THE 1968 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

SECOND SESSION

FEBRUARY 16, 19, 20, AND 21, 1968

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THE 1968 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 16, 1968

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

The committee met at 2 p.m., pursuant to adjournment, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Javits, and Jordan.

Also present: William H. Moore, senior staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

We are honored and delighted to have such an impressive panel of witnesses representing the great farm organizations of our Nation before us.

As I have said to some of you gentlemen, many of us on the committee are concerned about the lack of adequate expressions of policy with regard to our farm economy in the message of the President and the statement of the Council of Economic Advisers.

That is why the committee decided it would be desirable to have both the Secretary of Agriculture and the leading farm organizations appear before us this afternoon.

The Secretary of Agriculture appeared Wednesday and you gentlemen, of course, are here today.

One difficulty is that as we stated—the staff stated in the letter which I sent out, and I take responsibility for it—that statements should be confined to 25 minutes. As you can see, we have a four-man panel, and we want to have time for questions, so I would appreciate it very, very much if you could possibly abbreviate your statements as much as you can; and if you could confine your statements to 15 minutes, it would be most helpful.

Without question, your full statements will be printed in the record and will be made available, of course, to members of the committee and to Members of the Congress.

So, we will proceed as the witnesses are listed, with Mr. Harry Graham, the legislative representative of the National Grange, first.

Mr. Graham.

STATEMENT OF HARRY L. GRAHAM, LEGISLATIVE REPRESENTATIVE, THE NATIONAL GRANGE

Mr. GRAHAM. Thank you, Mr. Chairman.

I will be delighted to try to hold this to 15 minutes, and I will try to watch the clock. It probably is handier for me than for you to watch it, and if I do not, you know what your gavel is for.

We appreciate the opportunity that you have given us for the Grange, and I am sure this is shared by the rest of the Grange organization, to appear before this distinguished committee of the Congress and the Senate, and we appreciate the concern which you have had which motivated the panel meeting; of the graciousness which you have extended to us in this invitation to appear before you.

There are many parts of the President's report that we would like to talk about, but none of them, obviously, we can go into in detail in this time limitation which, I think, is very reasonable.

I would say, first, though, that the letter of transmittal which the President sent along with the report of the Council, that the President pointed out some very substantial and spectacular gains in the general prosperity of the Nation during the last 7 years.

They show up in almost all areas, with the highest number of employed people with the highest average earnings on record.

It shows an unemployment rate of 3.8 percent, a rate that has not been lower except twice in 169 months. With total employee compensation up $33 billion, and total consumer income after taxes up $35.5 billion, combined with an alltime high in industrial production with a yearly rate of growth in the gross national product of 4.5 percent, this is a continuation of the longest period of uninterrupted growth in our history.

We see undistributed profits in the nonfarm corporate businesses of $20.5 billion, and net working capital of $196.3 billion. This is after bond yields have increased for the triple A bonds by 38 cents, and for the triple B bonds by 60 cents during the last year, with total liquid assets up $47.1 billion.

These are solid economic accomplishments, but they leave some problems.

One is the relaxing of, in our opinion, the wage-price guidelines which were solidly based on productivity.

In the farm sector, we are concerned because the agricultural sector has not shared equitably in the returns for the contribution that they have made toward the total growth of our economy, both in GNP and also almost of as much importance to the contribution we make to the net balance of trade by the extremely high level of agricultural exports, which have been based primarily on the ability of the American farmer to produce in competition, through their technology, with almost any country in the world.

This, in turn, gives us another concern. If I go back for a minute in the relationship of the farm dollar to the rest of the economy, that is one of our concerns. Only the dairy industry showed an improvement in their parity ratio last year, it being up from 114 to 119. The Senator from Wisconsin, I am sure, is interested in that one. From previous experience I know of his concern.

Poultry and eggs were down from 102 to 84; food grains were down from 87 to 84; feed was down from 112 to 108, while tobacco was up to 114, its highest level.

The result was that cash receipts were down 17 points and net farm income was down $283 million, while the output was up from 113 to 117, with output per man-hour up 6 points to 167.

I wanted to particularly emphasize this one because if we are going to talk about income on the basis of production and the increase in production, then certainly agriculture has a claim that is not less than other parts of our economy, and certainly greater than some.

We noted with approval the deletion of the reference to farm income last year which proposed no interference with the law of supply and demand as the determinant for the allocation of the resources in agriculture. We hope that the statement previously referred to that Federal economic policy no longer relies primarily on the "automatic stabilizers" built into our system or waits for a recession or serious inflation to occur before measures are taken, includes agriculture with the rest of the economy.

In the international picture with which the report deals at some length, we have a very great concern because of the development of the protectionist attitude in the United States, and because this protectionist attitude, in our judgment, is based on some rather unsound economics.

I spent 2 weeks in Germany in November as a member of a delegation from the United States studying the effects of the Marshall plan after 20 years of their history. While we were there, there was a great deal of dissatisfaction in the coal area because of their closing down of a great share of their production because of inefficient and not needed production—dropping their coal production as quickly as they can, from 143 million tons down to somewhere around 80 million tons, and importing coal from the United States. With our technology we can produce it and ship it to Bremen cheaper than they can ship it from the Ruhr to Bremen, which is economic efficiency working as it should.

At the same time, the steel workers and the steel industry, along with the Government, were pounding out an agreement whereby they were not going to increase wages nor profits during the coming year or during the term of their contract that they were working on, because they felt that this would be an adverse factor in their attempt to maintain the markets that they already developed in the world. Over against this we are concerned, as I think everybody has to be concerned, about the threat of a rather serious increase in steel wages, and with the continued high level of profits that the steel industry is making, to the point where they can no longer compete in some types of steel right in their own area with the steel coming in from Japan and Germany. The failure of our American industry to plow back its profits into the industry, with the exception of National Steel, which has the only really modern steel complex in the United States, comparable to those in Germany and Japan, means that we are simply pricing ourselves out of our own market by maintaining an inefficient system.

In our judgment, protectionism that is being talked about today will put the burden of this upon the most efficient part of our industry, which is agriculture, and by this method the burdens which properly should be borne by the industry, are unreasonably shifted to agriculture and to the consuming public.

This is a matter of more than casual concern, and I will leave it at that, having more completely expressed it in the statement.

In terms of the budget and taxes, we have consistently stood in the Grange for enough taxes to pay the cost of government, especially at a time when there is still a substantial threat to inflation. We believe we have waited longer than we should to pass the surtax bill, but we believe it still should be passed, if not from the standpoint of stopping inflation, at least for the purposes of restoring confidence in the dollar among our trading partners around the world.

If there is consistency in the advice we have been getting from our financial friends, it is that if we are going to restore confidence in the dollar we are going to have to do something about balancing our domestic budget. These people are perfectly candid with us, and I do not think that we can just ignore the advice of the people who have taken part in the International Monetary Fund, the agreements in Rio, and the other action that has been taken to stabilize the dollar, especially after the devaluation of the pound.

I found in Europe a very great concern about this part of our American financial situation at the present time especially as it relates to Government finances and in balancing the budget.

We have the resources to produce enough goods to pay our debts to other countries. This concern is not expressed. What they are afraid of is our liquidity will get to the point where we will have difficulty even in maintaining this kind of productive system and I share the concern, and I know there are a great many people who share that same concern.

This, in general, Mr. Chairman, is a quick summary of the major concerns which we have, as we have expressed in this statement which the committee has, and which I am sure you are going to consider and maybe you already have.

Thank you.

(The prepared statement of Mr. Graham follows:)

PREPARED STATEMENT OF HARRY L. GRAHAM

In his letter of transmittal of the Annual Report of the Council of Economic Advisers to the Joint Economic Committee of the Congress, the President pointed out some very substantial and spectacular gains in the general prosperity of the Nation during the last seven years. These show up in almost all areas with the highest number of employed people at the highest average earnings on record. The Report showed an unemployment rate of 3.8 percent, a rate that has not been lower except twice in 169 months. With total employee compensation up $33 billion, and total consumer income after taxes up $35.5 billion, combined with an all time high in industrial production with a yearly rate of growth in the Gross National Product of 4.5 percent, this is a continuation of the longest period of uninterrupted growth in our history.

On the industrial side, we see undistributed profits on the non-farm corporate businesses of $20.5 billion and net working capital of $196.3 billion. This is after bond yields have increased for the Aaa bonds by 38¢ and for the Bbb bonds by 60¢ during the last year with total liquid assets up $47.1 billion.

These are solid economic accomplishments, brought about by the reluctance of the Administration to "rely primarily on the 'automatic stabilizers' built into our system or to wait for a recession or serious inflation to occur before measures are taken." However, all of these gains have not been without some losses, and there are some danger signals which have been hoisted into the air and possible gale warnings are ahead of us. One of these is the relaxing of the wage-price guidelines which were solidly based on increases in productivity. While average earnings of factory workers were increasing by $4.80 per week, the automotive-industrial production index was down 13.7 percent and the machinery index was down 0.4 percent.

These figures, connected with the ones previously given concerning bond yields, indicate that both industry and labor are engaged in profit-taking actually beyond their real earnings in terms of production, and that these increased profits and wages are being passed on to the consumer in the form of higher prices—the underlying cause of the present inflationary pressure.

THE FARM SECTOR

This is particularly pertinent to the problems which beset American farmers trying to retain some semblance of equity with the rest of our economy when the economy is expanding at a relatively rapid rate. In this regard, last year's accomplishments were not spectacular. The index of prices paid by farmers for their production inputs increased from 114 to 117 last year. Only feed and fertilizer held steady, and feed holding steady was the result of steady to downward prices on feed at the farm level. The higher non-farm wages and profits were reflected in the index for the cost of motor vehicles, a major item on every farm, increasing from 117 to 122, up 5 points. Machinery, the major item necessary in a technogically advancing agriculture, was up from 124 to 130, or 6 points.

Interest went up from 232 to 259 on the basis of the interest paid per acre of farm. Taxes were up to 178 from the previous level of 166. Wage rates rose from 135 to 146, all based on a 1958 figure of 100.

The increase in the index of assets of 11.7 was largely accounted for by the increase in real estate of 9.5. This is a classical pattern of investment and hedging when there is a possibility of inflation. Another way of saying the same thing is that in the consumer indices, durables were up 1.6 and non-durables 3.4, and the services up 6.1.

With the increased interdependence of farmers on the rest of the economy, the increase in the services as well as in automobiles and machinery were a prime reason for the decline in net earnings. Although no breakdown is given for the increased costs of medical services in rural areas, for city wages and clerical workers, medical services were up 11.7 points in the index. For the rural people, this simply means that the medical service is not available in many rural areas, the doctors requiring the patient to go to the city and their costs, therefore, are greater than their city cousins because of the cost and added expense of transportation, whether it is the patient going to the city, or occasionally, when a physician is found who is willing to make house calls, an increased charge for house calls in the country. Thus, the area which is at the bottom of the list in terms of medical services available is at the top of the list in terms of the costs of these same services. The President has properly pointed this out as one of the areas of major concern.

In terms of the relationship of the farm dollar to the rest of the economy, only the dairy industry showed an improvement in their parity ratio last year, it being up from 114 to 119. Poultry and eggs were down from 102 to 84, food grains down from 87 to 84, feed down from 112 to 108, while tobacco was up to 114—its highest level. The result was that cash receipts were down 17 points and net farm income was down \$283 million for the farmers while the output was up from 113 to 117, with output per man hour up 6 points to 167. The most dramatic increase in output, explaining some of the drop in prices, was the 22 points increase in the output per man hour for crops and the 6 point increase in output of livestock. This also helps to explain the decline in farm population of 595 thousand people last year, down to 11 million.

Thus, we see the familiar pattern of lower farm population, increased inputs into machinery to replace hand labor, followed by migration into the cities with many of these people having no saleable skills and contributing to the unrest in our cities.

Had it not been for the dramatic increase in exports, with a total increase of \$4.126 billion, of which agriculture apparently contributed more than \$2.5 billion, the picture would have been even worse. This not only prevented a further decline in agricultural prices, but it made a major contribution to our balance of payments. The Administration, especially the U.S. Department of Agriculture, deserves a big vote of appreciation for its export program.

We did note with approval the deletion of the refernce to farm income last year which proposed no interference with the laws of supply and demand as the determinant for the allocation of resources in agriculture. We hope that the statement previously referred to that federal economic policy no longer relies primarily on the "automatic stabilizers" built into our system or waits for a recession or serious inflation to occur before measures are taken, includes agriculture with the rest of the economy. Indeed, as we look at the action taken by the Department of Agriculture this year to shore up farm prices—32 separate actions in all—we are confident that the previous policy has been reversed and we are pleased to note this change. To leave agriculture subject to the vagaries of the market and the inelasticity of the demand for food over against a number of variables in production from weather to price, and to impose over it a controlled economy in the field of wages and profits and government policy, is to sentence agriculture to bankruptcy and then see the decline in the major market for American industrial products due to the decline in purchasing power seriously and adversely affect our total economic structure.

Only an expanding economy can hope to absorb the growing number of people who are coming into the employment age. This is particularly pertinent when we have estimates of an increase in our population of 50 percent in 23 to 32 years. New wine can no longer be poured into old goatskins in terms of our economic life, and the answers of 50 years ago, when we had a more stable population and economy, simply do not fit the expanding population picture which we have today.

The International Picture

If we may return to the expanded profits and wages to which we previously referred, we would like to discuss it in a different context. This is its effect upon our international trade and the rise of protectionism in the United States. With labor contracts expiring in the steel industry this summer, and with already announced goals of increases of 8 percent or more being sought, it is pertinent to relate this to the attempts to impose import quotas on foreign steel.

This would simply lock-in our inefficiencies in the competitive steel business and charge these inefficiencies to the consumer. While agriculture has been at the head of the technological revolution, producing its products to sell on world markets at competitive prices, making the greatest contribution to our net balance of payments of any industry, the steel industry by and large is still engaged in producing by the Bessemer process of the last century.

I spent two weeks in Germany in November of last year surveying the results of the use of Marshall Plan money for rebuilding the German economy. I was particularly interested in the pragmatic economic decisions being made by the Germans. These include reducing their yearly coal output from 143 million tons to 80 million tons, increased dependence on U.S. coal which is cheaper to import into Bremen than German coal is from the Ruhr, and the development of technically advanced steel production as a means of maintaining their share of the world market and increasing their growth, if possible. At the time we were there, the German Federal Republic laborers in the steel industry and the owners of the steel mills were pounding out an agreement under which they would freeze wages and profits at the present level in order not to undermine their competitive advantage overseas. They have been bringing into production new steel mills with the most advanced production techniques in the world. The same is true of Japan. As a result, these two countries are able to deliver their steel to automobile plants which are within two hundred miles of our basic steel complex at a cheaper price than U.S. steel can be delivered.

One of the main reasons is that most of the U.S. companies have been more interested in expanded profits, as previously noted, than in modernization of their plants. Although integrated steel production is relatively well advanced in both Japan and Germany, in the United States there is only one facility which has incorporated into a single large-scale operation the basic oxygen furnace, vacuum degassing and continuous casting—the latest and most important advances in steel making technology.

The National Steel Corporation will soon open its new $100 million facility in West Virginia, following hard upon the first basic oxygen furnace and the first 80 inch computerized hotstrip mill in the Nation. The last two gave National a three year jump on its competitors and the new facility is suppose to trim production costs by $10–$12 a ton.

This is the proper way to meet the competition from Japanese and German steel, not by restrictive tariff laws which serve to reduce our international trade and, at the same time, reduce the possibility of maintaining an expanding economy to serve the needs of a rapidly growing population.

We interject this into our testimony by way of stating our support for the treaty which the Senate must consider establishing tariff cuts during the Kennedy Round of Negotiations in the GATT.

Without discussing textiles which are basically in the same situation as steel, we would recommend the November 1967 issue of "Textile World" for information relative to textiles.

We use the example of the German steel industry to suggest to our friends in the rest of the U.S. economy that, at this time of intense competition, some statesmanship is in order. This includes both the willingness to accept lower earnings and lower targets for salaries for a temporary period while our industrial plants adopt the modernized methods of integrated production in the case of steel, and the modern technologies in other industries which are going to be necessary to preserve the competitive advantage which we have previously enjoyed, or to maintain a competitive balance with our trading partners around the world.

The abandonment of the previous wage-price guidelines do not make any contribution to a satisfactory solution to this problem. We would, therefore, urge this committee and the Council of Economic Advisers, to most seriously consider the ways in which we may place some type of controls over the tendencies toward inflation which the President and the Council both have noted in their message to this committee—not only so that the consumers may be benefited by products at reasonable costs, but simply because the long-term basic interest of our industries are intimately bound up in the solution to this problem.

The Budget and Taxes

At a time when our economy was threatened with a mild recession, the Administration and the Congress properly passed legislation resulting in rigid tax cuts in 1964 and 1965, equivalent to about $23 billion in today's economy. This resulted in bringing federal revenues into balance with federal spending. We would comment that it was precisely this approach which was recommended by Andrew Mellon to President Hoover in the depression of 40 years ago. Where this so-called "new economics" gets into trouble is when it is necessary to reverse the process in order to restrict inflationary pressures and to balance a budget which has gone out of balance partly as a result of inflation.

We do not agree with those who believe that it is too late for a tax boost to be valuable in the present situation. Although it might not be able to bring the necessary restraint upon the tendencies of inflation, it certainly has one basic validity, and that is the restoring to the money markets of the world confidence in the dollar.

The success of the policy just noted would be more certain if we could superimpose it upon an economy which did not have the extremely heavy drain which we are having today because of the effort in Vietnam. However, it is precisely just this effort that is still making an increase in federal income necessary.

At the same time, it should be noted that at the time the gold pool nations took their action under the International Monetary System to support the price of gold, and at the time the Special Drawing Rights Plan was agreed on in Rio de Janeiro in September, we were warned by our friendly allies, especially by the members of the international gold pool, that this program could be effective only if the U.S. began to balance its budget. In almost every instance where our friends from overseas have discussed the problem of maintaining the American dollar, which certainly is to their interest as well as our own, they have advised us that we should increase our taxes.

We were very free to advise the French to do the same thing some years back when they were in difficulty, and we have advised a number of the nations who are recipients of our unilateral aid to do the same. The time has now come for us to take a dose of our own medicine, and substitute statesmanship and responsibility for political considerations which might be arrived at with great expense to the long-term economic welfare of our country.

The President has submitted a "hard-nosed" budget. Some of the items left out raise a question as to the good judgment used. The failure to enact an adequate tax structure will mean that other items, no longer in the field of the luxuries which an expanding economy should be able to afford, but in the area of the absolute necessities for a strong economic and political and social system must be laid by the board.

The advice of the Chairman of the CEA, Mr. Ackley, should have been heeded a year ago. Despite the fact that we are late in coming to grips with this problem, we are still well advised to pursue this policy, if not to halt inflation at least to restore some confidence in the dollar which has been shaken by the events of the past few months.

This committee, the Congress and the Nation should also be extremely wary of accepting the suggestions that we should not have any tax increase, even in the midst of a war, but rather a further reduction of expenditures. These, most of the time, represent those who would dismantle our Federal System and this is an excuse to do through the back door exactly what could not be accomplished through the front door. It seems to us that it is beyond the realm of rational thought to expect a nation of 200 million people to get along with the same service level of its people as it did when it had only 100 million people. With the prospect of a growth to 300 million by the 1990's, it is obvious that the responsibilities of the Federal Government, instead of decreasing, will probably be increased. The major reason for this increase, in our judgment, will be the stresses put on our institutions at the state and local level—stresses which will result in a continuing demand for increased assistance from the Federal Government.

Grange members do not like to pay taxes any more than anyone else. However, if it becomes a choice between the irresponsible evasion of present duties which will result in simply postponing the "day of judgment", or accepting our responsibilities like mature citizens of a great country, then we stand at the side of those who propose a responsible course, and we are prepared to support the actions to accomplish the objectives of a responsible national policy.

In conclusion, the 1968 Report of the Council of Economic Advisers and the statistical information accompanying it, indicate a strong and vigorous economy. The Report indicates the points of weakness in our economy as well. If we have enough wisdom and vision to base our judgments upon sound economic conditions, instead of on irrelevant political concepts and irresponsible partisanship, then the future of this Republic is indeed bright. If we are going to bog down because of our reluctance to make the necessary difficult economic decisions, if we are afraid to take the political consequence of an economically responsible attitude, then this weakness and vacillation shall inevitably be reflected in the kind of life we live and the levels of prosperity we fail to attain.

Chairman PROXMIRE. Thank you very much, Mr. Graham. You set a fine example of brevity and conciseness, and we appreciate it a great deal.

Our next witness is Mr. Angus McDonald, director of research for the National Farmers Union.

Mr. McDonald.

STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH, NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman, we, too, appreciate the invitation to appear here and express our views on the President's Economic Report and, particularly, on the views of the President's Council.

In past years we have been very critical of some of the reports of the Council of Economic Advisers and, unfortunately—perhaps it is unfortunate—we continue to be very critical of this Report because we think it is entirely inadequate. It does not get to the roots of the farm problem, and it neglects certain areas such as high interest and the lack of bargaining power of the farmers.

It also does not seem to be aware of the managerial revolution that is going on at the present time in regard to agriculture.

The Council in the very few pages which it devotes to agriculture concentrates on supply and demand and on the poverty situation. There is little that the commercial farmer can find which would indicate that the Council has any awareness of his problems.

The Council is under the illusion, I believe, that we have a free market in agriculture. This is an inference, but it is lacking, it is lacking in the problem, for example, of economic concentration which, I believe, is responsible for many of the problems which the farmers face today and have faced for many years.

The Federal Trade Commission reports once more that there are about a thousand mergers, acquisitions, which have been made in the last year or so.

It reports that conglomerate corporations, the corporations which have two or more unrelated functions, are expanding by leaps and bounds into agriculture.

It reports, and the Department of Justice has given some attention to this problem, the fixing of prices by various groups. The price-fixing or price leadership, whatever you want to call it, is not restricted, of course, to the durable goods industries. We have been aware of that situation for many, many years, but it now extends to the food industry, and the result of that situation is that the farmer must take what he is offered in the marketplace, and the consumer and the farmer both suffer.

In regard to the invasion of agricutlure by corporations and wealthy individuals, the Farmers Union has made some brief studies based on Internal Revenue Service statistics published by the Treasury Department and I would just like to run through, Mr. Chairman, a few of these statistics which indicate why so many wealthy individuals and corporations are going into the farming business.

On page 16 of this 1965 report of the IRS on income of individuals, it reports that individuals with $1 million or more income, there were 119 engaged in farming, reported farm investment. It reported that of that 119, only 16 reported a profit.

In the category of income between $500,000 to $1 million, it reported 202 were engaged in farming, and only 32 showed a profit; 170 a loss.

In the $100,000 to $500,000 category, it reported 3,914 involved in farming; 1,040 showed a profit; and so on.

I have in my statement a complete list, almost complete—I did not give all the statistics down to the $1,000 category—but we find that these statistics are very revealing because as you go down into the lower income groups, you find a much higher percentage reporting a profit to IRS.

