed in various stages of completion and polish probably ever since July. At that meeting, we promised and then followed up on our promise to immediately get them copies and several copies went to different officials at HUD at the time for background and comment, and it took a good long time before the December 2 letter was generated.

Representative REUSS. When did you send for comment the copy of the draft report to Mr. Embry and Mr. Kaplan?

Mr. HICKS. Since it was prompted by that meeting, the promise was made at that meeting; I presume it was shortly after that meeting. The exact date of that meeting I don't recall, but it was, again, 4 to 7 weeks before the Commission report or the panel report was finalized.

Representative REUSS. But it could be that there was not available a copy of the draft report on the occasion of your meeting with Embry and Kaplan and that you sent them the draft report after that meeting, could it not?

Mr. HICKS. That was the case.

Representative REUSS. That was the case?

Mr. HICKS. That's correct. May I also interrupt and say that one of the very first things that the urban panel did when it commenced its activities 1 year ago was set up a State and local advisory board so that representatives of all the State and local advisory groups, the "Big 7," were asked to appoint a designate and we kept those people informed throughout by mailing successive drafts to them throughout the year. We tried on three occasions to meet with them, once at a symposium on these tough urban growth and development issues on June 3 and 4, cosponsored at and with the National Academy of Sciences; and we had some State and local representatives there. In late September, we met finally with representatives in Houston. We had these people flown in from around the country. They lived in places around the country and went through in detail the urban draft as it existed, which in September was substantially the same thing that you see before you, and they had that draft in enough time to comment and bring their comments in. They had all read it and I must say that after 3 or 4 hours of the meeting in Houston, the word unanimity would not be too strong to characterize their reaction to the report, and it was favorable.

Representative REUSS. Who are the "they" who assembled at Houston on that fateful September day?

Mr. HICKS. Either the specifically designated representative of a particular State and local group or a staff member who they elected to send.

Representative REUSS. I don't understand that. You talk about groups and State and local groups. Who were the bodies?

Mr. HICKS. What were their names?

Representative REUSS. Yes.

Mr. HICKS. The U.S. Conference of Mayors.

Representative REUSS. Let's take the U.S. Conference of Mayors. Who was the person?

Mr. HICKS. I'm afraid I don't know the individuals who were designated by the particular organizations well enough to recall the name of the individual.

Representative REUSS. Can you supply that for the record?

Mr. HICKS. I'd be happy to.

[The information referred to follows:]

MEMBERSHIP LIST OF THE STATE AND LOCAL GOVERNMENT ADVISORY BOARD TO THE PANEL ON POLICIES AND PROSPECTS FOR METROPOLITAN AND NONMETROPOLITAN AMERICA OF THE PRESIDENT'S COMMISSION FOR A NATIONAL AGENDA FOR THE EIGHTIES

NATIONAL ASSOCIATION OF COUNTIES

Contact Person: Mr. Bernie Hillenbrand, Executive Director, NAC Suite 5000, 1735 New York Avenue, NW, Washington, D.C.

Representative: Mr. Roy Orr, Commissioner, Dallas County, 4403 West Illinois, Dallas, Tex.

NATIONAL CONFERENCE OF STATE LEGISLATURES

Contact Person: Mr. Earl Mackey, Executive Director, NCSL, 23rd Floor, 1405 Curtis Street, Denver, Colo.

Representative: Mr. George B. Roberts, Jr., Speaker of the House, Speaker's Office, House of Representatives, Concord, N.H.

Senator Alfredo Gutierrez, Minority Leader, Arizona State Senate, 1700 West Washington, Phoenix, Ariz.

Mr. Stafford Hansell, Route 1, Box 1796, Hermiston, Oreg.

NATIONAL GOVERNORS' ASSOCIATION

Contact Person: Mr. Steve Farber, NGA, Hall of the States, Suite 250, 444 North Capitol Street, Washington, D.C.

Representative: Governor Lee S. Dreyfus, State Capitol, Madison, Wis.

Governor Michael Dukakis, J. F. Kennedy School of Government, Harvard University, Room 204, 79 Boylston Street, Cambridge, Mass.

COUNCIL OF STATE GOVERNMENTS

Contact Person: Mr. William (Pete) J. Page, Jr., Executive Director, CSG, P.O. Box 11910, Iron Works Pike, Lexington, Ky.

Representative: Senator Oliver Ocasek, President of Ohio Senate, State House, Columbus, Ohio.

INTERNATIONAL CITY MANAGEMENT ASSOCIATION

Contact Person: Mr. Mark Keane, Executive Director, ICMA, Suite 305, 1140 Connecticut Avenue, NW, Washington, D.C.
Representative: Mr. Robert Wilson, Chief Administrative Officer, County Office, 100 Maryland Avenue, Rockville, Md.

NATIONAL LEAGUE OF CITIES

Contact Person: Mr. Alan Beals, NLC, 1620 I Street, NW, Washington, D.C.
Representative: Mr. Philip L. Isenberg, Mayor of Sacramento, 915 I Street, Sacramento, Calif.

U.S. CONFERENCE OF MAYORS

Contact Person: Mr. John Gunther, Executive Director, USCM, 1620 I Street, NW., Washington, D.C.
Representative: Mr. Henry Maier, Mayor of Milwaukee, City Hall, Room 201, 200 East Wells Street, Milwaukee, Wis.

Representative REUSS. Go on with your list of the organizations with names where you know them.

Mr. HICKS. Certainly. The U.S. Conference of Mayors, National Governors' Association, Conference of State Legislatures—for some inescapable reason, the names of these organizations have flitted away from me, but around town they are known as the "Big 7" and those people were represented.

Representative REUSS. Were Embry or Kaplan of HUD there or anybody from HUD at the Houston meeting?

Mr. HICKS. No. This was just for the selected designates.

Representative REUSS. Now let me go back to the last paragraph of the Embry-Kaplan letter to the Commission of December 2, 1980, and I quote, "We would welcome an opportunity to discuss our comments and the document with you further at your convenience."

You testified that Embry and Kaplan had a discussion with you in late September or early October and that it wasn't until some weeks after that discussion that they were given a copy of the draft report. That is correct, is it not?

Mr. HICKS. No. It was probably immediately after that meeting.

Representative REUSS. But is was after?

Mr. HICKS. Yes.