Now, it seems to us, and in regard—let me interrupt myself just a moment—in regard to corporations, IRS in another document reported in the year ending July 1, 1964, there were 16,277 corporate farms reporting to the IRS in regard to their farm activities, and only 7,861 of these farm corporations reported a net profit.

Now, these facts, and particularly the facts regarding individuals, indicate to us that these people are going into farming not to make a profit—perhaps they are inefficient, too—but they are going into farming to escape taxation, in order to get into a lower tax bracket in regard to transfer of their farm losses to other income. That seems fairly obvious.

Now, in regard to the farmer himself, what is his economic situation today? We all know that income is supposed to go down $1 billion this year, and, last year it went down, and the year before was fairly good.

Today, according to the President's Council, the per capita income of those on farms, I believe that is in table 79 in this book, the per capita income was, if you go to their figures, amounted to $1,200 per capita. That is in 1967.

There were about, the Council estimates, 11 million people on farms. Despite the drastic decrease in farm population, over half, everyone knows that, it is reiterated again and again, per capita income on farms continues to fall and per capital income of those off farms or the total average per capita income of all the people continues to rise for reasons which Mr. Graham has just set forth.

It amounted last year to $2,787.

The farmer is—as Mr. Chairman, you pointed out, I believe on several occasions during the hearings before this committee—the farmer constitutes the No. 1 economic shame of America. The farmer is a second-class citizen.

Giving another example, the Department of Agriculture periodically puts out some very interesting statistics on the market basket, and we look back to 1947 to see how the farmer was doing that year on the market basket, that is, about as much food as a family of four would consume in a year, and it amounted to $870, and the farmer's share was $441 of that.

Now, according to USDA in September 1967, the market basket cost the consumer $1,089. The farmer only got $417 of this or $24 less than he got in 1947.

When it is considered that the farmer's dollar or, I suppose, anyone's dollar in 1965, was worth only 71 cents, these figures become doubly significant.

One of the problems which the Farmers Union has been concerned with has been the problem of bargaining power.

The Food Marketing Commission spent a great deal of time, we thought, and on the whole did an excellent job of studying farm food marketing over a period of a year and a half or so. Apparently the President's Council never heard of this report or at least it has not taken cognizance of it in its explanation of agriculture.

The Food Marketing Commission was very much concerned with the lack of bargaining power. We have recently seen a bill introduced—Senator Mondale, my office tells me, introduced the bill yesterday, and it is reported, Mr. Chairman, that you are one of the sponsors of this legislation. I have not checked that one out. Someone just told me they thought you were on the bill, and we appreciate that very much. We have not had time to study the bill, but on the face of it something should be done about farm bargaining power. Whether this is the bill which Congress should enact, I am not prepared to say.

Our National President has indicated in a press release that, in general, he favors this proposal to let the producers decide when prices are too low and bargaining power is needed; to let producers decide through commoditywide referendum when they want a bargaining committee for a particular commodity; to let producers decide in a referendum who will represent them on bargaining committees; to provide expanded authority for producers to strengthen prices under the provisions of the Agricultural Marketing Agreements Act of 1937; and, finally and very importantly, to provide penalties to be imposed upon those who conspire to intimidate, discriminate against or otherwise coerce producers or any producers association in their efforts to increase prices and strengthen bargaining power.

During the last 2 years I spent a great deal of time on what was originally S. 109 introduced in two separate Congresses and sponsored by both Republicans and Democrats. Unfortunately, this bill has not developed in the way that we thought that it should be developed, but this point which I mention is very important, particularly because farmers in the marketplace need protection and they need to organize and the right to bargain for their products in the same way that labor bargains for its labor.

I mention finally, Mr. Metcalf, in regard to the tax situation on farms. Senator Metcalf has introduced S. 2613, which would close one of these tax loopholes by prohibiting those who gain most of their income off farms from taking tax losses. The farmer himself would not be affected. The farmer who is a working farmer or who derives his income from agriculture, from the farm, would be exempt under this bill.

But it would, we hope, check this vast invasion of agriculture which is going on at the present time, due to other segments of the economy apparently have so much money they do not know what to do about it.

The profits, as Mr. Graham pointed out, are at an all-time high, and I think it was around $25 billion instead of $20 billion, as you said, which industrial corporations had left over after they paid their taxes, distributed their dividends, and so forth.

My point is that agriculture should be allowed to deal with those to whom it sells its products in the same way that other organizations and unions, and others, in the same way that the gigantic food chains get together and work together at getting the prices down.

If the farmer had some kind of countervailing power backed up by legislation, such as the NLRB Act—and I am not comparing this proposal with the Labor Relations Act, it has certain similarities, but there are certain other parts of it which are quite, quite different, as agriculture is different.

One final point, Mr. Chairman, with regard to Mr. Graham's statement. We are completely in accord with the importance of farm exports. I believe, in cash, there were over $5 billion last year, $7 billion if you count the soft currency and the giveaways and so forth.

The gold situation about which everyone seems to be worried, would be worsened if the protectionists were able to keep out other products.

We are not in favor, of course, of the substitute products for cheese and various gimmicks that have been used to let down the bars and let vast quantities of all kinds of dairy products and other products come into this country, and we were instrumental in, at least we presented our views to the Tariff Commission and to the President in regard to that, and we stand firmly behind the President, in reducing to some extent the amount of these products which were coming in.

But we believe that the last round, the Kennedy Round, was greatly successful. Our National President was in Geneva, and he reports great progress was made, which would benefit not only the American farmer but the American people as a whole.

I think, Mr. Chairman, I have just about used up my time.

(The prepared statement of Mr. McDonald follows:)

PREPARED STATEMENT OF ANGUS McDONALD

Mr. Chairman and Members of the Committee, we appreciate very much the opportunity to present our views on the Economic Report of the President and the Annual Report of the Council of Economic Advisers. We have appeared here over a long period of years along with representatives of other farm organizations. Our organization is particularly interested in the functioning of the Employment Act of 1946.

Our interest was manifested in the period 1944–1946 when our then National President, James G. Patton, participated actively in the formulation of legislation. One of the by-products of this activity was a book by Stephen Kemp

Bailey entitled, "Congress Makes a Law," published by the Columbia University Press in 1950. The activity of the Farmers Union in bringing about the enactment of the Full Employment Act is outlined in this volume.

Over the years the Farmers Union has generally been critical of the Council since we believe it failed to fulfill the policy set forth in the statute. For example, in Section II the Council is, in effect, directed to consult with agriculture and other groups in the formulation of its policies and its recommendations to the Congress. For a few years after passage of the Act representatives of the Farmers Union were invited to confer with Council members along with other farm organizations. However, this practice has been discontinued over a long period of years. As I recall, the last time that we were invited to confer with the Council was during the period when Harry S. Truman was President and Leon Keyserling was Chairman of the Council.

This witness has pointed out to this Committee and to other Congressional Committees the failure of the Council to fulfill the function which the Congress undoubtedly intended both in conferring with interested organizations and in legislative recommendations to the Congress. We have appreicated very much over the years the reports of the Joint Committee on the President's Economic Report which repeatedly pointed out that the Council was failing in its duty and that it also was neglecting certain economic situations in its discussions without which it was impossible to make valid recommendations or to even explain certain economic trends.

In 1965 this witness appeared before the Joint Committee and pointed out that under the Chairmanship of Gardiner Ackley vital economic areas had been neglected and that emphasis was on matters which did not go to the root of economic maladjustments, particularly in regard to agriculture. We pointed out in our 1965 discussion that argiculture was treated as a sick industry rather than an industry which had out-produced other segments of the economy and had become so efficient that it had flooded the market with commodities resulting in unduly low prices. There was no attempt in Mr. Ackley's 1965 report to get at the roots of the agricultural problems.

In the 1966 report, the Council ceased to speak of agriculture as a sick industry, but rather by inference concluded that it was only reacting to certain economic laws which inevitably pushed off the farm producers who were inefficient. There was, as I recall, a brief discussion about the dairy industry which was in a very depressed condition because of low milk prices. Dairy farmers were leaving the industry by thousands and economists predicted that if this trend was not checked, milk would have to be rationed in the not too distant future. The Secretary of Agriculture wisely increased the support price of milk so that farmers would be enabled to stay in production. The comment of the Council was that dairy farmers had moved to towns and cities because of excellent employment opportunities.

In past years the eminent Chairman of this Committee has rebuked the Chairman of the Council on at least two occasions because of the Council's neglect of agriculture which he called the number one shame of America. He also spread upon the record certain figures indicating that farmers were economically second class citizens who did not obtain from their investment, management and labor a sufficient income to enable them to continue production. This is the crucial problem which agriculture has faced for a long time and is facing today.

Certain questions were also raised by this Committee in regard to the lack of attention to economic concentration and to the monetary activities of the Federal Reserve Board.

The 1968 report, it seems to us, almost completely ignores, or gives only a passing glance to agriculture. On pages 116 and 117 only about one-half page is allocated to discussion of farm and food prices. It is apparent from this brief discussion that the Council is primarily interested in the laws of supply and demand and consumer prices and not at all interested in the economic problems of the farmer.

Although several pages of the report are devoted to monetary policy during the 1966–67 period, no real attempt is made to grapple with fundamental economic problems as affected by the mistaken policies of the Federal Reserve Board. For example, the Council merely notes that in 1965 the Federal Reserve Board raised the discount rate one-half of one percent and that the ceiling rate on certificates of deposit was also raised. It does not sufficiently expose this mistaken policy and connect it with the housing debacle which it caused in 1967. Farmers paid heavily for the 37½ percent increase in the time deposit rate since interest rates skyrocketed not only in housing, but in all kinds of real estate and short term loans. The country has paid dearly for the ill-advised policies of the Federal Reserve Board.

The Farmers Union has repeatedly condemned these policies and was instrumental in bringing about a national Tight Money Conference in Washington, D.C., in January 1967, sponsored by may organizations. We attempted in this conference and in other ways to bring the facts to our members and to all those who were consumers of credit.

We are aware that the policies of the Federal Reserve Board are controlled by no one unless it be the bankers who seem to have a decisive voice in the formulation of its policies. Several members of this Committee have pointed out this fact over a long period of years and have suggested remedies to be put into effect by the Executive Branch and the Congress, but nothing has been done. It seems to us that the President's Council should act in the interest of all the people and, as the President said on page 27 of the report, "This Administration will never forget that the purpose of our economy and of our economic policies is to serve the American people—not the reverse." It would appear that monetary policies during the past few years have not served the American people, but have served primarily one vested interest group. Interest rates at the present time are higher than they have been at any time since 1873. We suggest that the Council should have challenged the policy of the Federal Reserve Board and attempted to bring the best information policy on monetary matters to the attention of the President who has a multitude of problems and who finds it impossible to acquaint himself with the details of monetary policy.

I would like to take this opportunity to bring to the attention of the Committee certain studies that the Farmers Union has made during the last several months in regard to tax evasion by weathy individuals and corporations and the efficiency of the family farm. Our study on the relationship of non-farm individuals and the use of farm investment as a tax haven was published in our *Washington Newsletter* of September 15, 1967, and is primarily based on a report of the Internal Revenue Service of the U.S. Treasury Department, entitled "Statistics of Income 1965." The results of our study based on this document are as follows and is the record from individual income tax returns, broken down by income groups, on "farm" operations:

Millionaires.—Of the 119 engaged in farming, only 16 reported a profit on their income tax returns.

$500,000 to $1,000,000.—Of the 202 in farming, 32 showed a net profit and 170 showed a loss.

$100,000 to $500,000.—Of 3,914 involved in farming, 1,040 showed a profit and 2,874 reported a loss.

$50,000 to $100,000.—Of 12,398 involved in farming, 4,974 showed a profit and 7,424 reported a loss.

$20,000 to $50,000.—Of 69,132 involved in farming, 38,752 showed a profit and 30,380 reported a loss.

$15,000 to $20,000.—Of 66,003 involved in farming, 42,160 showed a profit and 23,843 reported a loss.

$10,000 to $15,000.—Of 211,673 involved in farming, 132,109 reported a profit and 79,564 reported a loss.

$5,000 to $10,000.—Of the 793,689 involved in farming, 473,948 reported a profit and 319,741 reported a loss.

We also made another brief study based on Statistics of Income for the period July 1964–June 1965, entitled "U.S. Tax Returns—Sole Proprietorships, Partnerships, Corporations," also published by the Internal Revenue Service. The partial results of our study of this document were published in the December 1, 1967, *Washington Newsletter.* This study showed that only 7,861 of the 16,227 corporation farms filing 1963 returns showed a net profit. The profit added up to $235.5 million, about $49 million more than the losses reported by the other 8,366.

These facts indicate a widespread situation in which thousands of wealthy individuals and corporations made use of certain loopholes in our tax laws to escape taxation. The wealthy individual, under existing law, may subtract his farm losses from off-the-farm income and thereby get into a lower tax bracket and pay less taxes than he otherwise would have paid. Senator Metcalf has introduced a bill (S. 2613) which would remedy this situation and would, we hope, discourage the invasion of agriculture by off-farm interests.

We have various reports in our files which indicate that corporations and individuals are buying up millions of acres of farm land as a hedge against inflation and for tax loss purposes. The South Dakota Farmers Union has con-

ducted a survey of corporate ownership in that State and has found that more than 30 corporations have acquired over 1,600,000 acres in South Dakota. Our members tell us that the same process is going on in other states.
conglomerate corporations. A conglomerate corporation, economists tell us, is a

During the last few years we have seen an increase in the number of so-called corporation which has two or more economic activities functionally unrelated to each other. One of the most notorious of these corporations is Textron which was originally in the textile business. At the present time, Textron is engaged in the manufacture and distribution of over 10 diverse products. Its holdings include a huge broiler and poultry feeding operation in the State of Maryland.

The incentive for the corporation buying up defunct and shaky businesses is perhaps the same as the incentive of the wealthy individual who invests in a farm to escape taxation. According to the *Wall Street Journal*, Textron, during a period of years, was exempted from paying $75 million in taxes to the Federal Government because of the "tax carry-forward" provision in our tax laws.

According to the Federal Trade Commission, merger activity which includes the acquisitions of both conglomerate and other kinds of corporations, continues at a high level. Almost 1,000 mergers were reported by Moody's Investor Service, Inc., and Standard and Poors Corporation for the year 1966.

Our interest in merger and corporate activity is not academic. We strongly feel that economic concentration is a primary cause of the excessively high costs of various items necessary to farm production. Significantly, although farm income, according to the Department of Agriculture, is due to remain at a very low level this year, farm receipts may increase by $1 billion. This decline in farm income can only be explained by an increase in farm costs. Farm prices have declined drastically during the last year. The parity index a month or two ago had dropped to 73—the lowest point since the '30's. *Agricultural Prices* in its last issue, reports that it has increased by one point. This simply means, of course, that farm prices in relation to the purchasing power of the farmer's dollar were lower than they had been in more than 30 years.

Low farm prices and low farm income represent a contradiction in our economy. National income is at an all time high. We have made various calculations based on figures taken from tables in the back of the *Economic Report*, *Economic Indicators* (published by the Council of Economic Advisers) and the November 9th issue of *Marketing and Transportation Situation*.

It is estimated that 11 million people are now living on American farms; that their farm income in 1967 amounted to $13.2 billion. This is equivalent to a per capita income of $1,200. According to the President's Council, per capita income of the total population amounted to $2.787 annually during the period October–December 1967. It is seen that even with the drastic decline of farm population that per capita income from farm activities lags far behind income derived from other activities.

According to *Marketing and Transportation Situation*, the typical market basket of farm foods cost $1,089 in September 1967. The farm value of this food was $417. This indicates a spread of $672.

The year 1947 was considered a fairly prosperous one for farmers. In that year the market basket cost consumers $890; the farmer got $441 of this amount. In other words, the consumer in September 1967 paid $199 more for food purchased by a typical family of four and the farmer got $24 less.

The significance of these figures is seen when it is realized that in 1965 the farmer's dollar was only worth 71 cents. We do not have at hand a calculation for the 1947 purchasing power of a dollar for a later date.

There has been a great deal of propaganda to the effect that the family farm or medium-sized farm is inefficient. This allegation has been disproved many times. However, the myth of family farm inefficiency persists despite the fact that the family farm produces most of the commodities which are consumed in this country and which are exported.

A recent study made by Farmers Union which is based on a study of the Department of Agriculture which in turn is based on 138 other studies, indicates that a family farm is relatively efficient over wide areas of the United States and in the production of many different commodities. (See Exhibit A, attached.)

Farmers Union periodically attempts to assemble as much information as possible in regard to actual income and expenses of farm operations, both in regard to current statistics and in regard to prices which farmers paid in a relatively prosperous period. We have in our file a list of actual farm operating costs as reported on Schedule F tax forms. Here are statistics taken from actual Minnesota farm reports:

SELECTED FARM EXPENSES ON ACTUAL MINNESOTA FARMS (BASED ON 1966 FEDERAL INCOME TAX RETURNS

Acres farmed	Gas and fuel	Feed purchased	Fertilizer and chemicals	Real estate taxes	Interest payments
200	$111		$98	$672	$1,378
322	907	$1,798	3,508	1,795	2,304
148	540	3,500	1,150	600	1,100
320	1,000	1,100	1,800	2,425	2,050
350	2,500		1,647	2,127	1,609
400	825	1,350	950	1,250	3,400

We have also compiled figures of relative costs of farm implements. Farm machinery prices of 1967 are compared with farm machinery prices of 1947 (see Exhibit B attached).

In conclusion, we would hope that the Committee would find it possible to inaugurate a study of the corporate farm invasion and wealthy individual invasion of agriculture. We consider this one of the most inimical trends which farmers now face.

We would hope that the Committee would continue to emphasize the importance of a monetary policy which pays some attention to the wishes of this expert Committee and to other Members of Congress. We hope you will continue to advise the President in regard to the necessity for a healthy agriculture. What happens to agriculture will in a great measure be dependent on action taken by the Congress.

We also hope the Committee will use its great prestige and influence to bring about the enactment of the Metcalf bill which will discourage the trend toward non-farm control and ownership of agriculture, as well as bringing in additional taxes to the Treasury of the United States which heretofore have been avoided.

Exhibit A

The Family Farm Is the Most Efficient Unit of Agriculture Production

(Prepared by Angus McDonald, Feb. 5, 1968)

Over the years there has been a vast propaganda campaign designed to convince the American people that the gigantic factories-in-the-field which exist in California and several other states should be models for all farm units. This campaign to discredit the Farmers Union idea that the family-type farm is the most desirable unit of agricultural production has been aided and abetted by economists in land grant colleges and in agriculture departments of universities. Editors of magazines, newspapers and no doubt many millions of people have been brainwashed and have consequently accepted without question the idea that the family farm is inefficient and that super-farms, owned and operated by millionaires and conglomerate corporations, represent the wave of the future.

Swept under the rug, ignored and suppressed are many studies which have been made which prove without any reasonable doubt that the small or medium-sized unit is more efficient than the large corporate unit. A number of economists apparently have been quietly working, gathering information in many parts of the United States. A recent publication of the Department of Agriculture represents summaries of these studies made in various areas of different types of farming under a variety of conditions. The overwhelming conclusion of this study, a composite of 138 studies which have been made in the last few years, leads to the inescapable conclusion that big farming is inefficient.

These studies, based on solid facts, are not wishful thinking. They are the result of hundreds of analyses of the costs and the gross profits which go into many types of farming including fruit, grain, livestock, cotton, vegetables, alfalfa, and dairy. These studies put the finger on the point of diminishing returns which is soon reached when the farm is unduly expanded or too large for efficient operation. Here are a few examples:

1. FRUIT FARMS IN CALIFORNIA

On the non-mechanized peach farms in Yuba City in the Maryville area of California, average production cost per ton of peaches declined up to a productive unit of about 60 acres (average production was 715 tons of peaches). Beyond that size slight reductions in harvesting costs and machinery investment per acre were realized, but these were offset by increases in costs of hired supervision.

On the mechanized peach farm the average cost declined up to a farm size of between 90 and 110 acres. After that point there was no reduction in cost on larger units.

2. IOWA CASH GRAIN AND CROP-LIVESTOCK FARMS

(*a*) *Southern Iowa*

The hilly farm in Southern Iowa showed lowest costs for a unit of about 320 to 360 acres. This represented a 2-man operation and a 3-plow tractor. The cost revenue ratio was 0.95. This figure means that the livestock-grain farmer had to spend 95 cents for every dollar of gross income.

On upland farms in Southern Iowa the cost revenue ratio was much lower. A 1-man, 3-plow tractor farm of 160-acres produced $1.00 of gross income for every 62 cents in costs. Two-man farms showed a little better ratio—a 320-acre farm with two 3-plow tractors only had to spend 57 cents for every dollar of gross income. However, cost advantages in larger units were less than the 320-acre farm.

(*b*) *Western and Northeast Iowa*

A 280-acre farm with a continuous corn program came out with a cost revenue ratio of 0.42. Under a 5-year rotation the lowest cost on a farm of 320-acres was 0.46. Under current cropping practices a 400-acre farm also resulted in a cost revenue ratio of 0.46. For Western Iowa costs were considerably higher. This study showed little difference in costs (only 2 cents per $1.00 of income) in Northeast Iowa between 400 and 800 acres.

3. IRRIGATED COTTON FARMS IN TEXAS AND CALIFORNIA

(*a*) *Texas High Plains*

This particular study concluded that a 1-man farm with adequate capital could be as efficient as any of the larger farms. A 1-man farm of 440-acres, with 102 acres of cotton and 6-row machinery resulted in an expenditure of 71 cents for every dollar of gross income. None of the larger farms could go below this. Here is a summary of the Texas High Plains farm statistics:

	Cost revenue ratios
1 man, 120 to 240 acres	0.732
1 man, 240 to 680 acres	.708
2 man, 560 to 920 acres	.73
3 man, 880 to 1,280 acres	.709
4 man, 1,200 to 1,520 acres	.711
5 man, 1,480 to 1,800 acres	.712

(*b*) *Fresno County, California*

On heavy soils in Fresno County, California, costs of producing cotton proved to be lowest on a 4-man farm of 1,134 acres. The cost revenue ratio was 0.85. On a 1-man farm of 270 acres, the cost revenue ratio was 0.91.

However, on light soils in Fresno County a 710-acre, 4-man farm proved to be most efficient. A 1-man, 193-acre farm had a cost revenue ratio of 0.83, the 4-man farm had a cost revenue ratio of 0.76. There was no increase in efficiency after this point. The study included farms up to an 8-man operation.

4. CALIFORNIA CASH CROP FARMS

This study, based on farms in Yolo County, included sugar beets, tomatoes, milo, barley and safflower. Cost per dollar of revenue on these farms declined sharply up to about $100,000 of revenue. The cost revenue figure on these farms was 0.70. On farms of 1,400 acres which produced on the average about $240,000 worth of products, the cost revenue declined to 0.65. After that point the cost revenue statistic increased to 0.72 at $440,000. There was no decrease after that on larger units.

Conclusion of the author of this study was that there was no economic incentive to operate extremely large farms—600 to 800 acres could compete with larger farms. The difference in cost was slight and risks pertaining to management on larger farms were considered greater.

5. IMPERIAL VALLEY VEGETABLE CROP FARMS

This particular study concluded that with contract services longrun costs are constant from very small farms up to 2400 acres. Another conclusion was that the Imperial Valley farmer achieves no advantage in owning equipment and actually has advantages over larger farms which own equipment used at less than full capacity. This assumes that contract facilities are available for the small and medium-sized farms. The general conclusion is that there are no significant economies based on size.

6. KERN COUNTY CASH CROP FARMS

In this area the 640-acre unit was most efficient. After that point costs per revenue dollar began to climb. The following table indicates the economies based on size:

CASH CROP FARMS, KERN COUNTY, CALIF.—TOTAL COST PER DOLLAR OF CROP REVENUE FOR 3 CROPPING PROGRAMS

Farm size (acres)	Cost-revenue ratio for—		
	Cotton-alfalfa farms	Cotton-alfalfa-potato farms	Cotton-alfalfa-barley-milo farms
80	1.06	1.06	1.00
160	.96	.94	.93
320	.92	.91	.91
640	.91	.89	.89
1,280	.94	.93	.91
3,200	.96	.93	.92

Source: Calculated from data in Faris and Armstrong study. California Experiment Station; Giannini Foundation Research Report No. 269.

7. WHEAT FARMS IN THE COLUMBIA BASIN OF OREGON

In Oregon, 1-man wheat farms achieve lower average costs than the two or three man farms. However, on farms smaller than 1,000 acres the costs were slightly higher. The following table indicates that increases in size beyond 1,000 acres resulted in increased costs.

COLUMBIA BASIN WHEAT FARMS: AVERAGE COST AND OPERATOR EARNINGS FOR SELECTED FARM PLANS USING THE MOLDBOARD FALLOW OPERATION

Farm size	Basic resources		Full-utilization farm plan		
	Men	Tractors	Acres	Operator income	Cost-revenue ratio
Small	1	1 30 to 40 horsepower	1,000	$3,669	0.85
Medium	1	1 50 to 60 horsepower	1,600	5,629	.86
Medium-large	2	2 50 to 60 horsepower	2,500	5,429	.91
Large	3	2 50 to 60 horsepower, 1 25 to 35 horsepower	3,600	5,252	.94

8. DAIRY FARMS

(*a*) *New England*

The most efficient unit on dairy farms in New England was a 2-man operation with 70 cows and costs estimated at $2,000 a year for labor and management. However, if no charge is made for labor, the 1-man operated farm with 35 cows achieved lower costs.

(*b*) *Iowa Dairy Cash Grain Farms*

On farms in Iowa in this category there was only a slight reduction in costs as herds were expanded from 34 to 58 cows. The cost revenue ratio was relatively higher—90 cents expended for $1.00 of gross income.

(*c*) *Arizona Dairies*

Average costs declined sharply up to a herd of 150 head. However, management difficulties typically occurred when the herd reached a size of 150 to 175 cows. This problem resulted from (1) feed waste increases with herd size; (2) difficulty in varying the level of grain feeding relative to each cow's production because of variation among cows, and (3) management, supervision and coordination duties became more difficult with resultant decline in efficiency of operation.

(*d*) *Minnesota Dairies*

A study based on dairying in Minnesota indicates that the 2-man dairy with 87 cows and a farm of 490 acres achieved a cost revenue ratio of 0.82. A 1-man, 48-cow, 290-acre operation was slightly less efficient. The cost revenue ratio was 0.84 on this farm size.

9. FEEDLOTS

Several studies have been made to determine the maximum efficiency of feedlots based on size. According to one Colorado study, feedlots with between 1,700 and 4,000 head on feed at a time with a 15-ton feed mill were most efficient. The feedlot with 4,000 to 9,000 head on feed at a time with a 50-ton mill was most efficient. This study indicates that economies of size obtained by feedlots feeding over 1,500 head are too small to have any appreciable effect on the average cost of producing beef.

A USDA study concludes that economies of size are attainable in a size range of 1,500 to 5,000 head. Beyond this point the cost curve declined slightly, but the savings were insignificant. All of these studies indicate that there is no economy resulting from the gigantic feedlots such as those operated by the National Tea food chain and the Gates Rubber Company. These feedlots are apt to be much less efficient because they are not operated at full capacity. Consequently the percentage of fixed costs are greater than in the small feedlot.

Exhibit B

Price Increases of Farm Machinery and Equipment

Price increases of farm machinery since 1947

The wholesale price of a 3 moldboard plow increased from $254 to $580.
The wholesale price of a drawn corn planter increased from $200 to $455.
A larger type drawn corn planter increased from $493 to $1,120.
The wholesale price of a grain drill increased from $391 to $901.
A larger type grain drill increased from $725 to $1,670.
The wholesale price of a manure spreader increased from $509 to $928.
The wholesale price of a 4-row cultivator increased from $363 to $811.

Percent price increase since 1947

Farm and garden tractors:	
Row Crop or general purpose, 30–49 HP	79.70
Tricycle, row-crop, 40 or over max. HP	57.70
4-Wheel, Diesel, 75–92 max. HP	74.20
Tracklaying Type, under 60 D. HP	161.30
Motor Tiller, 3–4 HP	22.80
Agricultural machinery:	
Excluding Tractors	95.40
Plow, Moldboard, Drawn, 4 Bottom	146.60
Plow, Moldboard, Mounted, 3 Bottom	128.10
Harrow, Drawn	102.90
Corn Planter, Drawn	127.10
Grain Drill, Fertilizer Type	130.20
Manure Spreader, PTO Driven	82.30
Hydraulic Loader	29.10
Cultivator, Mounted, 4 Row	123.30
Rotary Hoe, Pull Type	26.50
Hand Sprayer	98.98
Cotton Picker, 2 Row Self Propelled	31.70
Combine, Self Prop., Under 15 ft. cut	83.00
Corn Picking Attachment for Combines	114.55
Corn Picker, Mounted	57.60
Forage Harvester, Drawn	104.60
Mower, mounted	126.40
Rake, Drawn	117.20
Hay Baler, Drawn	56.60
Farm Elevator, Portable	76.00
Wagon, Chassis Only	47.40
Agricultural Equipment	44.40
Stock Tank	100.70
Brooder, Gas	67.70
Barn Cleaner	24.10
Water System, Shallow Well, Jet	77.70
Motor trucks	49.10
Composite for agricultural machinery and equipment	81.40

Chairman PROXMIRE. Thank you very much, Mr. McDonald.
Our next witness is Mr. Charles B. Shuman, president of the American Farm Bureau Federation.
Mr. Shuman.

STATEMENT OF CHARLES B. SHUMAN, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. SHUMAN. Thank you, Mr. Chairman and members of the committee.

I appreciate this opportunity to comment on the President's Economic Report for 1968.

I will read parts, and I do appreciate if this entire statement will be incorporated in the record.

Our comments will be based on policy resolutions adopted by voting delegates of the member State Farm Bureaus at the annual meeting of the American Farm Bureau Federation in December 1967. The delegates represented more than 1,750,000 families who are members of Farm Bureau in 49 States and Puerto Rico. We shall confine our comments to a few major national issues and to those aspects of the President's Economic Report which are of particular interest to farm and ranch families.

At the outset, let us make it clear that the overall fiscal policy which this Nation chooses to follow is of major importance to farmers. Government policies which have caused large budget deficits have led to an inflationary spiral which has compounded the cost-price squeeze on farmers. The resulting tightening of credit has become a serious concern to farmers attempting to meet sharp increases in capital requirements.

The fundamentals of the inflation problem are well described in the following extract from a newspaper report of a recent speech by W. Allen Wallis, a distinguished economist who is now president of the University of Rochester, and I quote from Dr. Wallis:

> Inflation can be generated only by the Government. Business firms, labor unions, or consumers with excessive market power can do many objectionable things that are contrary to the public interest; but one objectionable thing they cannot do is to cause inflation—or, for that matter, prevent it.

The overriding economic issue confronting the United States today is whether we are going to be fiscally responsible. Our domestic fiscal policy determines our ability to avoid an inflationary binge which would work a serious hardship on many people and lead to a painful readjustment at some future time. It is also the key to the balance-of-payments problem which threatens the stability of the dollar as the most widely used international currency.

It should be noted that the President's proposal for the elimination of the gold reserve requirement now applicable to Federal Reserve notes is merely an accommodation to the necessities of our balance-of-payments problem and not a solution for this problem. Unless we can correct the imbalance in our international accounts, we will dissipate the gold now used to back our currency—just as we have depleted the gold previously released by removing the requirement for a gold reserve against Federal Reserve deposit liabilities.

U.S. exports—industrial and agricultural—can and must be expanded. American farmers are already making a major contribution to U.S. export earnings. Last year U.S. agricultural exports reached a new high, totaling $6.8 billion. This accounted for 22 percent of total U.S. exports. But, as the world's largest exporter and most efficient producer of farm products, American farmers can play a larger role. We have set our sights on annual agricultural exports of $10 billion. This goal is attainable if we are permitted to price competitively and market efficiently. This requires vigorous trade negotiations designed to reduce restrictions on world trade with nations which are prepared to offer reciprocal benefits to U.S. exports. Such negotiations not only must include—they must emphasize—trade in agricultural products. At the same time, Government supply management features of domestic farm programs should be abandoned.

The proposed International Wheat Trade Convention, which has been sent to the U.S. Senate for ratification, is contrary to these objectives. This convention fails to liberalize world wheat trade; in fact, it tends to legitimize trade restrictions. It would restrict export opportunities for U.S. wheat farmers and significantly limit their ability to contribute further to solving the balance-of-payments deficit.

We agree with the President that the present situation calls for action to "* * * accomplish a sharp reduction in the Federal deficit * * *"; however, we believe that the reduction must be achieved by placing major emphasis on reductions in Federal spending before consideration is given to increases in Federal taxes.

Our policy on this point reads in part as follows:

> The current fiscal situation calls for action to eliminate strong inflationary pressures. At this time we oppose any increase in taxes which is not matched by a prior and equivalent reduction in government expenditures for the duration of the tax increase. Increases in federal receipts as a result of any tax increase should be used in future years to reduce or eliminate annual deficits rather than to justify higher expenditures.
>
> We urge the Executive Branch to make significant reductions in current expenditures and in future budget requests for both defense and nondefense programs.
>
> At the same time, Congress should take steps to make changes in basic legislation enabling effective evaluation and control of government spending within annual appropriations.

In practice, this means that before we would support a tax increase of $5 billion, for example, and we say in that resolution that we oppose a tax increase unless a comparable and prior reduction in spending was made. In practice, this means that before we would support a tax increase of $5 billion, for example, a spending cut of at least $5 billion must be achieved. This would result in a net reduction of $10 billion in the budget deficit. We reject outright the contention that no sizable reduction can be made in nondefense spending. Nondefense spending has been swollen in recent years by a tremendous expansion of new Federal programs. Regardless of any differences of opinion that may exist with respect to the merits of individual programs, it should be crystal clear that the Federal Government has been trying to do too much at once.

We must not overlook the fact that we are engaged in a major war in Southeast Asia. To assume that sacrifices in nondefense spending are unnecessary is folly. It is obvious that the Nation's security must have priority, and domestic spending must be adjusted accordingly. Continued expansion of expenditures at a rate greater than tax revenues cannot be tolerated.

We understand that Gardner Ackley, former Chairman of the Council of Economic Advisers, has ridiculed the idea of matching tax increases with budget cuts by calling it a "strange proposal" and by suggesting it could lead to fiscal "overkill."

Recognizing as we do the built-in pressures for more and more Government spending, we do not think there is any danger of an "overkill." All we are proposing is that Congress determine the amount by which the deficit should be reduced and then divide this amount equally between reductions in expenditures and increases in taxes.

We in the Farm Bureau are determined to do our part in getting at the root cause of inflation—excessive Government spending. Consequently, Farm Bureau will submit specific recommendations for budget cuts to appropriate committees of Congress—and these will include proposed cuts in Government expenditures of special interest to farmers and ranchers.

We shall make specific proposals to remove the drain on the Federal Treasury resulting from passage of the Food and Agriculture Act of 1965, which caused the Commodity Credit Corporation in 1967 to make expenditures of nearly $3 billion to compensate, in part, for Government-depressed market prices. When other price support functions of CCC are added to these direct payments, net losses of the Corporation have risen to nearly $4 billion annually. In spite of this, net farm income has continued to decline during 1967.

Much of the recent growth in nondefense Federal spending is the result of Federal assumption of responsibilities that properly should be discharged by State and local governments.

With this in mind, our delegates at our recent convention adopted a policy favoring the use of Federal income tax credits.

With this in mind, delegates to the AFBF annual meeting in December 1967, adopted the following policy:

> In order to increase local control of tax resources and responsibility for educational and welfare programs, we recommend that the federal government return the responsibility for these programs to the states through the use of federal income tax credits.
>
> We urge passage of legislation which would provide that individual taxpayers be given dollar-for-dollar credits toward federal income tax liabilities for individual income, corporate income and general sales taxes paid to states. With the return of this tax base to the states should go the authority and responsibility for costs and administration of welfare and elementary and secondary educational programs now carried on by the federal government.

A Federal credit for income and sales taxes paid to States would permit the States to increase their taxes sufficiently to raise revenue necessary to replace the Federal grants they are now receiving for welfare and for education at the primary and secondary school levels.

We believe this proposal to replace existing "grant-in-aid programs" with tax credits is far superior to the various proposals made in recent years for a sharing of Federal revenues with the States.

The tax-sharing approach requires that tax money be sent to Washington for redistribution to the States. This could increase—rather than reduce—the dependence of the States on Federal appropriations. Such handouts could be reduced, eliminated, or made subject to new Federal requirements at any time.

The tax-credit approach does not separate the responsibility for spending tax receipts from the responsibility for levying taxes as the tax-sharing approach would do. Instead, it gives each State a prior claim on the tax resources of its own taxpayers and thus provides a greatly expanded opportunity to develop a revenue system based on local needs.

We recognize it will take some time to work out in detail a procedure to substitute Federal tax credits for existing grant programs; however, we urge Congress to give this approach careful study as a means of achieving two worthwhile objectives: (1) reducing fiscal demands on the Federal Government and (2) increasing the revenue available to State and local governments without which it is impossible to have effective local control.

Agriculture, as such, received only a brief mention in the President's Economic Report and only a little more attention in the state of the Union message.

In recounting 1967 developments in the Economic Report, the President noted that "* * * farm proprietors' net income dipped, but by yearend had returned to the level of a year earlier * * *." It should be noted that this dip in net farm income was at least partly due to Government efforts to increase grain production. The fact is that the Government over-reacted to hysterical evaluations of the world food situation and encouraged farmers to expand grain production in advance of effective demand. Food aid shipments under Public Law 480 actually were reduced during the fiscal year 1966–67, particularly in the case of wheat and flour. The inevitable result of this combination of factors was lower grain prices.

We agree with the President's recommendation that Congress extend Public Law 480; however, we favor changes which will make certain that needed supplies are produced in response to market prices and are purchased in the market. It should be made clear that this program is a part of our foreign aid commitment, not a subsidy to domestic producers.

In the state of the Union message, the President said that he will recommend actions to establish "a security commodity reserve" and "programs to help farmers bargain more effectively for fair prices."

Practically everyone agrees that some reserves of agricultural products are desirable to meet unforseen variations in production. In our opinion, however, Government-held or controlled reserves are unnecessary for the protection of domestic consumers, bad from the standpoint of producers, expensive from the viewpoint of taxpayers, and not necessary for exports or foreign relief.

Then I go into some detail here in the statement on the reasons why we believe that these are bad for consumers, are not desirable for consumers, are bad for producers, and bad for taxpayers.

We also point out that these reserves come back as any Government-held stockpile to fall on the market and are disruptive to a market system since there is a constant danger that the Government will break the market by releasing its stocks.

We point out that the heaviest Commodity Credit sales of stocks have been made in order to first force farmers into so-called voluntary programs by penalizing noncooperators and, second, to attempt to counteract the effect of Government inflationary policies on food prices.

Farmers are seriously and increasingly interested in finding ways to develop greater market power through strengthening their bargaining power.

There are two ways to organize farmers to obtain greater bargaining power—voluntary and involuntary—only two ways. Farm Bureau believes the voluntary method of organization offers greater opportunity for success. Truly effective power comes through the willing cooperation of informed, conscious, loyal, and active members; and this type of power far exceeds that which flows from compulsory grouping.

The only power which can compel farmers to bargain together nationally is the Federal Government, and its authority must come from an act of Congress. The Congress, as well as the executive branch of our Government, must be concerned with justice and equity for all citizens—not farmers alone. Since 94 percent of the voters are consumers, not farmers, Congress and the administration necessarily must be more interested in low food prices than high farm income. Any Federal Government direction or enforcement of farmer bargaining most certainly would include rules or devices to "protect consumers" or the authority to issue cease-and-desist orders any time prices threaten to go higher than some Washington bureaucrat thinks they should. Obviously, farmers do not want Government as a "partner" in their bargaining efforts.

Farmers are painfully trying to crawl out of the cheap food trap created by existing Government-supply-management programs. It would be a tragedy if their current interest in bargaining were to lead them into a similar Government-price-management trap. Government supervised marketing is not the way to get better income for farmers.

There is, however, a proper role for Government in improving the marketing of farm products. Legislation currently before Congress would prohibit unfair trade practices designed to discourage farmer participation in voluntary marketing programs. Congress can play its proper role in this matter by guaranteeing farmers the right to voluntarily join a marketing association without fear of reprisal.

Thank you very much, Mr. Chairman.

(The balance of Mr. Shuman's prepared statement follows:)

* * * * * * *

Let us examine these considerations point by point.

(1) The idea that the maintenance of a government-held stockpile is a good idea for consumers developed, at least in part, out of a desire to justify the existence of the large stocks already accumulated under price support programs.

Now that surpluses of some commodities have been reduced by increased exports and domestic utilization, the alleged need for government-held stocks is being used to justify the continuation of government intervention in the production and pricing of farm products.

In the absence of government reserves, the willingness of farmers and agricultural industries to carry stocks constitutes a reliable defense against shortages of consumer goods. In addition, our agricultural economy contains many other built-in safeguards against shortages.

The consumers' real assurance of adequate supplies of farm products is in the productive capacity of American agriculture, the geographic dispersal of major areas of farm production, the fact that we have a livestock economy, and the capabilities of our processing and transportation industries.

The United States has never experienced a famine—even in the years before the government began carrying large inventories as a by-product of efforts to support farm prices.

It is difficult to understand why we have so much public discussion about consumers' need for government-held stockpiles of commodities produced in great abundance here in the United States when there is so little about the need for government reserves of commodities which are imported in substantial quantities.

(2) Government-held reserves are bad from the standpoint of producers for a number of reasons.

A policy of encouraging production in excess of consumption for the purpose of accumulating government reserve stocks thwarts, or at best delays, efforts to bring production into line with consumption. Difficult adjustment problems are created—which may lead to burdensome controls when stocks reach the point where the government decides that further accumulations are undesirable.

The release of reserve stocks inevitably depresses the price for current production. This compounds the effects of a short crop on farm income. When production falls below normal, farmers need to receive increased prices for what they have produced in order to maintain their incomes. Also, a price increase is necessary to spur greater production the following year.

A government-held stockpile is highly disruptive to a market system since there is a constant danger that the government will break the market by releasing its stocks.

On the basis of the record, it is clear that the exercise of administrative discretion with respect to the release of stocks always will be heavily affected by political considerations.

For example, heavy sales of CCC stocks have been made (1) to force farmers into so-called voluntary programs by penalizing noncooperators and (2) to attempt to counteract the effect of inflationary government fiscal policies on food prices.

From the standpoint of producers, government reserves of agricultural commodities constitute a device to manipulate markets politically, to coerce participation in government supply-management programs, and to impose price ceilings on farm products.

(3) Strategic reserves would be costly. It has been estimated that acquisition of the reserve could cost as much as $1 billion. This would only be the beginning cost. Storage of farm products is expensive. In a relatively few years storage and interest costs can easily exceed the original cost of government stocks. Thus, in conjunction with the relatively remote possibility of a real need for such stocks, makes government stockpiles a bad bargain for taxpayers. If a policy of accumulating stocks leads to the need for expensive control programs, the injury to taxpayers is compounded.

(4) It has been argued that government-held reserves are needed to assure that the United States will be able to relieve famine conditions anywhere in the world. In answer to this, we say that the characteristics of our agricultural economy which make reserves unnecessary for domestic consumers, also provide us a very great capacity to extend food aid to other countries—without the necessity of maintaining government reserves for this purpose.

Free world consumers abroad—whether customers or aid recipients—have a vital stake in our having a dynamic, progressive, market-directed agricultural economy rather than a stagnant, government dominated agriculture.

Farmers do not want to compete with CCC in the market place. They very much oppose any program—strategic reserve or otherwise—that will tend to rebuild stocks of farm commodities under government ownership or control.

Farmers are seriously and increasingly interested in finding ways to develop greater market power through strengthening their bargaining power.

There are two ways to organize farmers to obtain greater bargaining power—voluntary and involuntary. Farm Bureau believes the voluntary method of organization offers greater opportunity for success. Truly effective power comes through the willing cooperation of informed, conscious, loyal, and active members; and this type of power far exceeds that which flows from compulsory grouping.

The only power which can compel farmers to bargain together nationally is the federal government, and its authority must come from an Act of Congress. The Congress, as well as the Executive Branch of our government, must be concerned with justice and equity for all citizens—not farmers alone. Since 94 percent of the voters are consumers, not farmers, Congress and the Administration necessarily must be more interested in low food prices than high farm income. Any federal government direction or enforcement of farmer bargaining most certainly would include rules or devices to "protect consumers" or the authority to issue cease and desist orders any time prices threaten to go higher than some Washington bureaucrat thinks they should. Obviously, farmers do not want government as a "partner" in their bargaining efforts.

Farmers are painfully trying to crawl out of the cheap food trap created by existing government supply-management programs. It would be a tragedy if their current interest in bargaining were to lead them into a similar government price-management trap. Government supervised marketing is not the way to get better income for farmers.

There is, however, a proper role for government in improving the marketing of farm products. Legislation currently before Congress would prohibit unfair trade practices designed to discourage farmer participation in voluntary marketing programs. Congress can play its proper role in this matter by guaranteeing farmers the right to voluntarily join a marketing association without fear of reprisal.

Chairman PROXMIRE. Thank you, Mr. Shuman.

Our last witness is Mr. Gordon Shafer, chief negotiator, National Farmers Organization.

Mr. Shafer.

STATEMENT OF GORDON SHAFER, CHIEF NEGOTIATOR, NATIONAL FARMERS ORGANIZATION

Mr. SHAFER. Thank you, Mr. Chairman and members of the committee. I would like to take this opportunity to thank you on behalf of the organization, the National Farmers Organization, which I represent here today for inviting us to participate in this discussion.

As a preface to my remarks, I would like to remind this committee that agriculture is still the Nation's biggest single industry. Farming employs about 5.2 million workers, more than the combined employment in transportation, public utilties, the steel industry, and the automobile industry.