Representative REUSS. And you further testified that the Commission or its staff did not grant the request of Embry and Kaplan for an opportunity to meet and discuss "our comments and the document with you." That was not done?

Mr. HICKS. Not a face-to-face meeting. Certainly telephone calls.

Representative REUSS. They asked for a meeting and they didn't get one. Wasn't that being rather short with the two authors of the national urban policy? Shouldn't they, with their life work about to be trampled upon, be given the opportunity they requested to discuss the upcoming report of the President who formulated and proclaimed the national urban policy first in 1978 and then again in 1980? I would have thought that 5 or 10 minutes would not have been too much to ask of the Commission or staff.

Mr. HICKS. Well, again, we did give a hearing, although not in a face-to-face meeting with these gentlemen. It was decided and again——

Representative REUSS. If you can get into the active rather than the passive voice, who decided it?

Mr. HICKS. I hate to claim, just being a lieutenant, but I can say that the codirectors of the staff handled such matters and given——

Representative REUSS. And the codirectors were Mr. Barfield and Mr. Richard A. Wegman?

Mr. HICKS. That's correct.

Representative REUSS. And it was they who decided that they should decline to hear the comments of Embry and Kaplan?

Mr. HICKS. Yes; and for the very important reason that there was really no one to hear the comments. The Commissioners served at the pleasure of the President, but they lived all over the United States and the meeting schedule for them to be in Washington was established 1 year ago.

Representative REUSS. When was that meeting?

Mr. HICKS. I'm sorry?

Representative REUSS. When was that meeting?

Mr. HICKS. Well, Im just saying the schedule of all meetings was established early on and there was no meeting scheduled after December 2, so there was no critical mass of Commissioners there to listen to anyone. All the hearings had ended. The letter it was thought—it is thought came too late and it isn't clear that that letter would have changed the Commissioners' views anyway.

Representative REUSS. In the overall National Agenda for the Eighties, we find William J. McGill, Chairman of the President's Commission for a National Agenda for the Eighties, making public the various studies on December 31, 1980. That's 29 days after December 2.

Now he was not in Washington at any point in December?

Mr. HICKS. Not that I was aware of. I'm not saying he wasn't. Certainly not that I was aware of. Again, a great deal of our time was given to separate study panels and the panel draft that has raised such interest is meant to be the collection of opinions of simply the Commissioners who served on it.

Representative REUSS. Now the panel from the metropolitan America study consisted of Chairman Charles E. Bishop, president of the University of Houston; Robert S. Benson of Children's World; Pastora San Juan Cafferty, School of Social Service Administration, University of Chicago; Ruth Hinerfeld, president of the League of Women Voters; and Frank Pace, Jr. of the International Executive Service Corps. You were the Senior Professional Staff of that organization.

Were those five Commissioners informed of the December 2 request of Assistant Secretary Embry and Deputy Assistant Secretary Kaplan?

Mr. HICKS. Since we worked through a chairman and the chairman was Mr. Bishop in Houston, I'm certain that he was informed of the existence of the letter. I did not personally inform him of that. The staff directors would have, and I'm certain they did, and it was his decision we would not meet again. The objections in the letter had been heard before, and that is the issue of whether those perspectives had been presented before the Commissioners, and he thought that they had, and the Commission report would not have been changed.

Representative REUSS. Well, did Mr. Charles E. Bishop answer the letter of Embry and Kaplan saying, "We have your request that you'd like to see the Commission and we decided not to grant that request"? How was the refusal to see Embry and Kaplan conveyed to those poor fellows?

Mr. HICKS. I'm almost certain it was conveyed orally. I did not see such a letter from Chairman Bishop. It's likely that he wrote one, but I haven't seen it and he was—it would very likely have been crafted by Mr. Barfield or Mr. Wegman, and I would not have known about it.

Representative REUSS. Will you tell Mr. Bishop for me that I think he owes it to the Nation to read the 1978 and 1980 urban policy reports of President Carter, the man who appointed him to this position, and see whether the document which bears his name as the panel chairman in fact does justice to that policy? It's a square repudiation of President Carter and while I have had my differences with the Carter administration on their willingness to state a multifaceted urban policy, I thought they were right and I think as important a document as this, which is going to be around in homes and classrooms and the halls of Congress for the next decade, I think it's important that we learn whether Mr. Bishop really wants to substantiate the criticism that is made of that policy and the substitution of apparently another urban policy largely on the alleged glories of sprawl. That may be a defensible view, but I really think particularly in light of the unwillingness of Mr. Bishop to see the authors of the urban policy, Embry and Kaplan, that it would be good to have his views on this. Would you convey my wishes to him and hope that he will enlighten us? We certainly will see that his views are spread on the record of this hearing.

Mr. HICKS. I would be happy to.

Representative REUSS. Thank you. Thank you both. We appreciate your testimony very much and we now stand in recess.

[Whereupon, at 2:10 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, February 5, 1981.]

[The following articles were subsequently supplied for the record by Representative Reuss:]

[From the Washington Post, Jan. 4, 1981]

A DECADE OF CHOOSING

(By David S. Broder)

This time, the purists who insist that a new decade begins with the year ending with a 1—not a 0—have a point. This new year 1981, with a new administration and Congress gathering in Washington, represents a fresh start for the nation in a way that 1980 did not.

The mood is hardly buoyant, but it is realistic—and there is a lot to be said for that. It is plainly going to be a time of hard choices, but that knowledge creates a climate where sensible debate may proceed without the disabilities of a dream world where all good things may be done at once.

The framework for that debate is well defined in "A National Agenda for the Eighties," the soon-to-be-issued report of a blue-ribbon commission named in 1979 by President Carter and headed by William J. McGill, the former president of Columbia University.

The introduction to the report notes that 20 years ago a similar commission named by President Eisenhower "reflected the optimism of the entire nation and a belief in the government's ability to address and solve its problems both at home and abroad. Throughout the decade of the Sixties, the nation's leaders expected that we could simultaneously eradicate poverty, go to the moon and win a war in Vietnam."

"Today as we enter the Eighties . . . we full realize that the nation cannot proceed on all fronts at once. The nation faces a decade of difficult choices."

That is no news to the young David Stockman and the others struggling to frame Ronald Reagan's first budget, and it will soon be evident to Congress and the country. But the necessity for choice does not equate in any way to a policy of passivity for the national government.

On the contrary—as both the ongoing budget analysis and the commission report make plain—the one option that is not available to America is the continuation of the status quo. What is required is a searching reexamination of existing government programs and policies—and of the relationship of government to the forces shaping the private economy.

In some areas, that will likely and properly lead to a reduction of the federal role. But in others, there may be new duties forced on the government.

Advance stories on the commission report, for example, have provoked controversy by questioning the wisdom of federal urban policies designed to slow the shift of population and industry from the declining cities of the Northeast to the growing cities of the Sun Belt.

What has not been emphasized is that the commission calls for the creation of a national "minimum security income" program as a substitute for the welter of federal, state and local welfare programs—a step that by itself might offer more fiscal relief to New York City than the mix of urban-aid programs.

The commission is right when it says that choices will have to be made in years ahead between "place-oriented" and "people-oriented" programs. And it is right, too, when it says that sorting out and choosing the right mixture of policies for the new decade is no task for the simple-minded.

"The answers to our dilemmas," the report notes, "do not lie in such slogans as 'less government,' any more than they lie in automatic dependence on federal solutions."

The decade now beginning can be a challenging and rewarding time for those involved in those choices. But the first step is the recognition that there is no escape from choosing.

[From the Los Angeles Times]

Bigness for Bigness

Alexis de Tocqueville was the first writer to notice that Americans are subdividers at heart. The pioneers he described in 1833 were moving west (all the way to Michigan), clearing land, planting crops, building houses, selling their spreads at a profit to the next wave of migrants, and moving on, axes in hand.

The country took this revelation calmly enough at the time. But last week, when a presidential commission observed that Americans are still spreading out and suggested that federal urban policy accommodate movement rather than resist it, there was an awful uproar.

Some northern Democrats demanded that President Carter disown his Commission for a National Agenda for the Eighties. Some westerners, perhaps feeling crowded, thought federal resistance to more migration might be just the ticket. Some urban leaders denounced the report as a heartless proposal to lock the poor into the squalor of rotting cities.

All this criticism passes over a number of useful insights into energy, health care, the environment, welfare, economic growth and other items on the national agenda for the coming decade. It also distorts the one point on which the critics focus—urban policy.

It would be a shame if the outcry made the new Administration shy away from the report. Ronald Reagon's new team may not want to adopt the report outright, but it could learn—as we did—from a careful study of the commission's perspective on the nation's challenges.

The phrase that touched off the adverse reactions says that "cities are not permanent." Some critics obviously stopped reading at that point because what the report says about cities after that is worth pondering.

The commission finds America in a transition from a centralized manufacturing society to a decentralized and service-oriented society. The federal government cannot stop the change and should not try, it says.

About 20 industrial cities in the North and East are most deeply affected by the change because important factories have closed or moved, sometimes to the South and West, sometimes no farther than the suburbans. Those cities will not die, but they will shrink and change, and the jobs that remain will be not in manufacturing but in finance and research and data management.

Some workers have followed the factories to new locations. Some have left not only the cities but also the suburbs, gone out to clear the land, so to speak, and work at jobs that can be located almost anywhere, thanks to electronics and computers.

Many people have been left behind in the cities, and it is the federal approach to helping those still there that the commission questions. Although praising most of the report, Carter on Friday took issue with some of its comments on the cities.

The commission says the federal emphasis on help for the unemployed in older cities has been in creating jobs in the cities. That probably will be futile in the long run, as the commission sees it, and there should be at least as much emphasis on programs to train the urban unemployed and then help them get to where there are jobs to be filled.

The commission does not say that federal policy should force migration, only that it should not interfere with a trend that exists and will continue.

In other areas, the commission proposes policies with which the new Administration should readily agree. Economic growth has the highest priority on its agenda, largely because growth is necessary to provide a sound base for dealing with many social problems. The commission would replace many federal regulations with market incentives to promote national policies.

The nation's public schools must be strengthened. There should be a guaranteed minimum wage to replace the existing jumble of welfare programs. A national health insurance program should provide at least a basic level of medical care for every American. The federal government should stiffen its commitment to civil rights. Producing energy, particularly synthetic fuels, often will cost more than saving energy, and the nation should concentrate on increasing the productivity of the fuels that it already uses.

It is a big agenda that the commission has produced, but then it is a big country. The report may not have all the solutions exactly right, but the list of items that need attention is thorough and thoughtful. It is a good place to start.

[From the Boston Globe, Jan. 2, 1981]

New Frontiers for Those in Need?

Americans have always been a mobile people. Now a presidenial commission has wisely suggested the tendency should be encouraged.

Sometimes we tend to forget just how much movement there has been in our history. Settlement of the West, which Thomas Jefferson thought would take a thousand years, was accomplished in less than a tenth of that time. America's cities served as magnets and melting pots not only for immigrants from Europe but also for native sons and daughters from America's farms.

Some of the migrations have had romantic overtones, like the setting up of whole communities around a religious idea—the Mormons provided a prime example.

Others have been sadder. Among them are the instances when a bus ticket to New York could be delivered to a poor mother and her children by an Alabama sheriff, with comforting news that they would get welfare payments at the end of the trip.

Roles have changed. Sixty years ago California was a spacious paradise. Today it is urban, industrial and polluted, the nation's most populous state. The Northeast rode steel, coal and heavy industry into political power that has only recently broken. Now the Northeast is a supplicant rather than supplier of what once seemed boundless wealth.

Jimmy Carter last year asked a commission to take a look at America as it exists today and to propose institutional changes reflecting current realities. Headed by retired Columbia University president William J. McGill, the commission suggested the country should acknowledge the fact of urban and regional decline by assisting those who would move to more dynamic areas of the country.

Unlike the Alabama sheriff, government need not actively send people to other parts of the country. But according to the commission, it ought to make the process easier for those who want work elsewhere or who, for other reasons, want to take advantage of more benign conditions. It takes less heating oil to warm a house in Mobile than it does in Melrose.

The reaction has been predictable. New York Mayor Edward Koch complained immediately that it makes no sense to help the Sun Belt, which is very much on the upswing, while allowing the cities to slip into oblivion.

But the format for assistance proposed by the commission is, in a sense, even-handed. It recommends the federalization of all welfare programs and a major expansion of health assistance through a voucher program—two major social costs that weigh heavily on the Northeast, where programs are far more extensive than in the South and much of the West. Given the likelihood of uniform benefits under such a system, there would be far less tendency for the poor to congregate in northern cities.