Agriculture's assets total some $273 billion or an amount of money equal to about two-thirds of the value of the current assets of all corporations in the United States or about three-fifths of the market value of all corporation stocks on the New York Stock Exchange.

The value of agriculture's assets represents about $36,000 for each farm employee. Agriculture, of course, with this much invested is a good customer. The farmer spends over $33 billion a year for goods and services to produce crops and livestock; spends another $12 billion a year for the same things that city people buy—food, clothing, drugs, furniture, and other products.

Each year the farmers' purchases include over $4.6 billion in farm tractors, other motor vehicles, machinery, and equipment.

About $1.4 billion was spent in 1963 in the primary metals industry for equipment in new plant—it has increased somewhat since then.

About $3.4 billion is spent for fuel, lubricants, maintenance of machinery, motor vehicles. Farming uses more petroleum than any other single industry; uses about 320 million pounds of rubber; 28 to 30 billion kilowatt-hours of electricity or, in other words, more than the cities of Baltimore, Chicago, Boston, Detroit, Houston, and Washington, D.C., combined.

We use about 5 million tons of steel in the form of farm machinery, cars, trucks, fencing, and so forth.

In addition to this, farmers are the suppliers of the world's food supply. The United States is the largest exporter of agricultural products. We have already heard some testimony here today, something about the extent of our exports, but in 1966 we exported nearly

$7 billion worth of farm products. Actually we are pretty much the world market.

In 1966, the United States exported, as I said, some $6.7 billion of farm commodities, making up about 23 percent of the total of the U.S. exports.

The United States is now supplying approximately 90 percent of the world's, of the free world's supply of soybeans, about 57 percent of the free world's supply of corn, about 50 percent of all the feed grains in world trade.

Of the U.S. exports, approximately 75 percent of the exports, are sold for cash, and the other 25 percent, roughly, are sold for soft currency.

Now, this, I believe, will give us some sort of an idea about the importance of agriculture, and, when we remember a few of these figures, we see that farming is a business, and its productive assets must yield a return, as must the capital of any other business.

A farmer's productive assets are his real estate, livestock, crops stored on and off the farm, machinery, vehicles, equipment, furnishings, and other financial assets.

The Federal reporting of the farm income seems to make no allowance for return on the capital invested.

The per capita income—we have already heard some testimony on this, too—the per capita income of farmers from all sources, and this includes work off the farm as well as the farm income, for 1966, the last year that complete figures are available—was $1,717 a year as compared to the per capita income of the nonfarmers at $2,636 per year.

Of course, this is a year, 1966, when agriculture was supposed to be comparatively prosperous in relation to other years.

So this gives us an idea of the serious situation in which farmers find themselves.

In 1950 the net farm income was only $13.5 billion, and the average net farm income from 1951 to 1966 was only $13.1 billion. Actually the average was less than the 1950 net income, and by contrast the national, annual national, income 1951 through 1966 averaged 167½ percent of the 1950 national income.

In 1966 each farm family's weekly recompense for the management and labor which they expended in their farming operations was less than $50 a week per family.

Now, when we stop to think about this in relation to expenses as we find in our economy today, and compare this to the average wage of the balance of the economy, we begin to see just how serious this farm situation really is.

For 1950 each farmer's share of the national total farm debt was $2,798, and by 1966 it had risen to $20,286.

Putting this on a per-acre-harvested basis, thinking now of the farm debt, the per-harvested-acre in 1950, $36.65 was the debt, and in 1966 per-harvested-acre, the debt had risen to $143.58, an increase of 291.8 percent.

We hear much today about the poverty situation, and this is of much concern to everyone in the Nation. But I think most of us are, perhaps, mistaken about where our chief problem in this poverty area exists. It may surprise most Americans to know that there is more poverty in rural America, proportionately, than there is in our cities.

In the metropolitan areas, one person in eight is poor by our standards. In the suburbs the ratio is 1 to 15. But in the rural areas one in every four persons qualifies under the same standard for the poverty program.

Some 30 percent of our total population live in rural areas, but 40 percent of the Nation's poor live there.

We can no longer permit the public policy to ignore our rural poor, or, if we do, we shall see a continuing movement of rural people to our central cities.

As the summer of 1967 illustrated, the slums and ghettos of the city breed hatred and violence, which is no solution to the problems of either city or country and, of course, when the farm people are forced off the farm, as they are being, rapidly, then, of course, there is no place for them to go but to the cities where they swell the slum areas and become unemployed.

We could carry this a bit further, and we could say, I think, that world poverty is primarily brought about because of underpayment to agriculture, and the loss in trade in the world in terms of the gross farm dollar.

Now, this leads me to one other conclusion, and that is that our Nation is in serious jeopardy from an economic standpoint unless something is done to raise farm prices.

Then the next logical question, of course, is: Well, now, if this is the case, what do you propose as a solution to the problem—and we think that the problem has to have a dual solution? We think that Government has to have a share in the responsibility for creating a climate, at least, where our economic situation can be improved. We believe that our present Government program should be extended. We believe that the general public has a responsibility to farmers as well as to themselves, to assist in working through the problem which we have.

In addition to this, we believe that farmers themselves must take a major share of the responsibility for the condition in which they find themselves, and we believe that it is only through organizing and bargaining collectively that the farmer can change his economic status.

Now this, of course, is the purpose of the National Farmers Organization. We are a relatively new farm group so far as the general farm organizations are concerned. But we believe that what must be done, we think that farmers must band themselves together in sufficient numbers under the protection of the Capper-Volstead Act so that they can bargain and sell together for a cost of production plus a reasonable profit price on their commodities.

We do not think you can limit this to just the minor commodities. Some bargaining has been done, mostly in local areas, in the minor commodities. But we believe that this is not the real problem in trying to bargain for agriculture. We think that you must bargain for the major commodities and, of course, there is only one way that you can effectively bargain, and that is to bring together enough of the total production over the entire Nation of not just one commodity but of any and all commodities so that the purchasers of our production cannot bypass the organization of farmers and supply their needs.

With this in mind, the National Farmers Organization is organizing; we are now organizing, in some 35 States, with a little organization beginning in about five or six more. We have not completed the job, but we think that farmers owe it to themselves and to the Nation to band themselves together and bargain and sell together.

I think the alternative to solving our problem could very well lead to serious disaster for this Nation as a whole—not only for farmers but for this Nation as a whole.

We are now at about the lowest parity ratio that we have been in the United States since the middle 1930's and, of course, some of you gentlemen, I am sure all of you know, and many of you remember, the days of the 1930's so far as farming was concerned, and you know what happened to the rest of the Nation.

In other words, what I am trying to say is that depressions in this Nation have always been farm-bred and farm-led.

With the depressed state of agriculture as it is now in this country, I believe that we could very well be heading for the same type of problem, and I hesitate to predict, but I wonder if it would not be worse than anything we have ever seen before, unless something is done to right this situation, because with the extra assets of the Nation, the extra debt, I sometimes wonder if the Nation, as we know it today, can actually survive another serious depression.

So I believe that this is a concern of the Nation as well as a concern of the farmers, and we believe that the responsibility for correcting this situation will have to be shared by the farmers and by the people, and, of course, by that I mean Government action.

With this, I believe that I will terminate my remarks, and if there are any questions I will try to answer them.

Chairman PROXMIRE. Thank you very much, Mr. Shafer. I would like to ask each of you gentlemen to get out your pencils and maybe jot a note or two and remember these questions. I would like to have each of you in turn comment on them.

The point has been made by several of you this afternoon, and I do believe wholeheartedly, that farm income is too low. In fact, the statistics given by Mr. Shafer at the end, I think, would be most impressive. Farm per capita income in 1966, the good farm year, $1,700 or something like that; average nonfarm per capita income in 1966, was $2,600. My questions are these: Do you support or oppose each of the following measures to improve farm income?

1. The Mondale approach, and let me very quickly say what that is. It has two parts. The first part would provide for a national agricultural relations board to administer bargaining between farm committees and processors.

The second part of it would extend the marketing agreement system to all commodities.

2. A land retirement program; do you support or oppose such a program?

3. Additional credit facilities for farmers provided by additional Federal credit action.

4. The next is expansion of the food-for-peace program.

5. Finally, the kind of proposal which was described—I think, by Mr. McDonald—Senator Metcalf has introduced, that would sub-

stantially limit or eliminate using farm losses to offset income from other sources in computing income taxes.

Mr. Graham?

Mr. GRAHAM. Mr. Chairman, in regard to the Mondale bill, we would support the second part in preference to the first.

I should tell you that there have been a number of meetings between most of the farm organizations, and there is pretty general agreement among them on this point. This group includes the Grange, the Farmers Union, the NFO, the Missouri Mid-Conference Farmers Association, and the National Council of Farmer Cooperatives.

The approach generally of the second section of the Mondale bill—as I understand it has been introduced—is something that we would all support.

Chairman PROXMIRE. Your position, Mr. Graham, is that you would not support the first part; you would support the second part?

Mr. GRAHAM. Basically; yes. I think this is basically the position of most of us.

The second one on land retirement programs, if we were to believe what we hear or what we read, that we have a continued capacity for overproduction that is substantial, and according to Iowa State studies that it is going to continue for the foreseeable future, we cannot see any alternative except to continue some type of land retirement program.

If we would bring out 7 or 9 million acres out of a CAP program during the next couple of years, and they are going to come out unless something is done about it, and throw that on top of the surplus lands we have at the present time in terms of effective demand for the products, we are going to be in real trouble. I do not see any way around that one.

For additional credit, I think, generally, we have enough credit facilities if we just have enough cash to go into them. But, they are bidding against everybody else, including the Government, for a limited amount of available cash, and, so, the problem is not necessarily the amount so much as it is the cost at the present time. This is one of the reasons why we think there ought to be a tax increase that would take the money for the Federal Government out of taxes rather than bidding in the marketplace against all the private needs.

On expansion of Public Law 480, we favor very definitely an expansion of that. The Metcalf bill which you have asked about, and which Angus talked about is well within our policy, and we will support that also.

Chairman PROXMIRE. Mr. McDonald?

Mr. McDONALD. Mr. Chairman, we will support title II, the marketing order part, as I understand it. I have not had time to read the bill as introduced. We are in favor, in other words, of keeping the working programs and building on them. This is an extension.

Chairman PROXMIRE. It means you will not support title I, that is the National Agricultural Relations Board.

Mr. McDONALD. We will support title I also.

Chairman PROXMIRE. You will support both?

Mr. McDONALD. Yes, sir. We will support both titles of the bill. I would not say in every detail, but in principle, we will support the bill as indicated by our President's press release which came out just a few minutes before I got here.

Chairman PROXMIRE. Thank you.

Mr. McDONALD. On land retirement, we have supported land retirement, but not retirement of whole farms which Ezra Taft Benson brought about, as I remember, where you had the abandonment of rural communities, and the taking of whole farms out. Parts of farms, yes, for land retirement.

Adequate credit facilities, and I cut off part of what I have got in my statement with regard to the Federal Reserve Board credit and high interest, and so forth, certainly an expansion of credit we are in support of it.

Senator Moss' bill, S. 1971, which would give credit to small cooperatives not available to them under the Farmers Home Administration, and not available to them under the Farm Credit Administration, these little cooperatives were left out in the cold.

We also would favor utilizing parts of the Federal Reserve Act which are not yet used. Section 13, part 3, I suppose, section 13-3, provides that in an emergency the Federal Reserve banks may make available under the Home Owners Loan Act of 1933—they could have done it in 1966 when we had a crisis, they did not use that authority, which was reaffirmed in this bill which was passed by the Congress in 1966. So we especially want more credit and not high interest, credit at a reasonable rate for farmers and others.

Of course, expansion of the food-for-peace program under Public Law 480, we favor that, and we favor the Metcalf bill.

Chairman PROXMIRE. Thank you.

Mr. Shuman?

Mr. SHUMAN. Thank you. On the Mondale bill it is our understanding that these two titles, the National Agricultural Relations Board and marketing agreements, both would involve Government supervised bargaining and marketing, and we are unalterably opposed.

We think that it would result in having a marketing board appointed on which would be, of course—you could not deny it—consumer and labor union representation, and we would be right back in the same trap we are in now, where we have had the Government farm programs used to hold farm prices down. We are for better farm prices and not for any device that keeps farmers from negotiating for the best price possible. So we are opposed to the Mondale bill, and will fight it in every way we can.

Second, the land retirement proposals, many of them, some of them have been useful in the past, perhaps.

We do not believe, and I was pleased to hear Secretary Freeman, yesterday, in Des Moines, indicate that there is some question in his mind as to whether or not you can adjust production through acreage controls. He said that this is open to question, and we challenge that you can.

In fact, the signing up in the wheat program was for an 8-percent cut in production for the year of 1968, and the latest USDA figure says that if it is cut any it won't be over 1 percent. This illustrates the futility of trying to adjust production through land retirement.

However, we believe that a land retirement type of program in connection, and only in connection, with the ending of these present unworkable and unsuccessful control and payment programs might be a helpful thing. It could provide a transition program while farmers were adjusting to the market system again for these crops that are under controls.

I was glad to see Mr. Shafer point out that the parity ratio is the lowest it has been since 1937, and I emphasize that what we need are less Government programs.

Every time we have had a Government program in the last 30 years, the cost of farming has gone up, and the net income of farmers has gone down as a result of these programs.

During this last period of time, in the last several years, we have had the most expensive and the most extensive Government controls and subsidies in agriculture's history in effect, and we have an administration in charge of them that is pledged to make them work, and yet we are now near the depression level as far as farming is concerned. So we do not favor a land retirement program except in connection with ending the program we now have.

As far as additional credit facilities are concerned, we have got facilities running out of our ears. One of our biggest problems in agriculture is that farmers' indebtedness is going up. The total farm indebtedness in the last few years, particularly in the last 5 or 6 years, has skyrocketed, and so I do not, we do not, believe that we need new facilities.

We need to check inflation, which Mr. McDonald mentions as increasing interest rates. Well, the cause of increased interest rates is primarily inflation, and that is caused by the policies of this administration, which have been to spend more than we take in; and there is only one way to correct that, and that is to balance the budget and do it as quickly as we can.

So we do not favor additional Federal action in the credit field.

As far as expansion of the food-for-peace program, the Farm Bureau originated the Public Law 480 idea. We think it served a purpose, but we think it has largely served that purpose, and that it ought to be phased out as rapidly as possible. We want to sell for dollars and not to be in the business of export dumping, and so that is why we suggest that the needs for food for peace be met by purchases in the market.

I am not too familiar with the Metcalf bill, but we would not favor any bill which would cause farmers to lose any of their tax rights. We are not opposed to looking for loopholes which may be used by some to take unfair advantage of losses on farm operations. But we are very suspicious that any attempt to close these loopholes would take away some rightful privileges which farmers have under the tax laws.

That pretty well covers it.

Chairman PROXMIRE. Thank you very much, Mr. Shuman.

Mr. Shafer?

Mr. SHAFER. In regard to your first question on the Mondale proposal, which I have not seen as yet, but I think Mr. Graham pretty well stated the position that we would support on this proposal. We are in favor of any additional legislation which would enhance our bargaining position.

Question No. 2, land retirement, it is beyond me how anyone can figure that taking all of our land out of our retirement programs, phasing this program out, and expecting to put all of this land back into production, how in the world we can think this is going to cause higher prices, I cannot figure that out.

This last year is a good example of what increased production can do to farm prices; and without some way of keeping the added production from coming on to the market, I fear that prices would be much, much lower than they are today.

As far as additional credit is concerned, with the cost-price squeeze that has been on the farmers now for several years, and continues to get worse every year, the more money we can make available to the farmer—and the cheaper the rate of interest—the better position he is going to be in. Certainly this would help.

Sure, we are in favor of Public Law 480. We think it ought to be expanded to take up some more of the additional surplus, particularly in wheat, some of the feed grains, and so on, that this country is able to produce. Why not feed it to a hungry world? It seems to me that this is the logical approach.

No. 5, I am not acquainted with the Metcalf bill, but from what I have heard here today, we would be in favor of this approach, yes, to eliminate the tax writeoff of some of our other segments of our economy that come into farming.

Chairman PROXMIRE. Thank you. My time is up. I want to come back to that question.

Before I do, if Senator Jordan will permit, I would just like to ask Mr. Shafer—I missed because I was getting something from a member of the staff—did you say you are in support of both titles of the Mondale bill?

Mr. SHAFER. I said that I was not familiar with the Mondale bill, the proposal, yet. I believe that our position would be similar to the position expressed by Mr. Graham. I think that——

Chairman PROXMIRE. In favor of two but not one.

Mr. SHAFER. From what I understand. I would not say we would not support No. 1, but we are strongly in favor of No. 2, let us put it that way, from what I understand of the bill.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

I, too, have several questions, if you will use your scratch pads again, please, and I will not have to ask them of each one separately.

First of all, would you please supply for the record a list of your membership; that is, total membership in the United States and by States, if you will, please, for the record. You do not have to reply to that now.

Do you believe that Federal spending should be cut, and if so, where and how much?

Do you believe that we need a surtax and, if so, how much?

Do you believe we should remove the gold cover?

Most of you spoke briefly about land retirement, but you did not get into what incentives should be offered for further land retirement, if further land should be retired, and how should this be implemented.

These are my questions, Mr. Graham.

Mr. GRAHAM. Yes; we will furnish the first for the record.

(In answer to Senator Jordan's first question, Mr. Graham later supplied the following table:)

WHERE THEY ARE—GEOGRAPHIC ANALYSIS OF GRANGE MEMBERSHIP (DUES PAID)

	Members	Granges
New England:		
Maine	37,238	426
Vermont	12,105	191
New Hampshire	18,504	259
Massachusetts	28,245	302
Connecticut	27,158	186
Rhode Island	5,071	55
Total	128,321	1,419
Middle Atlantic:		
New York	78,866	1,110
New Jersey	11,823	131
Pennsylvania (except western)	46,184	618
Delaware	1,816	29
Maryland	2,008	47
District of Columbia	200	1
Total	140,897	1,936
East Central:		
Michigan	11,262	310
Ohio	106,414	1,126
West Virginia	1,322	27
Indiana	3,447	68
Western Pennsylvania	23,092	309
Total	145,537	1,840
West Central:		
Illinois	6,674	160
Wisconsin	1,663	34
Minnesota	1,720	56
Iowa	1,993	48
Missouri	2,188	36
West Central—Continued		
South Dakota	360	21
Nebraska	1,701	37
Kansas	26,213	220
Montana	1,486	29
Wyoming	1,064	31
Colorado	7,487	144
Total	52,549	816
Southeast:		
North Carolina	11,031	194
South Carolina	4,056	79
Florida	1,461	35
Tennessee	435	25
Virginia	1,139	30
Total	18,122	363
Southwest:		
Arkansas	641	20
Oklahoma	1,096	38
Texas	1,883	28
Total	3,620	86
Pacific:		
Washington	55,941	522
Idaho	9,409	168
Nevada	87	1
Oregon	26,062	360
California	40,122	363
Total	131,621	724
Grand total	620,668	7,184

Note: In addition, the Grange has an unknown number of members who are classified as honorary members, mostly those who have a long membership record, from whom no dues are requested. These probably number in 6 figures.

Mr. GRAHAM. In terms of Federal spending, we have some concept of the budget in terms of agriculture. But, as we testified before the House Ways and Means Committee, we do not set ourselves up as experts in the total budget of the U.S. Government. I do not think there are many people who are. We have areas in which we do have some expertise.

Frankly, we think that the cuts in agriculture at the present time have gone to the bone, and taken out some of the bone. There are substantial problems that we cannot answer at this budget level. One of them has to do with the proper funding of the Packers and Stockyards Act which, at least, guarantees some honesty in the marketplace. This, we think, ought to be increased, so at this point we do not see where you can cut more.

Frankly, I think that we have got some problems in doing any substantial cutting anywhere else. This has been a pretty rugged budget cutting session in the last 2 or 3 years.

If we are not going to eliminate military cuts, I do not conceive of how it is possible to equate cuts with tax increases.

If we would start from a year ago we might do that, or 2 years ago. But if we were to cut half of \$23 to \$29 billion we would practically dismantle a substantial amount of the Federal Government, if we do it outside of Defense.

We prefer, rather, a surtax. We have been in favor of this for a year. It puts the tax burden where it properly belongs—on those who have benefited from the inflation. We think it should have been passed at the time it was asked for. Our criticism before the House Ways and Means Committee was that we did not think it was enough. There is enough money in the United States today, and without substantially hurting anybody, because we are living in a pretty affluent society, after all. There is enough money to take care of most of this need which we have, at least to the point that we do not have to do quite so much deficit financing.

We would support the removal of the gold cover.

In terms of incentives for the land retirement, I am not sure what they need to be. I am not sure anybody has made a study which indicates what these incentives should be. But what we would say is that the incentive should be adequate to get the land retired, and it may be that the present incentives are sufficient. I have my doubts that they are, because of the added costs, taxes, and the like. Even idle land has taxes, and there has been a substantial increase in taxes of about 70 percent or so, and this would indicate to me that it would take a little more incentive than we have at the present time.

Senator JORDAN. Thank you.

Mr. McDonald?

Mr. McDONALD. We will furnish, Senator Jordan, for the record, our membership of our States.

(The following list was subsequently received from the National Farmers Union:)

National Farmers Union—Paid family membership, 1967

Arkansas	11,092	Ohio	3,138
Illinois	1,921	Oklahoma	50,010
Indiana	1,996	Oregon-Washington	1,150
Idaho	406	Pennsylvania	803
Iowa	3,491	Rocky Mountain	9,662
Kansas	7,142	South Dakota	14,612
Kentucky	426	Tennessee	118
Michigan	841	Texas	6,482
Minnesota	27,018	Utah	1,656
Montana	12,695	Virginia	638
Nebraska	7,085	Wisconsin	7,958
New Jersey	571	Miscellaneous	302
New York	441		
North Dakota	40,734	Total	212,388

Mr. McDONALD. In regard to spending and where to cut, frankly, I am not an expert on these matters and I do not know if we have resolutions to cover this or not.

But, in regard to some of these adventures, such as going to the moon, would it not be possible to cut off a few billion there? It is $5 billion, as I remember.

It would appear that the war effort and some of these things we have been talking about today are more important.

I agree with Mr. Graham. I do not know where you would cut agriculture even more than it has been cut. There is a super airplane which is supposed to carry thousands of people they have been working on, for I do not know how many years, and I am not sure it will fly yet, and hundreds of millions, I believe, Mr. Chairman, have been squandered on that project.

As far as I am concerned, the airplanes go too fast now.

We have supported, in principle, a taxing program. The farmers want to pay their taxes. But our Board, last September, passed a resolution that if we are going to have taxes which the middleclass is paying—parenthetically, this is the first war since I have been in Washington, and I have been here since 1935, where the middleclass is paying for the war. General Motors and these other people with billions of excess profits, with their war contracts are profiting from this war, and I do not see why the phrase "excess profits" has not been used a little bit up here around the Capitol.