Furthermore, the commission's report should not be read as a form of neo-racism. The commission strongly recommended passage of the open-housing legislation that failed in the past session of Congress.

Mayor Koch's angry reaction is not only misplaced, but probably unnecessary. The American electorate has embraced Ronald Reagan and his stated program for restoring as many human services as possible to states and localities. Neither a national welfare system nor a national health plan seems likely in the next four years. A larger reality prevails than the one perceived by the McGill commission: the cities and the Northeast will continue their downward slide in the 1980s, with an occasional bright spot like high technology in Massachusetts or a renascent Boston. Through it all. Americans will continue to do what they always have done—move around in search of something better.

[From the Detroit News, Jan. 6, 1981]

Don't Slay the Messenger

There are three major themes in the controversial urban report published by President Carter's Commission for a National Agenda for the '80s.

The urban renaissance touted in Detroit and elsewhere is somewhat illusory in that the poverty-level population of central cities continues to increase.

Urban and suburban sprawl are not totally devoid of virtue. For example, low-density development often means better housing for the middle and lower classes.

The urban poor may be better off in the long run if they are assisted in moving where jobs are plentiful.

The commission concludes by calling for new federal policies designed to spur further migration to those areas of the country experiencing the greatest economic growth.

There isn't a nation in Western Europe where such a study would raise more than an eyebrow. In America, where literally thousands of urban politicians have built their careers on assumptions challenged by the commission, the report inevitably raised a hullabaloo.

The political reaction has shed considerably more heat than light, so far. But we suspect that it marks the beginning of a fundamental reassessment of federal urban policy. This is reason enough to be grateful to the commission—although we by no means share all the report's assumptions.

For one thing, the study seems to ignore the chief virtue of capitalism, its capacity for creating new wealth. Thus, a major premise of the report is that if the Sun Belt continues to grow, it must do so at the expense of the Northeast and Midwest. Such pessimism is hardly justified by history.

Also, there seems to be little appreciation for the role of tax policy in promoting economic growth. Would the Sun Belt states be so attractive to industry if their tax rates were as high as those in the older industrial states? Will their low taxes continue to be possible as government services increase to meet the needs of growing and increasingly diverse populations? Part of the demographic shift may ultimatly be self-correcting.

Still, there are some liberating, if painful,truths in the report.

Federal urban policy has been designed, unintentionally, to warehouse millions of poor people in disintegrating central cities. Billions of tax dollars have been spent to improve these environments, with decidedly mixed results. Generations have been encouraged to subsist on welfare in the absence of expanding job opportunities. Programs of dubious merit have been maintained in large measure to employ a growing army of caretaker-bureaucrats.

In making a new start on urban problems the Reagan administration should recognize these truths. And this is not to say the older cities should be ignored or discarded as obsolete.

Offering tax advantages to businesses which settle or expand in depressed areas is one promising approach.

The industrial states and their aging cities can also help themselves by adopting tax policies and other strategies aimed at rebuilding urban cores as commercial, residential, and cultural centers. Some of these efforts are already evident and beginning to bear fruit.

National welfare standards are needed to provide poor families a guaranteed level of assistance wherever they live. This would break the bond between indigent populations and already overburdened cities, and would increase the mobility of the poor in pursuing job opportunities.

In stating boldly that Americans must begin to adapt to change rather than push against it with futile and wasteful programs, the President's commission has performed an important service.

This messenger should be heard, and not blamed for reporting hard facts.

[From the New York Times, Dec. 31, 1980]

Tomorrow's City: Worth Arguing About

An advisory panel to President Carter has put out a report that scandalizes Mayor Koch and a lot of other big-city partisans. They are shooting, unfairly, from the hip.

The report comes from a commission to establish a national agenda for the 80's. It urges, among other things, that Government should help underemployed people move out of declining Eastern cities and head to the South and West, where the country is growing. There are some passages in the draft report that are startling, perhaps even scary; but on the whole, it is a serious document worthy of careful study. It cannot be laughed at and should not be sneered away.

The report bruises sensitive spots in the psyches of urban politicians and pundits. They have watched economic development move south and west—often with Government help—and hence have emphasized the importance of restoring the urban core areas where many poor people live.

What the report dares to ask is whether the densely concentrated urban form of the classic Eastern city is suited to the communications technology of the post-industrial society. If the traditional cities are becoming obsolete, except for a few places like Manhattan, why should it be national policy to keep them alive? Just so that poor people can be kept in them?

To crusaders who have devoted lifetimes of effort and billions of dollars to saving "downtown," the very question verges on sacrilege. But it is a question that should be asked. The answer depends on how society now measures the relative importance of culture, economics, energy, transportation. All have changed since the rise of the Eastern industrial city.

Instead of reconstructing urban wastelands because they once looked nicer, housed more people and provided more jobs, the report urges programs that simply break the connection between the wastelands and the people still left in them, in the hope they will do better in a healthier economic environment.

This recommendation offends political and community leaders who fear the further shriveling of their political bases. Nobody knows, they will be quick to argue whether the welfare poor will do better if they move. And they can point to some successful economic development in cities, though there have also been many failures, at great public expense.

For years after World War II, many of America's economic difficulties could be described as urban problems, but the phrase is passé. America has several domestic problems—inflation, unemployment, low growth, welfare dependency that lasts for generations—that center in some cities and that cannot be solved without national remedies.

Restoring the national economy may require huge new investments in old metropolitan systems when these can be made productive. But the study panel wisely points out that unless Government can avoid squandering new capital on fruitless urban development projects, it will lack the resources to spend fruitfully on promising ones.

Because it takes the nation's cities seriously, as part of a country in economic trouble, the commission's report deserves better than the hasty anger and scorn it has produced.

[From the Philadelphia Inquirer, Jan. 11, 1981]

SHOULD THE U.S. SHIFT GEARS? PANEL SAYS RIGHT NOW

(By Douglas A. Campbell)

The report of the President's Commission for a National Agenda for the Eighties stirred up a storm even before most people had a chance to read it.

The commission is not scheduled to deliver its final 140-page report to President Carter until Friday, but a draft was leaked to the Washington Post and summarized thus in a Page One article on Dec. 26.:

"The United States must accept the inevitable decline of cities in the Northeast and Midwest and adopt a radically new urban policy that encourages people to move to the expanding Sun Belt. . . ."

The reaction, almost uniformly one of outrage, was swift in coming. Many, without an opportunity to read the report itself, denounced it as an attempt to undercut government support for the nation's poor.

An unexpected dissenter was W. Thacher Longstreth, president of the Greater Philadelphia Chamber of Commerce, who also had not read the report. Asked to comment, he expressed agreement with what he had heard. Indeed, federal dollars have been wasted in places like Philadelphia, he said; declining population and industry are facts of life and attempts to reverse those trends are "no win" situations.

On Thursday, Philadelphia's City Council passed a resolution demanding that the Chamber of Commerce fire him.

In fact, neither Longstreth nor the report suggested the abandonment of the cities of the Northeast in favor of federal investment in the Sun Belt. But both do insist that federal urban policies have failed substantially to relieve the economic hardship that afflicts many of those who dwell in the nation's largest cities.

"About the best you can say . . . is if you hadn't done it (spent the money), things might have been worse," Longstreth said in an interview last week.

And the report does say the lesson taught by experiences of the last two decades is that "a unified and coherent national urban policy designed to solve the problems of the nation's communities and those who live in them is not possible."

The commision is chaired by William J. McGill, former president of Columbia University and a native of New York City. Its report, which leans heavily on a broad range of empirical studies rather than on conventional wisdom draws these major conclusions:

The decline of the nation's largest cities, while to a minor degree worsened by some federal policies are largely the result of technological change and the nation's evolution from an industrial to a service-oriented society. Efforts to help city residents by propping up the city and its industries are doomed because federal resources are just too puny to stem the decline.

A policy that tries to make people better able to take jobs wherever the jobs are—rather than artificially prop up declining industries to keep jobs—will succeed in reducing hardships on urban and nonurban citizens alike.

Cities should be helped both by the state and federal governments to make the changeover from large to small, industry-oriented to service-oriented, as smooth as possible.

The federal government should turn over to states and localities many of the functions it has usurped over the years and should concentrate on developing a lively national economy.

The commission apparently anticipated that its report would cause controversy and be vulnerable to special interests seizing on isolated parts to support positions that the report, taken as a whole, would reject.

"Congressional support for urban policy initiatives is often the net result of the activities of those who believe that a proposal benefits their district, state or region, versus those who judge that it does not. Such political calculations unavoidably reflect a certain ultimate concern for the fates and fortunes of specific places," its authors write.

"Understandably, the political system therefore has had great difficulty dealing with a truly national issue without first translating it into countless, narrow parochial issues, because eventually political support and votes will be tied to local and regional calculations of self-interest."

It is the crippling effects of this parochialism that the commission's recommendations are aimed at eliminating. The first big step in that process, it says, is to get everyone to agree that the decline of large cities is inevitable. Central to that decline is the fact that "the nation's cities are transforming from centers of material goods production to centers of service consumption," the report says.

There have been a number of reasons for that change.

"The advantages of aglomeration (gathering together of factories) and central location have been eroded by technological innovations and new production technologies that have given locational freedom to an ever wider array of industries.

"Transportation and communications technologies have reinforced this dispersal because physical proximity has been eclipsed by electronic proximity.

"Difficulty in accumulating capital, complex local bureaucratic procedures engendering time and economic costs, general congestion and deterioration of a wide variety of amenities and delivered services have further reduced the attractiveness of central locations.

"Increasingly, firms and people have moved away not because they must, but because they can. When relocation decisions are made, new central locations are often avoided," the report said. Rather, economic development is tending to make the national landscape more homogeneous, and the differences between localities are being eliminated.

Thus, cities no longer offer any special attractions.

For instance, the report scuttles another piece of conventional wisdom among boosters of declining major cities—that energy shortages will cause a return to cities because, with mass transportation and other amenities, they are more energy efficient.

"Indications are that there are multiple options for accommodating higher energy costs that make the prospect of a large-scale return to compact, centralized, high-density urban development extremely unlikely, if not actually detrimental. Firms and households will likely be able to avoid profilgate energy consumption in a variety of ways without resorting to relocation," the report says.

Nor are urban services an inducement for massive migration back to cities, the report asserts.

"If public service packages are viewed as so vitally important, why do households and firms continue to move where the service packages contain less than what these users previously enjoyed?" it asks.

Finally, cities have failed in their historic role as processors of new manpower as the places where immigrants stepped onto the first rung of the economic ladder, the report says.

"For racial minorities . . . the social and economic escalators no longer functioned as effectively. Access to traditional avenues to success were blocked by individual and institutional discrimination," the report states. "A growing proportion of poor blacks and Hispanics have been left behind, and sizable proportions have become part of a nearly permanent urban underclass.

"Policy efforts should focus on helping the urban underclass of the poor and dependent, and not on maintaining outdated urban structures and functions."

The way to do that, the report suggests, is to scrap the whole idea of an urban policy and focus the federal effort instead on "linking people to economic opportunity," which "has often required that people relocate to settings where opportunities exist."

"Greater priority should be given to the displaced worker who bears the brunt of industrial restructuring and disinvestment (the shift of factories from one place to another)," the report recommends.

"The United States is virtually the only developed capitalist nation without policies or programs that assist the migration of people who are willing to follow employment opportunities " the report says.

It goes on to list a number of incentives provided in Europe, ranging from a national employment information clearinghouse that catalogs job openings everywhere in the country to transportation and housing subsidies for those who take distant jobs.

URGES TRAINING

Recognizing that simply sending many unskilled workers to distant jobs would be of little help, the report also urges that "efforts should continue to train those who have never had marketable skills and to retrain those whose skills have been rendered obsolete or redundant.

"With the ultimate goal of securing private-sector employment for these workers, supplemental and transitional public-employment programs are justified so that all who can work are able to do so.

"Improved access to economic opportunity through relocation or retraining or both is less useful for a sizeable portion of the urban underclass who cannot work and for those who work in low-wage sectors of the economy. As always, this residual class can best be assisted through a coherent blend of social policies and programs," the report says.

When it comes to policies and programs dealing with localities and their problems, however, there are already too many, according to the report. And in many cases, federal, state and local efforts overlap, duplicate and interfere with each other.