I do not see why Representative Ullman's plan of 2 or 3 years ago to put a tax on those people whose profits were excessive since the war started, that I think would be a sensible tax program.

I believe that covers the questions.

Senator JORDAN. I asked you, Would you remove the gold cover; and do you have a plan for land retirement?

Mr. McDONALD. For land retirement, well, I thought I answered that a few minutes ago. We would be for a modified system of land retirement. We think it was a mistake—of course, the Secretary could not know—to add 30 million acres to increase wheat production.

Chairman PROXMIRE. Would the Senator yield? As I recall, you said you preferred not to take whole farms out of production.

Mr. McDONALD. That is correct.

Chairman PROXMIRE. But you would save the land retirement short of that.

Mr. McDONALD. That is correct; to make ghost towns out of rural communities.

Senator JORDAN. How about the gold cover? Would you remove the gold cover from the Federal Reserve notes, the 25-percent gold cover?

Mr. McDONALD. Yes, sir; I believe I would.

It reminds me of a story. Someone got into Fort Knox one time and stole all the gold, and they did not find out about it for 20 years.

Senator JORDAN. Mr. Shuman?

Mr. SHUMAN. Thank you.

On the first question, A list of the members by States and total for the United States? We will be glad to furnish that for the committee.

(The membership list promised by Mr. Shuman was subsequently supplied as follows:)

FARM BUREAU MEMBERSHIP

Member families by States as of November 30, 1967 (audited report for the end of the American Farm Bureau Federation's 1967 fiscal year).

State	Total	State	Total
Alabama	100,024	Nevada	1,630
Arizona	4,051	New Hampshire	3,487
Arkansas	54,024	New Jersey	3,199
California	60,380	New Mexico	9,557
Colorado	13,478	New York	14,591
Connecticut	2,492	North Carolina	59,814
Delaware	1,500	North Dakota	15,736
Florida	35,069	Ohio	50,875
Georgia	51,733	Oklahoma	52,785
Hawaii	875	Oregon	8,367
Idaho	11,406	Pennsylvania	12,624
Illinois	190,477	Puerto Rico	5,960
Indiana	153,162	Rhode Island	227
Iowa	110,019	South Carolina	28,760
Kansas	83,697	South Dakota	3,943
Kentucky	87,839	Tennessee	87,956
Louisiana	26,657	Texas	105,653
Maine	2,003	Utah	8,636
Maryland	9,412	Vermont	5,255
Massachusetts	4,052	Virginia	20,360
Michigan	52,144	Washington	4,064
Minnesota	29,407	West Virginia	4,088
Mississippi	66,462	Wisconsin	25,311
Missouri	41,365	Wyoming	7,928
Montana	4,486		
Nebraska	15,693	National total	[1] 1,753,532

[1] Farm Bureau memberships are reported by families. The number of individuals is not reported; however, if it is assumed that the average member family includes three persons 14 years of age and over, the total number of individuals would be in excess of 5,250,000.

Mr. SHUMAN. The second one was: Should spending be cut, Federal spending be cut, and how much? We definitely favor a very heavy cut in Federal spending, and we believe it can be made.

It is absolutely ridiculous to take the attitude that you cannot cut spending because Congress keeps adding to it. They can take it off the way they have been putting it on.

Some of the things that could be cut, we are ready, willing, and have suggested cuts in Federal farm program spending of $1 billion or more. We believe that the poverty program, much of the poverty program, is money down the rathole. It has been wasted and squandered throughout the country, and it is not effective in the objectives which could be attained in different ways. Much of the poverty program expenses could be eliminated.

We think the foreign aid programs have had a lot of water in them, and a lot of waste, and that they can be cut down very drastically.

We agree with Mr. McDonald that the moonshot and some of these things could wait to a time when we were not in as drastic a situation as far as the fiscal survival of this Nation is concerned.

There is no question but what the rivers and harbors appropriations can be drastically cut. This is the pork barrel type of thing, a kind of make-work project for the Army Engineers, in which billions of dollars have been spent on these projects throughout the United States that ought to be curtailed, postponed, or eliminated.

As I said previously, we would oppose an increase in taxes until such time as the Congress is ready to make an equivalent cut in spending.

We think this cut can be at least $5 billion. With a $5 billion tax increase there would be a $10 billion reduction in the deficit, and it could be much more, without any question.

As far as that goes, we believe the military expenses should be scrutinized, and probably some of them can be cut without endangering the defense effort.

As far as removing the gold cover: No; we are not in favor of removing the gold cover. We think that if the Congress and the administration recognize the gravity of the situation, and take appropriate action to reduce expenditures, it will not be necessary.

If appropriate action is not taken, very likely, before the year is up, we will be forced to do the same thing that Great Britain was forced to do. The situation is desperate, but it is not a time to start taking actions to remove the gold cover. It is time to meet and to treat the problem, not the symptoms.

As far as incentives for land retirement: We favor land retirement on a competitive bid basis and, as I said before, its use only as a means of transition while we are dismantling the control and direct subsidy programs.

Senator JORDAN. Thank you.

Mr. Shafer?

Mr. SHAFER. In answer to your first question, it has been our policy not to release our membership. We are a farm organization organized primarily for bargaining purposes, and it has been the belief of our membership, at least, that we should not release to those that we are trying to deal with the areas in which we are strong and the areas in which we may be weak or just exactly what our total membership is. In other words, we believe that this is a part of bargaining; because of this, our membership asks, that we do not release our membership totals.

Regarding the next question: Should Federal spending be cut? Again, let me say that we are a farm organization, and we try not to get involved too much in things that do not pertain to agriculture.

So far as agriculture is concerned, we do not see any way that you could successfully have the agricultural expenditures and still expect to accomplish as good a job as we are doing now.

We have taken no stand on the gold cover, as far as our organization is concerned, or on the need for more taxes.

My personal opinion, so far as taxes are concerned, I cannot see how we can continue forever to go into debt to take care of all of our problems. So, it appears to me, personally, that probably we do have a need for more taxes.

The land retirement question: We believe that whatever incentives are necessary to get whatever land is needed out of production should be used. I am hopeful that the present feed grain program will siphon off sufficient production to be of great help.

I would agree with Mr. McDonald in his statement that we do not favor the retirement of whole farms where communities could be drastically affected.

So far as our land retirement program is concerned, we think it should be done more generally from individual farms rather than trying to close down entire communities.

Senator JORDAN. Thank you.

Thank you, gentlemen. I am sorry, Mr. Chairman, that I took so much time. I got some good answers.

Chairman PROXMIRE. Do you want to make a comment, Mr. Graham?

Mr. GRAHAM. Yes, indeed.

Chairman PROXMIRE. Please go ahead.

Mr. GRAHAM. I think just from the standpoint of accuracy we ought to catch a couple of things here.

The statement was made that net farm income has continued to decline, and in table 77 of the CEA report it shows that farm income did decline from 1952 to 1960 from $15.1 billion to $11.5 billion.

But, beginning in 1960, it went up, and with the exception, there have been only two times when it went down under the previous year, but the increase has been from $12 billion to $14.9 billion this year, even after the drop of income.

In terms of net income per farm, by 1967 dollars there was a drop from 1950 to 1960 of $42; but from 1960 to 1967 there was an increase of $1,314.

There is another statement that was made that the release of farm stocks inevitably depresses prices.

Chairman PROXMIRE. Let me just ask you at that point, Mr. Graham, because I agree with your figures, you are right: but, No. 1, the most recent figure shows that farm income has gone down in 1967 as compared to 1966, and gone down——

Mr. GRAHAM. $283 million.

Chairman PROXMIRE. And drastically.

Mr. GRAHAM. Right.

Chairman PROXMIRE. In the second place, we know the value of the dollar has diminished somewhat during this period. We also know that what has really happened is a statistical trick. What has happened is that many, many farmers—literally millions of farmers—have dropped out of farming.

Mr. GRAHAM. Of course.

Chairman PROXMIRE. These are the farmers with low incomes, by and large—not entirely—but by and large. The farms that remain are bigger, have a larger investment. Whereas they do have a higher per capita income, the reason they have a higher per capita income is, as I say, because the farmers with lower incomes have disappeared, are no longer in farming.

Mr. GRAHAM. That is correct; no question about it. But the net farm inventory, I mean the net, including inventory changes, has gone up even with the loss of farmers. I mean, this is total. This does not break it down to per farmer base.

It has gone up historically, and it has not gone steadily down as the statement was made. This was the only point I was making. It went down this last year by $283 million, but this does not indicate a steady decline.

Chairman PROXMIRE. Yes. We raised this point the day before yesterday when Secretary Freeman appeared before us, and I think the conclusion that the Secretary of Agriculture made was that whereas he argued that per capita farm income has gone up over the past few years, he agreed that it was still less than two-thirds of the income of those off the farm.

Mr. GRAHAM. I will agree with that.

Chairman PROXMIRE. Whether it has gone up or down, the point is that it is still too low on the basis of comparison with nonfarm income, particularly when you recognize the investment the farmer makes—which most people off the farm do not make—the enormous increases in efficiency, and the great risk involved in farming. When you put these elements together, together with the hours the farmer works, it would seem that the injustice is most conspicuous.

Mr. GRAHAM. I am not arguing about this relative——

Chairman PROXMIRE. I am sure you are not. But I wanted to put it in as much context as possible.

Mr. GRAHAM. The relative position is obviously not good, and we made that point in our testimony. The point I am making is that you cannot honestly say it has steadily gone down.

Another statement was that the release of CCC stocks inevitably depresses the price. Well, the fact is that the price went up steadily during the time we were dropping the supplies of wheat from 1 billion 400 million down to about 400 million, and we were dropping corn stocks from 85 million tons to 45 million tons. During that time the price did go up, and it is a strange thing that the price ceased to go up and started declining after the stocks had disappeared. This is a matter of historical record.

Chairman PROXMIRE. As the stocks diminished.

Mr. GRAHAM. I mean as the surplus stocks diminished. The overpowering surpluses were gone by the time prices began to go down. And furthermore, farm prices are at a low level of parity, but when the certitficates and program payments are added, the parity level is up except for nonsupported crops.

Chairman PROXMIRE. Mr. Shuman.

Mr. SHUMAN. Mr. Chairman, I just want to challenge that last statement, that it is not a matter of historical record, and we will submit figures to show it. I do not have them right here.

(Information later supplied, follows:)

CCC SALES OF FEED GRAIN IN RELATION TO UTILIZATION

Marketing year	Total utilization	CCC sales	CCC sales as a percent of utilization	Season average price
Corn:	Millions of bushels	Millions of bushels	Percent	Per bushel
1961	3,962.0	975.0	24.6	$1.10
1962	3,895.0	736.0	18.9	1.12
1963	3,848.0	170.0	4.4	1.11
1964	3,875.0	391.0	10.1	1.17
1965	4,392.0	398.0	9.1	1.16
1966	4,244.0	[1] 22.0		1.29
Sorghum grain:				Per hundredweight
1961	521.0	221.0	42.4	$1.80
1962	516.0	241.0	46.7	1.82
1963	591.0	122.0	20.6	1.74
1964	573.0	144.0	25.1	1.88
1965	848.0	240.0	28.3	1.79
1966	911.0	[1] 37.0		1.86
Oats:				Per bushel
1961	1,059.0	7.0	.7	$0.642
1962	1,019.0	6.0	.6	.624
1963	931.0	3.0	.3	.622
1964	891.0	13.0	1.5	.631
1965	891.0	18.0	2.0	.622
1966	869.0	14.0	1.6	.669
Barley:				
1961	441.0	40.0	9.1	.979
1962	410.0	11.0	2.7	.915
1963	420.0	30.0	7.1	.897
1964	430.0	15.0	3.5	.947
1965	395.0	12.0	3.0	1.02
1966	383.0	3.0	.8	1.06

CCC SALES OF WHEAT IN RELATION TO UTILIZATION

	Millions of bushels	Millions of bushels	Percent	Per bushel
1961	1,329.8	254.6	19.1	$1.83
1962	1,226.0	207.8	16.9	2.04
1963	1,439.7	341.7	23.7	1.85
1964	1,375.3	310.8	22.6	1.37
1965	1,598.6	379.1	23.7	1.35
1966	1,438.0	147.2	10.2	1.63

[1] Oct. 1, 1966, through July 14, 1967.

Mr. SHUMAN. I also want to point out that I would hate to try to tell any farmer today that his income situation is better today than it was before 1960. This just is not true. The income situation of the average farmer is best depicted by the parity ratio, and it is at the lowest point it has been since 1937.

The income situation, net income, and the points you brought out about the total, the fact that the improvement in individual farm income is up, is due largely to the tremendously large migration out of agriculture that has happened not only in the last 6, 7 years, but before that, and it has been about the same rate for the last 20 years. It does not matter which administration is in power, farmers are still being forced out of agriculture.

Chairman PROXMIRE. I would like to ask you, Mr. Shuman—and the other gentlemen, if you would like to comment on it—that I think some of you have already indicated your position, but Wednesday afternoon Secretary of Agriculture Freeman, when I asked him what would be the consequences of a $1 to $2 billion cut in the agricultural budget, said that in his view he would have no alternative except to virtually dismantle much of the farm support program.

On the basis of studies that he had seen, this would result in a very sharp drop in farm income. At the same time, there are many in Congress—and many outside of Congress—who feel if there are fewer farmers, with greater reductions we have had over the years, at least in surpluses, that it is hard for them to understand how our agricultural budget is still so very big. What is your response to this, Mr. Shuman?

Mr. SHUMAN. Well, I would respond by saying that any study as to what would happen by the dismantling of the present very expensive and ineffective farm program would depend upon who made the study, No. 1, and there have been studies made by people who did not want to see these programs dismantled; and, No. 2, by the assumptions that you make in such a study.

I think, without question, if you just simply jerked out the controls and the almost $3 billion subsidy, this would reduce farm income, if you did not do anything else.

We have made proposals and suggestions that, if implemented in connection with this dismantling process, I am sure would result in increased, not reduced, income as we got rid of these programs.

The purpose of the program, particularly the feed grain program, was to reduce farm production, and yet the average production of feed grains during the years since the feed grain program has been in effect has been considerably higher than it was in the 5 previous years. The program did not get any reduction in production. It assured farmers of a certain price, and they increased their production.

The proposals that we have made include such things as an expansion of the land retirement, a prohibition against the sales of surpluses by the Government to depress prices; expansion in our purchases for—purchases rather than direct aid—purchases of the commodities on the market for the aid programs. Other ideas could be implemented and a transition could be made very quickly without any great disruption.

Chairman PROXMIRE. I take it, then, you would directly disagree with the Secretary?

Mr. SHUMAN. Yes, sir.

Chairman PROXMIRE. And argue that you could reduce the farm program by a substantial amount, $1 billion or $2 billion without a disastrous effect on the farmer's income?

Mr. SHUMAN. Yes, sir. I believe that this could be done very rapidly, with some protections adopted by the Congress.

Chairman PROXMIRE. Would all of you gentlemen disagree? I do not want to put words in your mouth.

Yes, Mr. Graham.

Mr. GRAHAM. I do not see how anybody can say that you can take $3 billion away from farm income without any assurance that there is going to be a substantial increase in farm prices, which simply is not there, and say the farm income would not be hurt. It would be hurt obviously by $3 billion to start with.

If the feed grain program at the present time was taken out, we would obviously produce more feed grain. What would we have produced without it? This is the real problem.

If all of this land went back into production, whether it be feed grain or wheat, obviously we would have a continuous pressure upon us in terms of prices. Look what we had last year in terms of wheat. Mr. Shuman points out in his testimony that this increase in wheat acreage caused a price problem that resulted from the evaluation of the world food situation. So, if that increase caused the price break this last year as stated by Mr. Shuman, and incidentally, the Government did not demand that or insist on increases, but those farmers who could produce this extra wheat efficiently were permitted this extra increase, and they did produce enough in the light of the existing world situation so that the price of wheat was depressed; not the slightest question about it.

If it did increase acreage when the controls were loosened, what reason is there to believe that it would not happen again? If the acreage increased, would not the price decline again?

I just do not follow this business that the Government can increase acreage and cause prices to go down. But if they took off the controls and the acreage increased then prices would go up. I see no validity in that kind of an argument at all.

Chairman PROXMIRE. Mr. McDonald?

Mr. McDONALD. Mr. Chairman, we have always been puzzled in a friendly way by the reasoning of our friendly rival organization, and I am still very puzzled.

If you take controls off, we know that farmers like to work, they like to produce. History proves that if the farmer has an opportunity to make an extra dollar by putting in an extra acre, he is going to put it in. If his income is low he will put in a few more acres. He will clear off some land he had not been using so as to make up for his less income.

If you take off controls, Mr. Shuman, you will have the worst debacle. It will be much worse than the depression, it will be much worse than it was under Ezra Taft Benson. It would be a catastrophe. It would be a catastrophe not only for agriculture but for the whole country, and the little fellows who could not get credit at the bank would go out. The big guys, the insurance companies and these off-farm interests, would buy up the bankrupt farmers, and you would eventually have consumer prices controlled by a few giant corporations.

Chairman PROXMIRE. Mr. Shafer?

Mr. SHAFER. I just wanted to say that Mr. Shuman points out that the amount of production has continued to increase even though the number of acres is being decreased through the Government programs. I cannot see any reason to believe that farmers are going to quit using the fertilizer and they are going to quit using the increased technology which they have gained in producing to cause yields per acre to go down, and if you increase the number of acres it appears to me you have got to increase the amount of production.

Again Mr. Shuman told us that our problem last year was increased production. This is what caused the lower prices, and I agree with him. This is what caused the lower prices.

So, following the same line of reasoning, it appears only logical to me that if you decrease the number of acres that are in retirement, increase the amount of crop, I cannot see anything but lower prices for farmers.

Actually, the total gross income would probably be less, much less, than before when you consider what it costs to produce these extra acres, why the net has gone down. I cannot see it any other way.

Chairman PROXMIRE. I would like to ask Mr. Shafer—when we get back to Mr. Shuman we want a rebuttal—but I would like to ask you, in connection with this, your organization has an appeal to many nonfarmers as well as farmers on the ground that it would provide a collective bargaining substitute for some of the costs of the farm program. In other words, if the farmers could negotiate for a better price, the feeling of many people is that they would not have to rely on some of the many expensive programs we have now.

I take it from your remarks at least for a transition period you would want both. You would want both the present farm programs pretty much as they are, maybe expanded somewhat on the basis of what you said a little earlier, plus the opportunity to bargain under title II of the Mondale bill, for example.

Mr. SHAFER. Mr. Chairman, this is correct.

We are organizing farmers to bargain and sell collectively for cost of production plus reasonable profit prices, but we are not there yet, and until such time as farmers are organized so that they can accomplish this by themselves, I think that it would be disastrous to——

Charmain PROXMIRE. At that point, however, you feel we could begin to cut back the farm program?

Mr. SHAFER. At that point I think we may be able to cut back on farm programs; yes.

But I think that we possibly will still need all the help we can get in the way of enabling legislation to assure us the necessary protection to bargain. We have the Capper-Volstead Act which gives us the authority, the farmer in the United States, to join together into one organization and price his commodities. But some other legislation which, as I understand it, will be offered, if the Mondale proposal is adopted, could be very helpful.

Chairman PROXMIRE. Mr. Shuman wanted to say something.

Mr. SHUMAN. Mr. Chairman, just a minute of rebuttal. The best proof that there would be no disaster in the way of overproduction and price collapse is the fact, the experience that we have had in these 35 years, and that is that these control programs never reduced production and, therefore, removing them would not be expected to increase production.

There have been made many studies of this, and it is quite evident that the real cause of the surplus problem has not been the acreage either, whether it was what normally farmers put in or what they take out. The real cause of the surplus problem in the last few years has been the manipulation of prices and the assurance before the planting time that the price was going to be a certain level. It might have been a lower price than it would have been under the market, but it increased production because they knew ahead of time and they got the payments. Half the payments are made in the spring in time to buy fertilizer.

Now, proof that there would be no disaster? The best proof is that two-thirds of agriculture has been operating without Government subsidies, without any control programs, and under the handicap of having these programs transfer production and other disruptive effects into their production and markets as a result of the programs.

Chairman PROXMIRE. Was not a significant part of the purpose of supporting the 30 or 40 percent of the farm production which is under the program, to help support the other part of agriculture?

For example, as I understand it, beef and poultry, and so forth, are not directly controlled; they are not under the program. But, at the same time, the feed grain program would have a very direct influence on the price of beef, on the price of pork, on the price of poultry, and so forth.

Mr. SHUMAN. This has been the popular argument. But it has been a negative influence because if you take a look at the facts, the feed grain program caused a greater average production than was produced in the 5 previous years without any feed grain program. Of course, the additional feed you have produced, which was stimulated by the feed grain program, very seriously disrupts the livestock markets.

The soybean situation is another story. The cotton program has forced the transfer of resources from cotton into soybeans. The same is true, to some extent, with wheat in the feed grain programs.

So, I say the success of two-thirds of agriculture which has never had any programs, never had any subsidies, never had any price supports, despite the fact that these programs have channeled all these resources over to them, proves beyond any question of doubt that the cause of our serious trouble with agriculture today can logically be laid to the farm programs. The way to improve prosperity in agriculture is not to continue to do the thing that has got us into trouble.

After all, we have been trying to do that in the last 35 years, and particularly in the last 7 years we have gone all out for farm programs, and look where we are—73 percent of parity. It is time for a change.

Chairman PROXMIRE. My time is up. I will yield to Senator Jordan.

Before I do, Mr. Shafer wanted to make a comment, if that is all right with you.

Senator JORDAN. Yes.

Mr. SHAFER. I want to give an actual illustration from an actual farmer's standpoint as to why I think doing away with the programs would increase production.

The farm that I presently farm, my father farmed before me, and 30 years ago the average corn production on this farm was in the neighborhood of 35 bushels to the acre. Now, this did not happen overnight, but by using the increase in technology between then and now, my farm presently produces about 90 bushels of corn to the acre, on the average. Just the fact that we do away—let us say, I am producing 100 acres of corn. I have 100 acres that I can produce corn on. If I put 50 percent of that into the feed grain program, I am going to grow 50 acres of corn.

If I have no feed grain program I am very likely going to grow maybe not 100 acres but way up toward 100 acres of corn, and I do not think it is going to make 1 bushel per acre difference in the production on my farm if I do not have a feed grain program, or if I do, per acre.

So, it appears to me that on my farm there is going to be almost twice as much production of corn without a program as there is with a program. I just wanted to make this point as a farmer actually farming on a farm.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you.

I would like to find something that you would all subscribe to here. You have all stated, I think, the precarious position of agriculture in today's economy and implied that the farmer is the forgotten man in an affluent society.

This is a question I put to you: Do you know of any time in the entire history of the United States when so small a percentage of consumer disposable income is required to buy food for that consumer's family?

Chairman PROXMIRE. Mr. Graham?

Mr. GRAHAM. Not only in the history of the United States but in the history of the world. The production miracle of all time is here in the United States. It is the result of our technology. We have literally made cheap food available. It is not a cheap food policy, necessarily. It is a cheap production policy on the part of farmers and, thank God, they can do it.