"The intergovernmental system should be decongested and a clear functional division of labor reimposed," the report urges. Those jobs best done by the state should be given to the state, those performed best by the city should be given to the city. Similarly, some services now provided by government might better be acquired on the open market.

The federal government should not simply dump the work on the state and local governments but should assist in an orderly transition until the lower levels of government are capable of doing the job, the report says.

"The federal government can best assure the well-being of the nation's people and the vitality of the communities in which they live by striving to create and maintain a vibrant national economy characterized by an attractive investment climate that is conducive to high rates of economic productivity and growth and defined by low rates of inflation, unemployment and dependency," the report concludes.

The federal government should pursue an industrial policy that includes "national economic planning a coherent science policy, and invigorated research and development efforts." Also, there should be federal social policies that "aim to aid people directly wherever they may live" and include "a guaranteed job program for those who can work and a guaranteed cash assistance plan for both the working poor and those who cannot work"—a system that would amount to nationalized welfare.

The social policies should replace existing polices, the report says. Among those policies that should be eliminated, it says, are "place-oriented economic development, community development and public facilities investment, housing, transportation and development planning."

[From the Economist, Jan. 10, 1981]

America's North Will Rise Again

"Cities are not permanent," says the report of a presidential commission on a National Agenda for the Eighties, in a sentence that should sound orthodox for a society as restless and open to change as those 200-year-young United States. Yet the suggestion that the federal government should not stand in the way of the drift of industry and people from America's grimier northern industrial heartland to the booming states of the south and the west has been greeted as if it meant the end of life as Americans know it. There has been much caterwauling from nothern politicians whose reputations have been built on grabbing bigger slices of the federal porkbarrel for their cities and states; from sunbelt leaders who think their cities and towns are already growing fast enough, thank you, and who resist an invasion of the northern poor (who are often black); and from traditionalists everywhere who think that whatever Buffalo, Youngstown and Cleveland have stood for in the past should be preserved.

It will be sad if this babble is allowed to drown out the commission's message, which offers America a sensible regional policy of the sort that has long eluded west European governments. If the thrust of the report became government policy, it could do more to reverse America's relative economic decline than any amount of Federal Reserve monetarism, macroeconomic engineering or supply-side tax cuts. Yet President Carter is being urged by northern Democrats to repudiate his commission's report even before it is officially published on January 16th; and the incoming Reagan crew, which is more sympathetic to the market mechanism, has not embraced it with enthusiasm.

CHANGE IS NOT THE POLITICIANS' ALLY

The commission's central argument is that federal money should not be used to prop up the past. The European mentality, which assumed that because Glasgow has always built ships and St Etienne has always dug coal they always should (provided enough taxpayers' money is thrown at them), now permeates the American north east, whose urban centres depend on huge federal handouts and whose declining industries are propped up by protection (and clamouring for more). New investment, despite these federal handouts, has headed for the south and the west where labour is cheaper (and tamer), taxes lower and the climate warmer.

The commission rightly applauds this trend, because it raises the wealth of the whole country. The rise of the sunbelt has helped America's international competitiveness; increased investment (by capturing firms which would otherwise have gone abroad) ; and raised living standards (all consumers benefit from cheaper production. Federal intervention seeks merely to slow the desirable trend; to squander taxpayers' money in an expensive bid to delay the inevitable. Better, says the commission, for the federal government to move out of the way and allow the drift to the sunbelt to reinvigorate American industry.

All this makes right-wingers glow and liberals glum. But the commission's report is no laissez-faire tract. If a market-based regional policy is to function smoothly, then there is much for the federal government to do. For a start, there is a tricky question of differential welfare payments; unemployed slum dwellers in New York (where welfare is civilised) are understandably reluctant to move to seek jobs in booming Dallas (where welfare is primitive). So the commission proposes more than the usual job retraining and mobility grants: it wants to nationalise the welfare system because it is only when welfare payments are equal all over the country that the poor and the unemployed in the labour force will become truly mobile.

Add to this the commission's plan for a national health-care system, through vouchers which would allow individuals to choose from a variety of competing insurance schemes, and the report suddenly becomes anathema to many of Mr. Reagan's supporters. He won his biggest margins of victory in western states where resentment against federal poaching in areas of government that have been the preserve of the states runs high.

America's sunbelt need not always grow at the snowbelt's expense. The competitive edge of the south and west is already eroding. Many of its areas are arid, with insufficient water to sustain both farming and industry. Labour costs are approaching northern levels. Cities such as Houston, Miami and Atlanta now have greater social drawbacks than more entrepreneurial Minneapolis. The sunbelt-snowbelt distinction is fading. Industries are tending to go where the environment is most pleasant, which usually means away from cities whether they are in the south, west or north: sometimes to areas where one can ski at weekends. The rise of an advanced electronics industry among the white fences and church steeples of rural New England shows that nothern industrial decline need not be inevitable when the federal tap to the cities is turned off.

The lesson for the nastier northern cities is that there is no alternative to disgorging many of their present inhabitants if they are ever to compete as attractive slimmed-down service centres for the new surrounding rural industries. Rather than fighting the exodus to the south with the rest of the country's money, they should be learning to adapt to it. In Mr. Reagan's America federal taxpayers' money will not willingly keep open job opportunities in the Democrat-voting agglomerations where it is least pleasant to live.

[From Time Magazine, Jan. 12, 1981]

BURNING UP THE SNOWBELT

"Ridiculous!" scoffed Jake Godbold, mayor of Jacksonville. "Idiocy!" exclaimed Robert McCabe, president of Detroit Renaissance, the city's urban revitalization organization. For once, the contentious spokesmen for the Snowbelt and the Sunbelt were agreed on something; they were outraged by the draft of a presidential report on urban policy that was leaked to the press last week in an obvious attempt to discredit it. Probably the most controversial of a package of proposals to be presented to President Carter on Jan. 16 by the President's Commission for a National Agenda for the Eighties, the report calls the decline of the Snowbelt cities inevitable and urges the Government to assist the urban poor to migrate to the Sunbelt, where jobs are available. Says the analysis: "Contrary to popular wisdom, cities are not permanent."

Such provocative prose is not usually found in blue-ribbon commission reports, which are generally filed away and forgotten. But this commission, set up by Carter in October 1979 at the recommendation of Retired Time Inc. Editor in Chief Hedley Donovan, intends to have impact. Its chairman, former Columbia University President William McGill, admits that his 50-member group wants to "think the unthinkable." Says McGill: "We forecast for the 80's a very difficult era in which [U.S.] resources will not be equal to demands. If there is anything we have attempted to do, it is to force the people who establish policy to make hard decisions on priorities. We are suggesting things typically not done because of short-term political perspectives. So, of course, parts of the recommendations are bound to yield political uproar."

The draft of urban policy states, essentially, that the traditional big Northern city has outlived its usefulness. Contemporary trends in the economy have render it largely obsolete. Because of revolutionary changes in production and communications, there is no need for industries to huddle together in a single congested setting. They have dispersed to the suburbs and the Sunbelt, leaving behind a much altered and diminished city.

The Snowbelt city can best maintain its viability, says the report, by specializing in service functions, which are increasingly dependent on better-educated employees. Thus a traditional means of upward mobility for the poor has been blocked. The report states that it is self-defeating to try to reindustrialize the central cities; too much federal aid is given in a vain effort to sustain them, and not enough is given directly to the poor. According to the report, the poor should be helped by a guaranteed minimum income, by job training and by assistance in migrating to areas where work is available. Instead of trying to bring jobs to people, the Government should take people to jobs. The report contends that the Government should support the "historical role of migration as the dominant means of linking people to opportunity."

Fearful of losing federal dollars for their hard-pressed communities, Northern mayors charged that the report was yet another example of federal bias against their region. It is their citizens' taxes, they argued, that helped build the military installations and technological institutions that have contributed to the boom in the Sunbelt. Complained McCabe: "It's as if we should be Arabs and fold up our tents to move South." Protested Cleveland Mayor George Voinovich: "We're dealing with human beings, not checkers."

Meanwhile, Sunbelt residents envisioned a second Yankee march through the South; hordes of poor descending from the slums of the North. Fumed Jake Godbold: "The report seems to be saying, "Let's pack them all up in buses and ship them down to the Sunbelt like refugees'."

Amid the catcalls, there were also some cheers for a report willing to break fresh ground in such blunt fashion. Said George Sternlieb, director of urban policy research at Rutgers University: "The proposal says that cities have ended up as sandboxes for the poor. It faces up to the reality of migration of jobs and people and says Government should help those who can't make the shift on their own. A new land of opportunity has opened up, and we should give poor people a chance to share in this opportunity." The report is only a draft, but already a hurricane seems to be brewing.

[From the Rocky Mountain News, Denver, Colo., Jan. 4, 1981]

Commission's Plan for 1980's Is Realistic

For one of the few times in the history of this grand old republic, a presidential commission has said something intelligent and realistic, which fact has come as an unbearable shock to a great many people.

The commission, which was named by President Carter in 1979, stated the obvious, namely, that the cities of the Northeast and Midwest are declining and that there's nothing that can be done to resurrect them.

In the preliminary draft of its report, "*A National Agenda for the Eighties*," the report then drew the obvious conclusion. Federal urban policy should be directed at helping those cities adjust to their new status, it should not attempt to return them to their days of glory, a task as pointless as applying mouth-to-mouth resuscitation to someone who's been dead and buried for the past two decades.

Instead, the blue-ribbon panel urges the U.S. government should adopt a "radical new policy" of encouraging people to move where the action is, the South and the West.

As soon as news of these recommendations hit the streets, the caterwauling began. The protests have been legion. It is always thus when self-evident truths encounter closed minds.

You have to wonder, though, how anyone, at this point, can seriously doubt that as a consequence of a great many factors, among them the energy crunch, this country is witnessing a profound economic and demographic change. Economic opportunity is moving West and South, and the population is following. This is documented by the new census, but has been clear for some years.

There's nothing any government except a totalitarian one can do to stop what's happening. Historical forces are at work, stand in their way, and you'll be flattened—you sure as heck won't flatten them.

But Eastern mayors, governors and congressmen want to pretend this isn't the case. They want to spend not just million, but billions, of dollars on Scotch tape and Band-aid programs that will fuel inflation and make the taxpayer poorer but won't really help those cities.

The report, of course, does not suggest that the cities be abandoned, just that federal programs address problems that can be solved instead of ones that will persist no matter how many dollars are thrown at them. Suppose, for instance, that the jobless in cities where jobs don't exist were encouraged by the government to move to cities where the market is creating new jobs. The Eastern cities would no longer have to provide as much welfare or as many other services, and might actually thrive.

We're not making this argument for the purely parochial reason that we believe Colorado and the West would profit extravagantly from such a federal policy. Indeed, growth poses as many difficulties as it does opportunities for the West, and that will be so even if the feds come up with a wide variety of Sun Belt programs, including so-called impact aid for boom towns.

We're making this argument because it seems to us about time for the government to base its policies on hard facts instead of slushy dreams.

[From the Boston Globe, Jan. 17, 1981]

AGENDA FOR 1980'S—PRESIDENTIAL PANEL URGES NATIONAL CONSENSUS

(By David Nyhan)

A vast study of America's looming problems, commissioned by President Jimmy Carter, spewed out a host of recommended changes yesterday as the nation bid him farewell and looked to a new decade and a new government.

And the two sentences out of 214 pages that seem best to sum up the quandary, as measured by the President's Commission for a National Agenda for the Eighties, are:

"What seems to be emerging is that the government is viewed as desirable if it is doing something for you, but not if it is doing something to you. This ambivalent attitude on the part of the people toward the role of government is self-deluding and inhibits the development of a political consensus about national priorities consistent with limited resources."

Carter, who named the 45-member commission just over a year before the election he lost to Ronald Reagan, was quick to dissociate himself from some of the more controversial recommendations it turned in. The commission did not include any elected public officials. And its suggestion that Uncle Sam encourage poor city dwellers from the North and Midwest to move to the Sun Belt in search of jobs created a firestorm among congressmen and special interest groups with a vested interest in maintaining the pipeline of federal grants to sagging Snow Belt cities.

"I disagree with the implication," said Carter, "that the federal government should play a role in facilitating the population trend from the Frost Belt to the Sun Belt."

The report, a sort of firecracker of social theories exploded on the eve of the Reagan inaugural, contains something for every pressure group to oppose. Its philosophy seems more liberal than conservative, though the commission chairman, William J. McGill, former president of Columbia University, rejected either label as inaccurate.