The only problem is whether they should get paid on what they produce. The consumer never had such a break in all the history of the world. They have the highest quality of food, in the greatest variety, and at the cheapest prices that they have ever had and, frankly, I do not think the average consumer would raise very many objections to farmers getting a decent price, either.

Senator JORDAN. Mr. McDonald?

Mr. McDONALD. Well, I am completely—I am just trying to think of what to add to Harry's statement. I am in enthusiastic approval of what he has said.

I might add that food could be even cheaper if the middleman was not taking such a huge slice, and if you did not have, as you have in every market area in the United States, just about, the control of wholesale food prices by food chains.

Here in Washington, six chains control 90 percent of the food that is sold, and I am told that the direct buying now is taking the place of competitive terminal markets all over the United States. So that if the farmer had some kind of bargaining power, the consumer need not suffer.

The farmer could get a better price for his product, and slice off a little of this unnecessary middleman profit.

Chairman PROXMIRE. Mr. Shuman?

Mr. SHUMAN. I think you did hit on something we could all agree on and brag about, and that is the fact that in terms of the purchasing power of the consumer, in other words, measured on the basis of factory wages, average factory workers' weekly wages, the consumer spends less of his take-home income on food today than any time in the history of the country. I think it is around 17 or 18 percent. It has been dropping steadily.

I would want to point out that this is due primarily to the increased research and efficiency, due to the fact we have stayed competitive. There is no question but what the law of supply and demand still operates despite attempts to nullify it or do something else.

In fact, when programs are used to try to establish prices arbitrarily, whether by bargaining or by Government, you destroy markets, and the consumer will determine the price.

We might think as farmers that the housewife ought not to worry about a little increase in price of butter or milk or cotton goods, but when those prices do increase she looks for substitutes, and if we are going to continue to produce for consumers, we are going to have to meet competition. You cannot arbitrarily fix a price.

The cotton industry has lost about a third of its market because it decided to price cotton through Government edict without regard to competition. Within 10 years there will be no cotton industry in this country if we do not get rid of the cotton program.

Chairman PROXMIRE. Mr. Shafer?

Mr. SHAFER. I would agree that statistics show that food is cheaper in this country than it has been any time in the history of this country, and not only in the history of this country, but it is also cheaper in terms of time spent earning it here in our Nation than it is anywhere in the world or in the history of the world.

So far as I am concerned, I think that this is another place that the farmers have been partly asleep. I see no reason why we should let the nonessential industries of the country take over the spending power of the consumer. Actually it appears to me that the serious situation in agriculure and, as I have tried to outline earlier in my remarks, the seriousness that I believe is involved for the entire Nation, I believe that the entire Nation could well afford to move this percentage of their consumers' time that is spent for food back up a little to keep the family-type farming operation alive in this country.

I realize that the substitutes, and so forth, are somewhat of a problem. But I would like to state that food is food, and if you move from one commodity to another you may have a problem. But when you are dealing with all food items, the elasticity of the human consumption in this country is pretty constant.

In other words, we do not have much up and down in the amount of food that we as people eat. There is some change in which food items we might eat, according to price. But this gets back to our philosophy of bringing all prices up more or less in balance.

If this can be accomplished, I think we can reclaim some of the dollar market that we farmers have lost.

Senator JORDAN. Thank you.

Chairman PROXMIRE. That was a very good question, and I think the answers were excellent, and I am delighted to see this kind of consensus.

I would like to follow this up with a very closely related question, because it is one that I think is very troublesome for this Joint Economic Committee in recommending policy for the country.

Many of the witnesses who have come before us, administration and otherwise, have said the principal problem facing this country is inflation—rising prices. We know that one reason why prices did not increase more rapidly last year than they did was because farm prices were depressed. The farmer, in a sense, was kind of a hero in keeping prices down, but an unwilling hero and an unjustified one.

Mr. GRAHAM. Reluctant.

Chairman PROXMIRE. We do not want him to continue in that hero's mold.

My question is, To what extent in your view would more just prices for the farmer increase the cost of living for the American consumer?

Mr. GRAHAM. Well, that is taking a shot in the dark, I think. Would you mind if I would interject here something to say to Senator Jordan, that there is another area of agreement, and that is in opposition to increased protectionism. I think we are all in agreement on that one.

Chairman PROXMIRE. Yes, indeed. I went over that much too fast, but I think that is an excellent point. All four of you are agreed that we should have the freest possible trade, and you are opposed to restriction.

Mr. GRAHAM. Yes.

It depends on how much markup there is on the farm products. If we could get a markup on the basis of the actual increase in cost, there would be some increase in the cost of living, there is no question on this. But what is happening is that when we increase the price of milk by 3 cents, we increase the price of milk to the consumer by 5 cents, because the markup is on a percentage of the total instead of on the basis of the increase in cost. This is a traditional markup system on the part of most industries. Everybody uses it but agriculture, and we cannot do it very well.

The question really becomes more acute when we ask the question as to whether the rest of the increases in wages and profits are going to be based on any productivity standard whatsoever.

If we could have this kind of a relationship like the Council tried to have before where wage increases were tied somewhere to productivity, then this would not necessarily be extremely bad.

But, where we get into trouble is, each segment of the economy wants not to have equality but wants to have an advantage, and as long as this happens, then we are in trouble. If we go up to get any kind of equality, and labor and industry both are increasing their wages and their profits, then we just go around and around in a spiral. How we can do this is the great question in the world.

I listened in the FAO to the 120 nations reporting, and if there was one single thing they said over and over again it was that the major question was how do the farmers in their countries gain an equitable income in countries with expanding economies. Over and over the same thing is said.

Chairman PROXMIRE. Do you find, Mr. Graham, an inconsistent situation in which labor is organized, militant, effective, experienced and able to negotiate for a good wage; business, with some exceptions, is organized, effective, powerful politically, is able to get a price; the farmers are not organized at all, and one of the things—the impression that I got and, perhaps Senator Jordan did to some extent—while you gentlemen do agree on two points, you disagree on just about everything else, and we find this is so common among farmers. It is hard to get agreement, and if you do not get agreement it is hard to get organization, and if you do not have organization it is hard to have effective power, and if you do not have that it is hard to get a price.

Mr. GRAHAM. We have more agreement than this, really, with one exception, and all of us are out of step but Mr. Shuman.

Mr. SHUMAN. And we have got more members than all the rest of you combined.

Mr. GRAHAM. They may have better insurance salesmen than we have.

Mr. SHUMAN. That is part of it.

Mr. GRAHAM. But the fact is that we are in agreement. All the rest of the farm organizations, as far as I know, are in agreement with the continuation of the present farm program. We are all in agreement for a reserve, even to the point of agreeing on the exact language of the bill, and this is something when you get that kind of agreement, and agreement with the administration at the same time.

Now, this maximizes agreement. We are basically in agreement in terms of the bargaining bills, very little difference there. So, there are vast areas of agreement, except for this one point.

The problem is even if we could arrive at nirvana where we had, everybody was in agreement, and all belonging to the same organization, I do not know whether it would be Mr. Staley's or Mr. Shuman's, but someone would have to give at that point, and even if we did that, and could come effectively into a bargaining situation, I doubt that we could get public support to allow us to do the things that labor now can do, and whether we can even get legislation that would give us the power that labor has at the present time. I doubt it because I think there is enough opposition to some of the use of power that labor has at the present time that I doubt if the Congress would give us this kind of power.

So we are talking in terms of a never-never land to which I do not think we can get.

Chairman PROXMIRE. We will find out. This is the first time we have got a bill before us, to my knowledge, and it is a bill to which some of you have agreed; and Mr. Shuman, as a very significant and highly respected voice disagrees with, but I think there will be a real debate in Congress, and it is possible that some of it may be at least, in part, legislated.

Mr. McDonald?

Mr. McDONALD. Mr. Chairman, I would like to address myself to your original question about increasing prices to the farmer and how it would affect the consumer, and I am in agreement with Mr. Graham that there would be some increase, and there would be not a proportionate increase.

We have an example of that, or we had, a few years ago, 2 or 3 years ago, when dairymen were going out of business so fast that it was feared milk would have to be rationed during the next few years, due to low dairy prices and for other reasons.

So the Secretary of Agriculture increased the price on 100 pounds of milk, $1, about 2 cents a quart.

And over here in Baltimore the price of milk was increased about 6 cents a quart. The Federal Trade Commission made a survey and study showing that the price of milk—it was a situation on bread, too—the prices were just about doubled. The increases were just about doubled and tripled.

Whenever the farmer gets 2 cents, he gets incidentally 2 or 3 cents out of a bushel of wheat; whatever it is, very little, why, the bakers would go ahead and double and triple the wholesale price increase.

In regard to inflation, it seems to me that the last few years it is a profit inflation. It seems to me that the interest crisis is a war inflation. The war-affected industries have chased after dollars and goods on that side of the economy so that they have caused inflation.

Over here you have poor agriculture and housing in a state of depression, who could not benefit from this increased prosperity.

When Ralph Nader comes up here and gets safety provisions in the bill—at least he was important, I guess, in the propaganda that led to this—the automobile industry now is refusing to sell automobiles to the Government, according to Drew Pearson this morning. At least the Big Three are refusing to sell automobiles, because of the safety features required. They have to reveal certain facts if they sell these automobiles and trucks to the Government.

So you have sort of a conspiracy in the durable goods industry. They raise their prices disproportionately.

When labor gets—this has been proved over and over—when wages increase, when labor gets their wage increase, then they are doubled, they are pyramided; and, getting back to the point I made a while ago, I think we should have these profits, the highest in history, exorbitant profits up to 25, 30 percent after payment of taxes, and I think we should have excess profits legislation. I do not think that the people sitting in this room should have to pay almost entirely for this war. I think big industry should have to bear a large part of the burden.

Chairman PROXMIRE. I just have one more question, and this is to Mr. Shuman.

Mr. Shuman, you make a very interesting proposal for dollar-for-dollar tax credit to the States for their income taxes, sales taxes, and corporation income taxes.

I compute that, on the basis of the present taxes paid by the States, this would mean a credit of $30 billion. Maybe it would be somewhat less than that, because some people would not be in a position to claim it. Total Federal grants are only $15 billion.

It seems to me if you go through with that resolution, and I presume you might agree to some refinements or limitations on it, you are pretty much asking the States just to back up their trucks to Fort Knox or the Treasury and cart off as much as they want; because what they can do is to have an income tax that would match the Federal income tax, which would be fantastically burdensome, of course. It would not increase the taxes paid by any of the residents because the residents would get a dollar-for-dollar offset through the income taxes they would not then pay to the Federal Government.

But this, of course, would tremendously diminish revenues to our Federal Government. In fact, it would wipe out corporate and personal income tax, and then some, because in addition to that, of course, you would have sales tax offsets.

I just wondered if there should not be some limitation on the enthusiastic resolution that the Farm Bureau has.

Mr. SHUMAN. Well, I think there would be in practical application. Certainly we would not advocate a tax credit without a matching amount of transferred spending responsibilities. In other words, if the Congress aprpoved a tax credit then we would, of course, expect Congress to discontinue the appropriations for welfare, education, any anything else which they thought was, could be, covered by this corresponding gain by the States.

Chairman PROXMIRE. But, as I pointed out, your tax credit right now, if it is on a dollar-for-dollar basis, would be $30 billion, and the grants—all grants—are only $15 billion.

Mr. SHUMAN. That is right.

Well, there are other grants besides education and welfare, and undoubtedly there would be limitations placed on it by the Congress as to whether or not they were going to transfer more of the Federal grants in aid or other programs besides the $15 billion of basic grants. That comes to around $15 billion, I think.

Chairman PROXMIRE. Well, perhaps the figures we have are incomplete.

(The following supplemental explanatory information on the proposal was subsequently received for the record from American Farm Bureau Federation representatives:)

REGAINING CONTROL OF FEDERAL EXPENDITURES

One of the most urgent problems facing America today is the question of how to deal with the ever increasing federal budget. For a number of years Farm Bureau has felt that the *financing* and *control* of welfare programs and public education should be returned to state and local governments. Recent expansion of welfare programs and federal aid to elementary and secondary schools underscores the need for a change in direction. With federal funds goes federal control—more federal funds, more federal control.

With this in mind, delegates to the American Farm Bureau Federation annual meeting in December, 1967, adopted a policy calling for taxpayers to receive dollar-for dollar credits against their federal income tax liabilities for state, corporate, and individual income taxes and general sales taxes paid. The policy calls for these credits to be used *by the states* to provide the tax base necessary for state and local governments to assume the *full authority and responsibility for costs* and administration of basic welfare and elementary and secondary educational programs.

Using 1966 figures, the latest available, this is how the proposal would work. In 1966 more than $14.2 billion was paid to states in the form of individual income taxes, corporate income taxes and sales taxes. Federal support for basic welfare and elementary and secondary school programs amounted to $5 billion, which is approximately 35 percent of these state taxes. For states to assume this $5 billion in costs, a 35 percent credit for state taxes paid would be needed ($5 billion is approximately 35 percent of $14.2 billion).

The following table shows the program's effect on an individual now paying $2,500 in federal and state taxes. By taking a credit of $175 against his federal liability (35 percent of $500) he would reduce his present $2,000 federal tax payment to $1,825. At the same time, his state taxes could be raised to $675 ($500+$175) to fully support basic welfare and elementary and secondary school programs at state and local levels. His total tax liability would still be $2,500.

	Present system—Taxes paid	New system—Federal credit, higher State taxes	New system—Taxes paid
Individual State income and sales taxes paid	$500	$500	$675
State tax increase to pick up 35 percent credit	None	+175	
Individual Federal income tax liability (gross)	2,000	2,000	1,825
35 percent Federal credit for State income and sales taxes	None	—175	
Total individual tax bill	2,500		2,500

FEDERAL PAYMENTS TO STATE AND LOCAL GOVERNMENTS, AND INDIVIDUALS AND PRIVATE INSTITUTIONS, BY STATE, FOR 1966, FOR ELEMENTARY AND SECONDARY EDUCATION, AND GENERAL WELFARE

State	Education [1]	Welfare [2]	Total
Alabama	$45,393,394	$98,509,446	$143,902,840
Alaska	12,491,740	3,035,141	15,526,881
Arizona	21,701,301	23,336,124	45,037,425
Arkansas	23,932,648	58,913,692	82,846,340
California	132,840,505	583,055,676	715,896,181
Colorado	22,382,239	55,375,715	77,757,954
Connecticut	12,410,346	41,458,627	53,868,973
Delaware	2,395,680	5,307,520	7,703,200
Florida	41,320,409	90,342,762	131,663,171
Georgia	47,690,499	100,366,922	148,057,421
Hawaii	11,347,729	8,982,728	20,330,457
Idaho	5,986,728	10,571,785	16,558,513
Illinois	49,173,001	164,211,175	213,384,176
Indiana	26,681,970	33,663,110	60,345,080
Iowa	20,343,929	41,180,146	61,524,075
Kansas	19,675,384	36,523,607	56,198,991
Kentucky	25,297,234	76,761,242	102,058,476
Louisiana	12,444,133	148,332,345	160,776,478
Maine	8,320,108	17,336,383	25,656,491
Maryland	29,812,986	47,013,765	76,826,751
Massachusetts	23,740,016	115,151,578	138,891,594
Michigan	37,264,863	112,490,931	149,755,794
Minnesota	14,385,315	77,448,590	91,833,905
Mississippi	22,722,553	51,438,598	74,161,151
Missouri	28,586,077	103,496,333	132,082,410
Montana	7,096,066	9,492,008	16,588,074
Nebraska	11,744,445	20,100,719	31,845,164
Nevada	5,859,751	5,165,496	11,025,247
New Hampshire	4,230,427	5,581,229	9,811,656
New Jersey	41,524,780	63,962,317	105,487,097
New Mexico	19,899,205	22,829,204	42,738,409
New York	80,582,544	376,953,071	457,535,615
North Carolina	45,831,935	84,848,088	130,680,023
North Dakota	7,195,705	12,390,373	19,586,078
Ohio	46,165,553	123,832,005	169,997,558
Oklahoma	31,264,094	114,789,897	146,053,991
Oregon	11,773,284	30,902,009	42,675,293
Pennsylvania	43,632,992	180,885,408	224,518,400
Rhode Island	8,071,820	18,528,852	26,600,672
South Carolina	24,520,645	29,545,372	54,066,017
South Dakota	8,838,389	10,958,490	19,796,879
Tennessee	41,077,781	65,307,868	106,385,649
Texas	89,832,479	192,590,261	282,422,740
Utah	11,096,056	16,476,664	27,572,720
Vermont	2,278,581	7,565,318	9,843,899
Virginia	36,744,585	33,599,219	70,343,804
Washington	21,130,945	62,140,239	83,271,184
West Virginia	20,028,510	48,065,308	68,093,818
Wisconsin	13,498,394	49,533,895	63,032,289
Wyoming	3,610,676	3,995,568	7,606,244
Adjustments or undistributed to States	229,250	−4,320,704	−4,091,454
U.S. totals [3]	1,365,279,348	3,725,644,201	5,090,923,549

[1] The figures in this column represent total Federal aid payments to State and local units of government under programs for assistance to public school construction, defense educational activities, elementary and secondary educational activities, equal educational opportunities, maintenance and operation of schools; and Federal aid payments to individuals and private institutions in the States under programs for defense educational activities.

[2] The figures in this column represent Federal aid payments to State and local units of government under programs of the Vocational Rehabilitation Administration and for public assistance from the Welfare Administration's Bureau of Family Services; and payments to individuals and private institutions in the States through the Vocational Rehabilitation Administration.

[3] Includes District of Columbia, Puerto Rico, Virgin Islands, American Samoa, Guam, Trust Territory of the Pacific, and certain foreign countries.

Source: 1966 Report of the Secretary of the Treasury, table 84, pts. A and B.

STATE REVENUES FROM SELECTED TAX SOURCES, BY SOURCE AND STATE, 1966

[In thousands of dollars]

	General sales or gross receipts [1]	Individual income	Corporation net income	Total, 3 sources
All States	7,893,187	[2] 4,302,842	[2] 2,036,550	14,212,579
Alabama	166,729	53,294	22,890	242,913
Alaska		19,238	4,105	23,343
Arizona	96,171	21,702	13,379	131,252
Arkansas	84,415	27,423	20,848	132,686
California	1,099,383	454,313	433,825	1,987,521
Colorado	98,735	70,287	24,759	193,781
Connecticut	136,389		67,959	204,348
Delaware		49,934	12,991	62,925
Florida	283,050			283,050
Georgia	227,205	80,291	59,288	366,784
Hawaii	93,499	47,349	9,950	150,798
Idaho	28,399	29,204	8,493	66,096
Illinois	669,508			669,508
Indiana	282,318	143,678	14,248	440,244
Iowa	114,027	86,802	7,793	208,622
Kansas	113,406	72,805	22,736	208,947
Kentucky	126,880	69,747	36,253	232,880
Louisiana	139,425	30,455	31,766	201,766
Maine	52,315			52,315
Maryland	127,277	159,910	32,729	319,916
Massachusetts	16,534	253,893	[3] 49,830	320,257
Michigan	657,708			657,708
Minnesota		221,276	75,298	296,574
Mississippi	121,039	9,710	15,849	146,598
Missouri	243,756	82,149	11,161	337,066
Montana		21,111	6,958	28,069
Nebraska				
Nevada	23,419			23,419
New Hampshire		2,289		2,289
New Jersey		9,731	42,916	52,647
New Mexico	66,977	[2] 19,051	([2])	86,028
New York	298,437	1,285,881	392,358	1,976,676
North Carolina	188,246	165,070	90,481	443,797
North Dakota	23,561	9,222	3,054	35,837
Ohio	354,221			354,221
Oklahoma	74,129	30,344	22,323	126,796
Oregon		147,367	31,076	178,443
Pennsylvania	599,329		229,088	828,417
Rhode Island	45,719		14,715	60,434
South Carolina	106,119	52,928	36,483	195,530
South Dakota	26,915		586	27,501
Tennessee	177,717	8,216	38,032	223,965
Texas	240,823			240,823
Utah	53,774	38,031	8,008	99,813
Vermont		21,574	4,116	25,690
Virginia		165,171	47,864	213,035
Washington	384,362			384,362
West Virginia	120,564		23,729	144,293
Wisconsin	92,132	319,667	92,342	504,141
Wyoming	18,575			18,575

[1] Excludes motor fuel and other selective taxes.
[2] For New Mexico, combined corporation and individual income taxes are tabulated with individual income taxes.
[3] Excludes portion paid on corporate excesses.

Source: "Compendium of State Government Finances in 1965," Bureau of the Census, U.S. Department of Commerce.

Mr. SHUMAN. Could I make one comment further on the previous question which the other two gentlemn discussed?

Chairman PROXMIRE. Yes.

Mr. SHUMAN. It is not particularly different. It is true, of course, that an increase in farm prices, a fairly significant increase in farm prices, if directly transferred to consumer prices, would be rather small.

But the point, the main point, that most people miss in making this argument is that farmers in most cases do not sell directly to the consumer. We sell to manufacturers and to processors, and when we sell corn or cotton or wheat to a manufacturer, we are selling in competition with other products which many times can be substituted.

This is what happened with the cotton farmer. All over the South I saw these little demonstrations where they held up a man's shirt and said the cotton in this shirt only cost so many cents. If cotton is raised from $20 a bale to $30 a bale it will only increase the price of that shirt by 2 or 3 cents. I am sure Senator Jordan remembers those demonstrations.

It was this kind of philosophy, it is this kind of philosophy, that is destroying the cotton industry, because you do not sell cotton directly to consumers, you sell it to shirt manufacturers, and when they found the price of cotton went up compared to the synthetics, they bought the synthetics.

Chairman PROXMIRE. It is a very good point, but you are picking the nonfood segment of agriculture.

Mr. SHUMAN. You can take the food section and take milk, because today if we insist on pricing milk without regard to competition we are going to find synthetic milk made out of soybean protein or something else replacing the natural product, not because the consumer——

Chairman PROXMIRE. You touch me in a tender spot, Mr. Shuman, I must say.

Mr. SHUMAN. Well, thank you.

Chairman PROXMIRE. I want to thank you gentlemen for being a very, very stimulating panel. It has been a most interesting afternoon and a fine contribution to the Joint Economic Committee's study. We thank you very much.

The committee will stand in recess until Monday morning at 10 o'clock.

(Thereupon, at 4:10 p.m., a recess was taken in the hearing to reconvene at 10 a.m., on Monday, Feb. 19, 1968.)

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 19, 1968

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

The Joint Economic Committee met at 10:05 a.m., pursuant to recess, in room S–228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Miller, Jordan, and Percy; and Representatives Boggs, Curtis, Widnall, Reuss, and Rumsfeld.