The Commission cited the failing economy as the nation's most urgent concern, urged a top-to-bottom overhaul of most government institutions and programs, and warned that hard choices are inescapable in an age of diminished natural resources, sterner foreign pressures and a smaller pie to be shared by groups who've benefitted from Uncle Sam's redistribution of income.

It was 20 years ago that the last similar presidential commission, under President Dwight D. Eisenhower, tried to chart a course for the future. And this report is far more pessimistic in tone. Inflation, now at unprecedented levels, typifies the nature of the new challenges:

"No group is willing to forgo its own immediate short-term benefit, often a cost-of-living or profit margin increase. Yet without some mechanism for breaking the cycle, inflation spirals ever upward, undercutting all short-term benefits in the long run. Pervading the society is a stress on immediate gain, without concern for the long-run future."

In nine areas, the commission, whose proposals had to be approved by only a simple majority of the commissioners, suggested:

Giving highest priority to the economy, and making workers more productive; rewarding saving and investment; spending more tax dollars on basic research and development; encouraging companies to train the jobless; abandoning government "fine-tuning" of economic cycles.

Admitting that energy conservation still gives the most bang for the buck; scraping the synfuel plan; stockpiling more oil against foreign disruption; stepping up insulation and weatherization programs to save heat.

Deregulation of finance, transportation, communications, energy and insurance; but keep regulating environmental, health and safety matters.

The health care delivery system is "woefully inadequate." The commission embraces the general idea of Sen. Edward M. Kennedy's universal comprehensive national health insurance program. It suggests a voucher system with different levels of coverage, help for the elderly without putting them in institutions and disease prevention at every age level.

Scrapping much of the welfare maze, including aid to families with dependent children (AFDC), food stamps and general assistance; replacing them with a negative income tax designed to encourage the poor to work, with less risk of losing benefits; making the federal government responsible for welfare costs, and imposing a negative income tax to help bear costs.

Moving poor people from decaying Northern cities to prospering Sun Belt locales. The original draft of this section, stoutly opposed by a minority of commission members and many congressmen from affected areas, was leaked to some Washington reporters several weeks ago in an apparent attempt to discredit the notion. Cities change, the report argues; poor people should get aid directly, not through federal grants sent to places.

Elsewhere, the report argues that it was traditional in this country for poor people to migrate in search of jobs, up until the point where the government began paying them to stay in place and live marginal existences on the dole. The report also suggests:

Improving the political process and limiting the dominance of single interest pressure groups by taxpayer financing of congressional elections, giving the Democratic and Republican parties some say in the distribution of funds, limiting candidates contributions from political action committee, streamlining the presidential primary system by replacing it with four time zoned regional primaries, and ensuring that officeholders get seats at national political conventions.

Civil rights, the ERA and fair housing laws need immediate attention. "The public schools are failing to provide the quality education desired by the American public." Soon, one out of five Americans will be nonwhite. Massive improvement is needed in child-care systems to aid working mothers.

Abroad, America's role will be diminished, but we should curb oil imports, improve aid to poor countries persuade our allies to pay more defense costs, push for peace in the Mideast and seek arms-control agreements with the Soviets; progress in all fronts is tied to harnessing inflation at home.

The commission members were drawn from diverse groups; 14 of the 45 have degrees of one kind or another from Harvard. Members include Radcliffe president Matina Horner, Prof. Daniel Bell of Harvard, television producer Joan

Cooney, Marion Wright Edelman of the Children's Defense Fund, Common Cause founder John Gardner, and executives from firms like Deere & Co., Chemical Bank, General Motors and Texas Instruments.

The main report is available from the Government Printing Office at $4.75, separate sections on different topics are also printed, and a copy of the whole lot can be had for a total of $38.50.

[From the Wall Street Journal, Jan. 2, 1981]

Facing the Urban Music

We seem to recall a Nineteenth-Century literary exchange in which Margaret Fuller, that excessively highminded American transcendentalist lady, declared, "I accept the universe." Upon hearing which Thomas Carlyle responded, "By God! She'd better." We are reminded of all this by the hue and cry that has greeted the leaking of pieces of the report of the Commission for a National Agenda for the Eighties. The commission has evidently come to the conclusion that the decline of some cities in the Northeast and Midwest is inevitable, and federal policy should adjust to the fact. You would think the earth had been declared flat.

The commission's argument on this point is not very esoteric. For years, federal urban policy has been pumping in money to try and shore up older cities that are now losing populatoin and jobs to the Sun Belt. This is not working. Furthermore, there are no signs of any coming bolts out of the blue to change circumstance enough to make it work. Therefore, elementary reasoning would seem to dictate a policy shift. Instead of trying to lug the jobs to where the people are, the government should try to minimize the human costs of the unstoppable economic shift by helping get the people to where the jobs are.

A commission staff draft asserts that following this approach would entail a whole laundry list of policies, not corresponding exactly to the agenda of either the left or the right: retraining and relocation assistance for individuals, a federal guaranteed income plan to replace present welfare arrangements, a reduction in the granting of "place-oriented" rather than "people-oriented" aid, and above all the fostering of an investment climate conducive to high rates of economic productivity and growth.

Some news reports say the commission has recommended that the government actually "encourage" this movement to the Sun Belt. That may not quite be a fair characterization. True, the staff report does talk in non-specific terms about "a policy of assisted migration" that would "help underemployed and displaced workers who wish to migrate to locations of long-term growth." But most of the language is the other way around, speaking more guardedly of how "federal urban policy efforts should not necessarily be used to discourage" such movement. Mainly, the text is saying, the government should get out of the way.

Now there is a lot of yelling and screaming going on about the report. Carter HUD officials have objected strongly to the language. The president of the National Urban League says the commission's policies probably can't succeed at moving people from their home cities. Labor representation on the commission is going to file dissenting views. It is an oddly violent reaction, you might think, to a report that is not only a mere think piece in the first place but the product of an outgoing administration and a document with no claim to influence over the new one.

Maybe some of the vehemence comes not just because the report's recommendations would cost some cities a lot of money but because it has hit a nerve by telling what eevrybody really knows; that the present system of subsidies is an intellectual sham and an ineffectual one at that. If that is what is going on, then the brouhaha serves a good purpose. Near-impossible though it is going to be to chip away at the current system of pork barrel, the first step is surely to get the business out in the open.

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