Also present: John R. Stark, executive director; and John B. Henderson, staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

The committee devotes this morning and afternoon to hearings on the international economic position of the United States, one of the most serious and perplexing issues of the time. Our witnesses this morning are three outstanding students of the subject. They are distinguished in their achievement and distinguished from each other by the diversity of their experience. First, Fritz Machlup, Walker professor of economics and international finance, Princeton University. Professor Machlup's own writings in the notable papers written for his international finance section of the Princeton Economics Department have brought him worldwide renown. He has recently held the presidency of the American Economic Association. With his wit and wisdom, and Viennese gaiety, economics can never be a dismal science.

Next, Prof. Jack N. Behrman, professor of international business, University of North Carolina. Professor Behrman had close experience with the problem of international development when he was Deputy Assistant Secretary of Commerce for International Affairs in the early 1960's. His challenging views on the payback process arising from U.S. investments abroad are well known and most appropriate.

Third, Mr. William F. Butler, vice president and director of economic research at the Chase Manhattan Bank. Mr. Butler enjoys a well-deserved reputation as one of the wisest of commentators in economic affairs in the banking community. His range is far wider than today's topic. Most recently he has given his views on the role of gold in world monetary affairs in a brilliantly written article in "Foreign Affairs."

We will begin with Professor Machlup; he has been invited by the committee to give a broad assessment of the international situation.

STATEMENT OF FRITZ MACHLUP, WALKER PROFESSOR OF ECONOMICS AND INTERNATIONAL FINANCE, PRINCETON UNIVERSITY

Mr. MACHLUP. Thank you, Chairman Proxmire.

Chairman PROXMIRE. I might interrupt by saying, Professor Machlup, I have not had a chance to see your statement. I understand you put it in the mail on Friday. But I would appreciate it if you gentlemen would confine your statements to 15 or 20 minutes, if you could. Of course, your entire statement will be filed in the record in full and made available to members of the committee and the Congress. We would like, if possible, to have as much opportunity as we could for questioning and discussion.

Mr. MACHLUP. Yes, sir; I have a prepared statement which I herewith offer for the record. I prefer not to read it to you, but to speak freely. I shall try to summarize in 15 or 20 minutes the highlights of my analysis.

Chairman PROXMIRE. Very good.

Mr. MACHLUP. We have become accustomed to discuss the problems before us under three headings: the problem of liquidity; that is, the adequacy of an annual increase in reserves; the problem of adjustment, that is chiefly the balance-of-payments problem of the United States; and the problem of confidence, which is essentially the problem of switches between dollars and gold.

The problem of liquidity, I think, has been nicely and neatly solved through the agreement in Rio de Janeiro. Unfortunately, the prospects of early activation do not seem to be too good, and for that we must blame partly our own tactics. I think it was a tactical error to give priority to the problem of liquidity and not discuss, or not include in the discussion, the problems of adjustment and of confidence.

We brought the other countries to the negotiating table by telling them: "Of course, this is only a contingency plan and we will first solve our adjustment problem." But we have never made any real efforts to do that; and this is quite easy to explain, for we cannot alone and unilaterally by politically accepted methods succeed in achieving adjustment. Yet it was a tactical error. Good strategy would have been to discuss all three problems at the same time. Perhaps, if any one problem should have gotten priority, it would have been the problem of confidence, the problem of avoiding the destruction of reserves. After all, it is illogical to try to devise a system by which reserves can be increased, but not devise a safeguard against the wholesale destruction of reserves—and the problem of confidence is exactly that.

I would like to congratulate the men who have contributed to the solution of the problem of liquidity. They did a spendid job. Unfortunately, it does not help us now in our predicament.

I propose to discuss first the problem of adjustment. To my regret, I must be highly critical of what our administration has been trying to do. As a matter of fact, we have done nothing toward solving the problem of adjustment in the strict sense of the word. There is widespread misunderstanding: The terms "adjusting something" and "tinkering with something" are being confused. We have been tinkering all along, but have done nothing that deserves to be called adjustment.

Let me explain what adjustment means. It is an economic term, and it needs explanation. Otherwise we do not understand one another.

Adjustment means that the deficit countries reduce their income and price levels relative to the surplus countries. This can be done in three ways: One, by deflation in the deficit country, which I believe no man in his senses will propose.

Secondly, by inflation in the surplus countries, which these countries do not want to do—and I doubt that they will do us this favor.

Thirdly, by an adjustment of the exchange rates, the rates by which price and income levels, expressed in different currencies, are being compared.

There are no other ways of adjustment. Everything else is tinkering, or expressed more politely, attempts to correct the balance of payments. All sorts of measures are used as correctives. We must distinguish, before all, measures that work only temporarily, and measures that work in the long run. None of the measures that we have taken or are proposing can work in the long run. They are all temporary measures. It is as if a pipe were leaking and we take our thumb and hold it over the leak. As soon as we remove the thumb, the leaking goes on.

This is not to be confused with adjustment. Perhaps we can clarify this by another example. If you see that you are bleeding from your finger and you put a bandaid over it, you stop the bleeding and there is hope that the skin will heal. And, if you remove the bandaid after awhile, maybe you won't bleed any more. But, what we have been doing to the balance of payments is not of that self-healing type. It is only of the thumb-holding type. This is why I say that no attempt at adjustment has been made or proposed.

Let me read a quotation from someone who understands a good deal of these things, about the problem of restrictions on capital movements. I read it first and shall name the source afterwards.

> Imposition of capital controls by the United States would not be a satisfactory solution. It would be contrary to all that we have been striving for in freeing trade and payments between countries. It would not be in keeping with our special responsibilities as custodian of a reserve currency, and it would be contrary to our long-run interest in ensuring that funds move to where they will be used most productively.

This statement is by Secretary Dillon, and it was made in 1962. He was right then and he still is right. I shall explain presently why restrictions on capital movement are probably ineffectual and, to the extent to which they are effectual, why they are not of the type that will bring about an adjustment. They amount to holding the thumb over a leak.

But there is also the idea of restrictions on foreign travel. On this I have more to say, though it may be a bit emotional. I have been brought up in Central Europe, and I know this type of restriction. I would never have believed that this country could sink so low as to restrict foreign travel. Whether a tax on travel expenditures will be effective or not, I cannot tell. It can be easily evaded. It will probably lead to reduced tax morality, and this can then spread to the income tax. This country has much higher tax morality than practically any other country, perhaps, with the exception of Britain. But tax morality can be undermined, and if you introduce a tax that is considered unethical, or immoral, then the people's tax morality may be permanently lowered.

Moreover, if you do restrict foreign travel and the restriction is successful, it will be successful only while the restriction is in effect. As soon as you take it off, you are back where you were. This is not a method of curing a balance-of-payments deficit. This is not an adjustment measure.

You will ask me why restrictions on capital movements may be ineffective. They may be ineffective for several reasons. First, there is always the question of substitution, substituting one kind of capital movement for another. Every economist ought to know it, and I said it when we introduced the interest equalization tax, the tax on buying foreign securities. It was quite clear that capital outflow would simply take another form, and so it did. Thereafter we introduced the voluntary program restraining bank lending. Then we introduced the voluntary program restraining direct investment. There are always ways of substitution. Thus, if you really are successful in restricting the outflow of American capital, you cannot restrict the outflow of foreign capital from the United States, and this is exactly what will happen.

This is an easy way of substitution. If, for example, our own firms borrow in Europe, the rates of interest there will increase, and Europeans take back their capital from the United States. It can be done in various ways. Assume that an American firm issues securities in Europe. These securities will have to be offered at somewhat favorable prices. Otherwise you cannot sell them. Foreigners will subscribe to these issues, but sell at the same time some of their holdings of American securities in the New York stock market, and bring back the proceeds from their sales. In other words, American funds, not European funds, will have financed our sale of securities in Europe.

There are always many possibilities of substitution. But even if there is no substitution, there is always the possibility of repercussions on other items of the balance of payments. If total spending in Europe is reduced—and after all, a firm that does not receive capital will spend less—Europeans will buy less and import less. If total spending in America is increased—and, after all, a firm that does not invest in Europe will probably invest a little bit more in the United States—we shall find that this increases our imports and reduces our exports. As a result a part of the whole effectiveness will be whittled away by offsetting changes in the balance on current account. We shall find our exports reduced and our imports increased.

I do not say that this will be 100 percent of the amount saved directly by the restraint, but it may be a large part of it. With both substitution and repercussion at work, it is quite possible that you will find the results quite disappointing, apart from the fact that the whole thing is only temporary, and as soon as you lift the restrictions, you will be back where you were. In other words, this is not a program of adjustment. This is only tinkering and, unfortunately, tinkering with little hope of success.

I would like to comment on one type of corrective that has become quite customary in the United States; namely, disguised partial devaluations of the dollar. We have used this technique three or four times in the last few years. We started in 1960, when we devalued, in effect, though not formally, the military-expenditures dollar. The Department of Defense told the military that they must buy American whenever the cost of buying here, calculated at the fixed exchange rate, is not more than 25 percent, later raised to 50 percent, higher than what they would have to pay in Europe. The effect of this is that the Armed Forces must calculate as if the exchange rate were really 25 or 50 percent different from what it actually was; that is, a disguised devaluation.

The next disguised partial devaluation was that of the foreign-aid dollar. It was done by our forcing the aid recipients to buy in America, even if the prices here were higher than elsewhere; they had to do that even if they lost up to 30 percent. So we have devalued the foreign-aid dollar.

Then we had the partial devaluation of the dollar that was used for buying foreign securities, the 15 percent tax. And now you consider introducing the partial devaluation of the tourists' dollar. I hope you won't introduce it, but will reject this plan. And there are proposals that we should have still other partial devaluations through surcharges on certain import duties, and through similar arrangements.

All this is very inefficient and partly ineffectual. It is discriminatory. It distorts the allocation of resources. It is a poor way of doing things.

If it were possible to make these devaluations general, even if it were in the form of taxes, you might say that is all right. If all imports were taxed by the same percentage, and if all exports got a subsidy by the same percentage, the same for all foreign transactions, then you would have something. But this is technically not practicable, and the only practical way of doing it is to change the exchange rates between the dollar and the currencies of the surplus countries.

Let me come to the problem of confidence. This problem seems now almost insoluble. I shall quickly mention five approaches that have been proposed or may be proposed.

The first approach is to make the dollar so scarce that people no longer want to switch from dollars into gold. This is out of the question, because the expected scarcity of gold is so much that, in order to make the dollar equally scarce we would have to adopt a deflationary program that would be a catastrophe for the United States as well as for foreign countries.

The second possibility is to raise the price of gold by 100 percent or something like that. I think it would be most dishonest if we did this, and it would also be most injurious for the whole world, because the inflationary consequences would be serious. Even if the profits made by central banks and other monetary authorities could be sterilized, you cannot sterilize the profits made by the speculators. They would sell their gold at the increased prices to the monetary authorities. There would be an avalanche of new money all over the world, with prices and incomes rising everywhere. I must warn against this approach, and I hope that our Congress will never think of doing anything of the sort.

Approach No. 3 is the so-called harmonization of reserves. This means to negotiate with monetary authorities that they agree not to convert the dollars they hold. The dollars would be locked-in by the monetary authorities agreeing to hold dollars in certain proportions or in certain minimum amounts. However, this could not work unless you have at the same time also a really workable gold pool, which you do not have now. The present gold pool, with seven countries participating, operates at the expense of the U.S. gold holdings. I doubt that effective harmonization agreement can be negotiated now. It would have been possible 2 or 3 years ago. Unfortunately, that opportunity was missed.

Approach No. 4 is the one that I regard as the best one, from an economic point of view. The most workable plan would be to pool all gold holdings and all foreign-exchange holdings in an international pool, perhaps maintained by the International Monetary Fund. The present danger is that dollars will be exchanged into gold, and the dollars thereby wiped out. I want to safeguard against this by an agreement under which all countries deposit their gold and their dollars and pounds in a central pool, maintained by the International Monetary Fund, and replace their reserve assets with the new deposits with the fund. These deposits would then be international reserve, and the central banks would hold no gold, no dollars, and no pounds.

This plan could not be negotiable except with certain provisions reassuring to some distrustful nations. First, the gold must not be held entirely on American soil. Otherwise the plan would not be credible. You would have to deposit some of the gold on French soil and perhaps some on other countries' soil.

Secondly, there must be no increase in dollar holdings or pound sterling holdings either by the new account of the International Monetary Fund or by any central bank. That means we must give up any attempt to finance a future payments deficit by accumlations of dollars by monetary authorities.

Well, whether this plan would be negotiable or not I do not know. I believe it could be negotiable if we proceeded skillfully. But if it proves not to be negotiable, I see only one way out, and that is the fifth and last approach, to cut the link between dollar and gold.

The aim is to avoid that, in a series of gold rushes and dollar crises, too many dollars are turned in against gold. If we cut the link, it would be a meaningful way of achieving the aim. Of course, the Europeans won't like it, but we should first offer them a chance to accept a better alternative. My plan No. 4 would be much better, and it is only with genuine regrets that we should resort to No. 5. But if No. 4 is not negotiable, then No. 5 is the only way out.

The other countries would have three possible reactions that we would accept with equal pleasure. They could say, "We stick to the present exchange rates, we do not want the dollar to be devalued." In this case, they would have to purchase and hold dollars, and we should have no objection to that if the dollar is no longer convertible into gold.

The second type of reaction—some countries could devalue the dollar in terms of their own currencies. They could say, "No, we do not want to buy too many dollars. Hence, we shall pay less for the dollar. We devalue the dollar by 5 percent, 8 percent, perhaps 10 percent." This would be all right for the United States, since it would help adjust the balance of payments. We should have no objection to that.

The third possibility is for countries to say, "We do not want to buy any more dollars and we do not want to fix the new price for the dollar. We do not know what the right price would be. We shall, therefore, let the exchange rate float." Again, I think this would be a very good solution, and we certainly should not mind. Perhaps they would prefer not to let the dollar float without any limits, but they could arrange for upper and lower limits if they so desired.

These are the three attractive possibilities, but unfortunately there is a fourth possibility, which they could choose. They could say, "We shall keep the dollar rate fixed for current-account dollars. We shall devalue the dollar or leave it float if it originates from capital transactions." Such a multiple-rate system could be enforced only through foreign-exchange restrictions on their part. Such a raction would be deplorable. I wouldn't like it, but I would rather have other countries impose foreign-exchange restrictions than the United States. Hence, from our point of view, this reaction would still be preferable to our own program of restrictions.

Senator, I think I have exceeded the time that you have allotted me, and I can only hope that your questions will give me an opportunity to expatiate on some of these issues. I thank you very much for your attention.

(Professor Machlup's prepared statement follows:)

PREPARED STATEMENT OF DR. FRITZ MACHLUP

Mr. Chairman and Members of the Joint Economic Committee, you have invited me to present, in these hearings on the 1968 Economic Report, my views on the international position of the United States. I have accepted with pleasure and especially appreciate that you encouraged me to include in my testimony historical as well as analytical aspects.

THE THREE PROBLEMS

It has become customary to divide discussions of the international monetary situation into three problems: liquidity, confidence, and adjustments. All three have to do with international monetary reserves.

The problem of liquidity is concerned with the adequacy of the combined total of reserves held by all national monetary authorities and with the capacity of the international system to provide for sufficient annual increases in total reserves.

The problem of confidence is concerned with the danger that holders of monetary reserve assets alter the composition of their holdings and in the process destroy large parts of the existing reserves.

The problem of adjustment is concerned with the distribution of reserves among various countries and especially with the reversal of such imbalances of payments as would result in persistent losses of reserves in particular countries.

Experts have for years debated the relative importance of the three problems. My own view has been that they should all be taken care of at the same time. Our Government, regrettably, has insisted on giving priority to the problem of liquidity. A very neat solution has been found for it. The agreement signed in Rio de Janeiro last September provides for a novel, but well-designed mechanism for creating and distributing new reserves in the form of Special Drawing Rights. We hope that this agreement will be ratified soon and then activated without delay.

Unfortunately, there is some danger of considerable delay in its activation. Our own declarations of intentions have contributed to this danger in that we have repeatedly stated that the creation of new reserves can be postponed until we have solved our balance-of-payments problem. If this has seemed to be clever tactics in order to get other nations to negotiate on the contingent creation of additonal liquidity, it probably was poor strategy. For it is difficult and perhaps impossible to remove our payments deficit in the near future. Yet, postponing the activation of the new scheme for the creation of liquidity will make it more difficult to restore balance in international payments. We should have tried to negotiate on all aspects of international monetary arrangements so that we would not be fouled up now in this vicious circle.

The worst part of the vicious circle lies in the problem of confidence. Too many people believe that there will be a scarcity of gold and an abundance of dollars. Of course, nothing can be scarce or abundant except at a given price ratio. If expectations concerning relative scarcities change, but a fixed price ratio is maintained, an untenable situation arises. This is a very old experience, commonly known as Gresham's Law. (Gresham died in 1579.)

If any of the three problems deserved priority, it would have been the problem of confidence. How illogical it is to design a system that provides additional reserves but makes no provisions to safeguard against the destruction of existing reserves.

I shall present my views on the position of the United States regarding all three problems. I shall follow the example of the Council of Economic Advisers and begin with the problem of adjustment.

The Adjustment Problem

The Report of the Council discusses this problem under two headings, "Adjustment Process" and "The U.S. Balance of Payments." Their analysis of the problem suffers from a failure to distinguish different kinds of approach to the problem of reducing or removing an imbalance of international payments.

They do distinguish "temporary measures" from policies that are "long term in character," but this leaves open the question whether the temporary measures have only temporary effects or long-lasting effects. If I discover a leak in a pipe and press my thumb against the hole, this is a temporary measure with only temporary effect: as soon as I remove my thumb, the leaking resumes. If I discover a bleeding cut on my finger and put a band-aid over it, this temporary measure may have lasting effects, because the wound may heal, the lesion of my skin disappear. The difference between these temporary measures is essential; to call both of them "leak-stopping policies" and be silent on the question whether they are palliatives or cures is not very helpful.

For some 250 years economists studying international finance have known the process of economic adjustment that would remove imbalance and restore balance. This adjustment involves changes in relative prices and incomes in the countries concerned, resulting in changes in the allocation of productive resources and in the international flow of goods and services. The process had originally been conceived as an automatic one, but it can be fully automatic only under monetary institutions that no longer exist. Hence, deliberate adjustment policies are now required to produce the effects which the conceivably automatic mechanism would have produced. These policies do not, however, include every type of measure, including direct controls, that may be instituted for the purpose of removing a payments deficit.

In medicine, no one would doubt for a moment that there is a difference between a surgical operation or some other painful treatment and a disappearance or removal of the need for it. There may be some alternative therapeutic techniques that could remove the need for the painful one; or perhaps the afflication may disappear all by itself. The same possibilities exist for balance-of-payments troubles: with luck, the troubles may go away or some other therapy may make it unnecessary to go through the operations which economists have called the adjustment process. I use the term "compensatory corrections" or "correctives" to indicate those things that are considered as alternatives to the adjustment process.

Reducing the Payments Deficit: Alternative Methods

We need even more distinctions. There are measures that do not remove deficits but facilitate financing them. For example, if an increase in interest rates attracts short-term capital from abroad, one may not want to regard this as a credit item in the balance of payments that removes a deficit, but may prefer to regard as a temporary stopgap, a way of financing an existing deficit for a while. (As soon as the attractive interest differential is terminated, the inflow of short-term capital will stop and what has been received will flow back.) In addition, we should separate measures that work on the flow of goods and services from those that work on the flow of capital funds. The adjectives "real" and "financial" can be used for this purpose.

We thus distinguish real adjustment, real correctives, financial correctives, corrective management of government transactions, and external financing.

To *finance* a deficit is to pay for it by reducing the net monetary reserves or by increasing liquid liabilities to foreigners incurred just for this purpose. (If an increase in foreign liabilities arises from an increased foreign demand for dollar balances and other dollar assets, it should be treated as an autonomous capital inflow, as a debt incurred in order to finance a deficit. Unfortunately, we usually lack the information required for this distinction.)

To reduce or remove a deficit by *real adjustment* is to induce such changes in relative prices and incomes as will alter the allocation of real resources and cause such changes in the international flows of goods and services as will improve the current account to match the balance on capital account and unilateral payments. We distinguish aggregate-demand adjustment, cost-and-price adjustment, and exchange-rate adjustment.

Real correctives influence the international flow of goods and services through selective impacts on particular goods, industries, or sectors. *Financial correctives* influence the international flows of private capital funds. *Corrective management of government transactions* may affect government expenditures, loans, and grants to other countries.

REAL ADJUSTMENTS

Economists trained in the classical or neoclassical tradition—the present writer included—have a deep-seated prejudice in favor of real adjustment: (1) It relies largely on market forces rather than selective "interventions" by the state; (2) it is more likely to operate without discrimination, avoiding differential treatment of particular industries or firms; and (3) the chance of its working, of achieving its objectives, is greater.

On the other hand, practical-political considerations militate against real adjustment: (a) Policies to check the expansion of aggregate demand are apt to reduce business activity and employment; (b) policies to check increases in wage rates and prices are resented by some of the strongest groups in society; and (c) policies to adjust foreign-exchange rates are opposed by leaders in business and finance, here and abroad, for reasons good and bad; most understandable is the opposition abroad to a successful adjustment in the flow of goods and services, since it would hurt the business of some of the industries abroad.

Aggregate-demand adjustment is not without advocates among practical men: some highly respected bankers here and abroad advise the United States to "put its house in order" and "halt inflation;" and they intimate that this can be done by means of higher interest rates, higher taxes, and economies in government programs.

Their practical advice is unexceptionable if it refers merely to avoiding inflation of incomes and prices. As a matter of fact, high interest rates, higher taxes, and budget cuts are badly needed to prevent a further deterioration of the imbalance of payments. But it would be far too optimistic to expect that containment of further expansion would restore external balance, especially since the major industrial nations of Europe are likewise pursuing anti-inflationary policies, some even more successful than the United States.

If the conservative advice goes beyond mere avoidance of inflation and suggests in effect that aggregate demand in this country be *reduced* to such a level that our imports fall and exports rise sufficiently for the export surplus to match all other outflows of dollars—then the advice is not acceptable. A deflation of such force could have well-nigh catastrophic consequences for domestic employment and world trade.

Real adjustment by means of demand deflation in the United States is out of the question; adjustment by means of demand inflation abroad is not likely to be accepted, nor would it be advisable. Now, if the adjustment of levels and structures of costs and prices cannot be expected to occur either through reductions in the United States or through increases abroad, the only remaining possibility of real adjustment lies in alignments of foreign-exchange rates. Yet, the resistance to any moves in this direction seems too strong to allow it to be contemplated. I shall, however, not be inhibited and will return to this only chance for a workable adjustment.

PARTIAL DEVALUATIONS

Among real correctives the policies most appealing to advocates of selective measures are what I have for years called "disguised partial devaluations of the dollar." Open and uniform devaluation being ruled out, measures are recommended to reduce the value of the dollar for particular purposes or in chosen sectors of the economy.

The United States has resorted to such makeshifts several times. For example, it devalued, not formally but in effect the dollar used for foreign military expenditures. This was done by trying to save foreign exchange whenever the cost of buying at home was at first not more than 25 per cent, later 50 per cent, above the cost in foreign currencies calculated at the official exchange rate. In other words, in decisions whether to buy abroad or at home, foreign currencies were to be given a higher value than would correspond to the official parity.

Through tying foreign aid to purchases of our products, the United States reduced the value of its foreign-aid dollar. Countries receiving aid had to buy in this country even if they could have bought at lower prices elsewhere. It cost some of them about 30 per cent more, which corresponds to a devaluation of the aid-dollar by about 23 per cent.

In July 1963, the United States began taxing purchases of foreign long-term securities at a rate of 15 percent. This is the equivalent of devaluing the dollar used for buying foreign securities. This partial devaluation, designed to reduce capital outflows, is a financial, not a real, corrective.

Last month, in January 1967, the administration proposed a tax on foreign travel and tourism, which would be the equivalent of devaluing the tourist's dollar. In addition, there are nonofficial proposals for taxes or tariff-surcharges on imports—the equivalent of devaluing the dollar for imports—and for subsidies or tax-refunds on exports—the equivalent of lowering the price of the dollar to foreign buyers of our exports.

If these disguised devaluations of the dollar were uniform, affecting proportionally all imports, all exports, and all other international transactions, they might work indiscriminately and perhaps efficiently. As it is, however, they are selective, disproportionate, and inefficient. They discriminate against some sectors and in favor of others, distort the structure of prices and the allocation of productive resources, and are usually incapable of effecting their purpose.

Partial devaluations can improve particular items in the balance of payments, but may worsen others in the process, partly because of the substitution of purchases for which the dollar is not "devalued," partly because of foreign and domestic repercussions to the reduction of purchases for which the value of the dollar is reduced.

DIRECT CONTROLS

Partial devaluations have at least one advantage: they work through price incentives and disincentives, and leave the markets essentially free. The bureaucratic mind, however, prefers a more direct approach, a more direct attack on the "item" that has been found irritating or insalubrious: it prefers direct controls, which give to some governmental authority the power to prohibit, to restrict, to license, or to permit, according to its unfailing judgment of what is or is not warranted in the national interest.

Direct controls can be employed as real correctives or as financial correctives of the payments deficit. As real correctives they may involve discretionary subsidies to exporters, quotas and other nontariff restrictions on imports, licensing of foreign travel or fixing the amounts that travelers may spend abroad. As financial correctives they may restrict bank credits to foreigners, direct foreign investment, portfolio investment and foreign loans of various types.

The effectiveness of controls that are not comprehensive, not all-inclusive (as general foreign-exchange controls, comprising all foreign transactions would be) is limited by the possibilities of avoiding, evading, and circumventing the restrictions. The elasticity of substitution among different forms of capital outflow, for example, is not sufficiently appreciated; there are also those offsetting changes in other items that are classed as repercussions, though in some instances substitutions and repercussions shade into one another.

It should be easy to understand that portfolio investment, bank loans, trade credit, and direct investment may be substituted for one another. Restrict one and you will see the others expand. Yet, many overlook that there is also substitution between foreign and domestic funds. Restrict the outflow of American capital funds and you will see foreign funds withdrawn from the United States.

This is not retaliation or an unfriendly act, but the operation of normal market forces: if American funds are kept from going abroad, interest rates abroad will rise and, naturally, foreign funds will "go home." Or, if American firms are forbidden to use their own money for direct investment abroad, but are permitted to raise foreign funds in foreign markets, foreigners holding American securities may decide to sell them in New York and buy the more attractive new securities offered by the American subsidiaries abroad. Thus, a legitimate outflow of capital takes the place of a forbidden one. Call it repercussion or call it substitution, it severely limits the effectiveness of the financial correctives.

If financial correctives are effective in reducing the outflow of capital, they may induce offsetting reductions in the trade surplus. These repercussions or feedbacks may be small or large, but will rarely be zero. They can be zero only if the reduction in the flow of capital does not affect the use of funds either in the domestic or in the foreign markets. Assume that an American, A, is prevented from lending his money to a foreigner, F; only if A then decides to sit on his money and not to spend, lend, or invest it at all, and if F manages to disburse abroad exactly the same amount of money that he would have disbursed, thanks to the receipt of A's funds, only then will imports and exports be unaffected by the financial corrective. In all probability, A will use some of his funds at home and F will have less to spend abroad, and the United States will have larger imports and smaller exports as a result.

FOREIGN PROGRAMS OF THE GOVERNMENT

In the search for "guilty items" in the balance of payments, foreign disbursements by the U.S. Government are the most popular targets. According to one's political philosophy, one will argue for cutting military expenditures abroad or for cutting foreign aid. The question whether these funds for fighting wars and fighting poverty abroad are desirable expenditures is often confused with the question whether the reduction of these funds would cure the imbalance of payments.

Both hawks and doves are inclined to exaggerate the effects which a reduction of expenditures for military operations in Viet-Nam would have on the payments deficit. If the war ends and military expenditures in Viet-Nam are reduced, there will probably be an increase in economic aid to Viet-Nam, in an effort to rebuild what has been destroyed and to show the world that our intentions all along had been to help the country maintain its freedom and develop its economy. If, nonetheless, total expenditures abroad are reduced when military operations cease, then the Vietnamese will have less money to purchase goods and to import from abroad. The reduction of their imports may not always directly reduce exports from the United States, but through triangular trade and multilateral repercussion our exports may still be affected.

In addition, there is the probability that defense expenditures in the United States will be replaced by expenditures for other purposes. Programs in our domestic war against poverty have been cut because of the rising cost of the war in the Far East. If, with the end of military operations, we escalate expenditures for domestic programs, imports from abroad are likely to increase above the volume they would have otherwise. Hence, with all these repercussions on the flow of goods and services, one must not count on an improvement of the balance of payments by anything near the full amount by which our military expenditures are reduced.

THE INEXORABLE DEFICIT

I may well be accused of undue pessimism. Is there any historical or theoretical support for my warnings about the ineffectiveness of the various corrective measures adopted or proposed? Is the deficit really impervious to all efforts to deal with it through corrective measures?

Our actual experience can really make us rather fatalistic. Year after year, at least since 1960, we have done all sorts of things to work on the balance of payments; we have picked one item after another for special treatment; yet, we have failed. I have prepared a list of quotations from statements by our Presidents and Secretaries of the Treasury expressing their assurances and confident expectations that balance was just around the corner, that the deficit would disappear within the year, or the next one. Yet, the deficit is still with us and one cannot even say that it is substantially smaller than it used to be.

I am not including this list of assurances in my testimony, because to do so would not be charitable. After all, the President and the Secretary of the Treasury were courageously battling a Hydra: they did not realize that for every head cut off two grew in its place. They did not know that you cannot decapitate a Hydra; you have to dehydrate her if you want to get rid of her. (Incidentally, the metaphoric dehydration need not be an absolute reduction of domestic liquidity. It suffices to reduce liquidity relative to foreign countries, calculated at current exchange rates.)

I am, however, offering you a tabulation of statistical figures illustrating the problem. In Table 1, some of the strategic items of our balance of payments are so arranged that we can see at a glance the remittances that can give rise to a transfer problem. The table shows side by side our military expenditures abroad, remittances and pensions, grants and net capital exports of the U.S. Government, and net outflows of private capital of U.S. residents. Ordinarily, military expenditures abroad are reported as part of the balance of goods and services. I took them out of there, because this is one of the items that are usually regarded as autonomous or disturbing factors. I wanted to show it as part of the financial transfers which, if all goes well, induce matching flows of goods and services.

The table indicates that the financial tranfers, in the 17 years from 1950 to 1966, varied from a low of $5.6 billion in 1953 to a high of $13.9 billion in 1964. The balance of goods and services (exclusive, of course, of military expenditures) varied in the same period from a low of $2.4 billion to a high of $11.4 billion. By and large, the years of high financial transfers were also years of high export surpluses. For example, the year with the lowest financial transfers, 1953, was the year with the second lowest export surpluses. The year with the highest financial transfers, 1964, was also the year of the highest export surpluses. The difference between financial transfers and export surplus I have called "transfer gap." This transfer gap varied between $1 billion and $5 billion. In the last six years it varied only between $2.2 billion and $3.2 billion.

My table, partly to make it less clumsy, omits inflows and backflows of foreign capital, private and official. The net inflow of foreign capital, inclusive of unrecorded transactions and inclusive of the dollar accumulations by monetary authorities, is equal to the difference between the transfer gap and the change in our gross reserves. Another reason why I omitted figures for foreign capital was the impossibility of separating autonomous inflows and those that were merely accommodating (that is, financing the deficit).

If we succeeded in achieving full adjustment, the surplus in the balance of goods and services would match the net deficit on the other accounts. Why full adjustment has not been attained and why, therefore, a transfer gap has remained throughout the years is a controversial question. Probably several factors have accounted for the lack of adjustment.

Virtually all theoretical analyses of the transfer problem include as necessary conditions for full adjustment relative price and income deflation in the paying country and relative price and income inflation abroad. Perhaps these conditions have not been met, chiefly because we have, for very good reasons, been unwilling to allow production and employment in the United States to be sufficiently depressed to "push out" enough of our products to achieve an adequate export surplus. Likewise, foreign nations have been unwilling to allow a rate of inflation sufficient to "suck in" enough goods from the United States.

Another important factor in the incomplete working of the adjustment process may have been the policy of some countries to offset the external effects of their price and income inflations by devaluations of their currencies. France, for example, devalued the franc in 1957 and 1958 with the result that the franc became undervalued and France could within a few years accumulate a gold reserve of almost $6 billion.

THE TRANSFER PROBLEM

It is sometimes said that the theory of the adjustment mechanism—a theory explaining how the trade balance adjusts to remove imbalances of payments—was not designated for countries or periods in which large amounts of financial transfers disturbed the balance of payments. This is not so. The classical debate of this problem of adjustment started when Britain had extraordinarily large military expenditures on the Continent during the Napoleonic Wars.

The discussion of the adjustment to large financial transfers was resumed when France had to pay indemnities after the Franco-Prussian War, and again when Germany had to pay reparations after the First World War. It was in connection with the discussions of the German transfer problem that some economists raised doubts as to whether the balance of goods and services could ever be flexible enough to allow adjustment to large transfer commitments.

In Table 2, some of the dollar figures of Table 1 were transformed into percentages of gross national product. It is significant that all the figures in question are minute fractions of our GNP. Exports of goods and services, in the period of 17 years, varied from 4.7 to 6.0 per cent of GNP. Imports (excluding military expenditures) varied from 3.6 to 4.6 per cent. The export surplus is, of course, a still smaller fraction. It varied from 0.7 to 2.0 per cent, of GNP.

The financial transfers varied from 1.5 to 2.3 per cent of GNP. It may be worth pointing out that there has been no consistent increase in financial transfers relative to GNP. On the contrary, from 1964 to 1966 they declined from 2.2 to

1.5 per cent of GNP. The transfer gap varied only between 0.3 per cent of GNP (in 1951, 1957, and 1966) and 1.2 per cent (in 1950).

The smallness of these figures is most impressive. For it shows what minimal transfers of productive resources in the economy from domestic industry to export industry would suffice to achieve full adjustment. That we should have been incapable of achieving it seems to indicate that anonymous forces involving market prices and incomes can be strong enough year after year to frustrate the aspirations and expectations of this wealthy nation. I hope my observation will not be mistaken for a plea to restrict the forces of the free market. It is meant, on the contrary, as a warning that these forces should be treated with more respect.

THE NEW BALANCE-OF-PAYMENTS PROGRAM

After seven years of unsuccessful corrective measures, the Government has now embarked on a new program. It is, again, not a program to promote real adjustment in the economic sense; instead, it relies on selective correctives operating on hand-picked items of the balance of payments. The President, the Secretary of the Treasury, and the Council of Economic Advisers hope that the country will save at least $1 billion by a "mandatory program" to restrain direct investment abroad and to bring home larger parts of foreign earnings from past investments; another $500 million by a "tightened program" to restrain foreign lending by banks and other financial institutions; another $500 million by discouraging "non-essential travel outside the Western Hemisphere"; and again another $500 million by reducing the foreign-exchange cost of keeping troops in Europe.

In summary, $1.5 billion are to be saved by financial restrictions, $500 million by a corrective measure operating on the private demand for foreign travel, and $500 by corrective management of government disbursements abroad. The last of these may turn out to be the only continuing saving, if troops are brought back from Europe or if compensating payments are received from NATO allies. The other $2 billion are nothing but stop-gaps.

Even if the three stop-gap measures succeeded in improving the balance by the full $2 billion, and even if this improvement eliminated the deficit for the time the restrictions are in force, it would not restore balance; it would only suppress imbalance. As soon as the restrictions are lifted, the deficit will reappear, for their is nothing in the program that has any adjusting, remedial or curative effects. The demand for foreign travel will not be reduced over a long period by restricting for a few years the chance of satisfying it. The flow of capital funds from this country to Europe is determined by relative incomes, prices, profit rates, interest rates, and saving ratios. None of these underlying conditions is altered by the restrictions. The flow is likely to resume, perhaps even to broaden, when the restrictions and prohibitions are taken off.

But that these selective controls are only temporary, and that they have no lasting effects, is not all. An additional question arises concerning the effects that they will have even temporarily. The possibilities of substitution and of repercussions must not be disregarded. Permitted outflows may be substituted for the prohibited ones, and repercussions in the trade balance may offset some of the savings achieved in the selected items. I shall presently provide explanations for these warnings. But I must first deliver myself of an observation on the principle of restrictive measures.

As one who has lived many years in Central Europe under all sorts of prohibitions, restrictions, and controls, I have always admired and loved the supposedly indomitable spirit of freedom in this great country. It is a traumatic experience to see the lighthearted sacrifice of several freedoms with the adoption of the program of payments restrictions. I would never have thought that this wonderful country could sink so low as to impose restrictions on foreign travel.

SOME THEORETICAL EXPLANATIONS

But now I must make good on my promise to present explanations for my skepticism concerning the effectiveness of the corrective measures. The explanations are theoretical, but I hope they will not appear esoteric or specious.

I shall use as illustration the restriction of direct investment, which is intended to save $1 billion a year.

There are two extreme positions concerning the effectiveness of such a corrective measure. At one end is the opinion that a reduction of a financial transfer, say by $1 billion, will leave all other items in the payments balance unchanged and merely reduce the financing item, that is, reduce the loss of gold or the increase in liquid foreign liabilities.

At the opposite end is the opinion that a reduction in financial transfers by $1 billion will reduce the export surplus by the same amount and hence will leave the deficit, and the need to finance it, unchanged.

I propose to regard the first theory as naive and the second as oversophisticated; both are wrong. The truth lies in the middle, and whether it comes closer to the naive or to the over-sophisticated theory will depend on circumstances. What kind of circumstances control the outcome can be briefly indicated, still with reference to the same illustration, the reduction in direct investment abroad.

If American firms that have for several years been making direct investments abroad are now barred from doing so unless they can raise new capital in foreign markets, it is possible that the increased demand in the foreign capital markets leads to a backflow of foreign capital from the United States. It may be short-term capital or it may be long-term capital that returns to Europe. To repeat the example used before, American firms issuing new securities in a European market may find foreign buyers who secure the needed funds by selling in the New York stock market some of the American shares they have been holding. The incentive for such a switch from old to new securities is clear: newly issued securities have to be offered at slightly reduced prices. To the extent that this way of financing is used, the restrictive measure by the United States will be ineffective.

Let us assume that the American firms reduce direct investment in Europe but make, within the limits stipulated by the new mandatory restrictions, some investments in Canada which they might not have made otherwise. The addition to the investible funds available in Canada may make it possible for Canadians to engage in the purchase of European securities. This would again constitute substitution of another form of capital flow from the United States to Europe.

Let us assume next that direct investment abroad is in fact reduced by the full $1 billion and that there is no replacement by any other funds going from the United States to Europe. Investment in Europe in preceding years has unquestionably contributed to effective demand and, directly or indirectly via third countries, to purchases of goods and services from the United States. The amount so used may have been relatively small; if so, the feedback from the reduction in investment, resulting in a reduction of American exports, may be small, too. But it will surely be greater than zero.

The next repercussion to be considered is connected with the use the American firms make of the funds which they, but for the restriction, would have invested in Europe. If they use any of these funds for increased investment in the United States, this will amount to an injection of additional funds into the stream of effective demand. Some fraction of any addition to effective demand is likely to show up as an increased demand for imports. The fraction may be small, but not zero.

To the extent that the domestic market, because of the increase in effective demand, becomes more attractive than foreign markets, American firms will be less eager to seek foreign outlets and will divert some of their production from export to domestic sales. It is unlikely that the amounts involved would be very large, but it is just as unlikely that they would be zero.

We have seen in the tabulation of financial and trade statistics that increases in our financial transfers to foreign countries have for many years failed to produce equal increases in our export surplus. The same conditions that can explain the incomplete adjustment of the trade balance to increased financial transfers can explain also why reductions in our financial transfers are unlikely to be matched by equal reductions in our export surplus. On the other hand, just as our increased financial transfers have increased our export surplus significantly, so reductions in financial transfers can be expected to reduce our export surplus.

CONCLUSIONS REGARDING THE PAYMENTS DEFICIT

I shall not be so bold as to present my conclusion in the form of a numerical forecast. It is not possible to predict a result determined by so many unknown variables. At this point we do not even know whether the Congress will pass the proposed surcharge on the income tax. This one factor alone can make a difference of about $1 billion in the payments deficit. That is to say, if we get the surtax, and thereby reduce the spending power of individuals and corporations, imports will be smaller and exports larger than if no tax increase is imposed.

But there are too many other factors in the picture to permit anyone to come up with a reliable forecast. Nobody knows, for example, what will happen concerning movements of foreign capital. This item can change either way and in very substantial amounts.

None the less, I believe that conclusions of a qualitative sort can and should be drawn. The two conclusions on which I feel pretty sure are the negative and regrettable ones concerning the effects of the restrictive program. There will not be an improvement of the payments balance by $2.5 billion, as the Administration seems to hope. And whatever improvement will be achieved by the program, it will be only temporary and will not contribute to the adjustment process, will not bring us closer to a solution of our problems.

The widely believed excuse that our military expenditures abroad, chiefly those connected with the war in Viet-Nam, are too large to permit balance in our payments to be achieved, is not justified. Our total financial transfers, inclusive of military expenditures, have been between 2.3 and 1.5 per cent of our GNP. This is a modest drain on our resources. There is no reason why a nation should be unable to accomplish a real transfer of such magnitude.

Adjustment of the balance of goods and services to make the real transfer match a financial transfer of around two per cent of GNP is not an impossible task, provided the adjustment process is allowed to work. I agree that we must not try to do it by depressing domestic incomes and prices. I am afraid that we must not expect our major trading partners to help us sufficiently by means of inflations of their income and price levels. But I see no reason other than superstition and timidity why we should not try to achieve the required relative reduction of our income and price level through adjustments of foreign-exchange rates. The rate adjustment that would achieve the needed adjustment of the trade balance is quite modest and should be negotiable.

I must safeguard myself against misinterpretation. If I speak of adjustment of exchange rates, this does not mean devaluation of the dollar in terms of gold. I do not believe either the desirability or the inevitability of an increase in the price of gold, and I shall explain this position presently. So let no one confuse exchange rate and gold price.

I shall not make the mistake of discussing the problem of adjustment independently of the problem of confidence. This, I am sorry to say, is hardly discussed in the *Economic Report*. Let us turn to it.

The Confidence Problem

I have stated what is meant by the confidence problem: it lies in the danger of massive switches from holdings of dollars to holdings of gold, with a destruction of monetary reserves in the process.

The first distinction required for analysis of this problem is that between private and official holders.

HOLDERS AND SWITCHERS, PRIVATE AND OFFICIAL

The distinction is important chiefly because of differences in motivation. Private holders of assets make their decisions mainly in their own interest—which includes, of course, the interest of their firm or their family. Official holders make their decisions in what they conceive to be the interest of their country; by definition, they are politically motivated, which may imply that their considerations of the putative national interest are fused with consideration of their own chances for re-election, re-appointment, or popular acclaim.

The differences in motivation can mean that official holders may refrain from switching from dollars to gold while private holders decide to switch, or the other way around, even if their expectations of future events are the same. On the other hand, massive gold purchases by private dollar holders can induce monetary authorities to act similarly even if their expectations differ. For when private purchases of gold result in losses of gold and in accumulations of dollars by central banks, the authorities may convert these dollars into gold merely to restore the previous composition of their reserves. And if these conversions make a heavy dent in the gold stocks of the United States, some official holders may find it prudent to increase the metallic portion of their reserves.

The virulence of private speculation in gold became apparent in December 1967, when the United States within four weeks lost almost $1 billion of its gold; and this despite the fact that other monetary authorities gave up some of their gold and increased their dollar balances. There is nothing under present arrangements that would preclude frequent recurrences of such gold rushes. One wonders how many similar scrambles for gold we are able or willing to endure.

Official switches from dollars to gold have sometimes taken place without any provocation from private speculation. The most conspicuous moves were, of course, those of the two largest European owners of gold, Germany and France. In the years 1964 and 1965, Germany reduced her foreign-exchange holdings by almost one half and increased her gold stock. France did the same thing in 1965 and 1966. Not all but most of their accumulations of gold cut into the gold reserves of the United States. There has been none of such official switching in recent months, if we disregard the action by Algeria. On the contrary, the major monetary authorities have realized that they had better stabilize the boat rather than join in rocking it. Germany, especially, has cooperated with the United States as the Bundesbank accumulated large amounts of dollars. Similar accommodation has been received from Italy.

This kind of bilateral accommodation, however, is no solution to the problem of confidence. A viable situation can exist only if massive raids on official gold holdings are excluded by institutional changes.

THE PRIVATE DEMAND FOR GOLD

There exists widespread confusion concerning the increase in private demand for gold. Observers often confuse speculative purchases with long-run demand. They also fail to distinguish increases in the demand for gold that are associated with decreases in the demand for dollars from gold purchases that do not involve reductions in private dollar holdings.

When the Council of Economic Advisers observe that our "deficit may have been increased further indirectly by the flurry of private gold purchases," they probably assume that these gold purchases were financed, directly or indirectly, by capital outflows from the United States. This is only a very small part of the picture. Perhaps they mean that many foreigners would be more interested in American securities if they were not so crazy about buying gold. In this sense it is true that our balance of payments is worsened by the gold rush. On the other hand, when private foreigners use their dollar balances to pay for the gold, both our dollar stocks and our liquid liabilities are reduced, and the balance is unchanged.

I believe the Council also overestimate the industrial use of gold when they figure that it was about $750 million last year. Since even industrial processors of gold may be speculators in their inventory policies, it is possible that industrial purchases in 1967 were unusually high. But that the current use of gold for industrial purposes, including jewelry, is much less, can be gathered from the known figures for the United States. In 1965 industrial users of gold in the United States purchased $185 million worth of gold. Statistics are available for only eleven other countries; the rest has to be guessed, and the total was estimated at $300 million. I doubt that the total for the world reached $500 million in 1967—which still would have been less than one-third of the gold production in the western world.

The remainder was probably divided between traditional gold hoarders and speculative gold buyers. The difference between them is that the traditional buyer acquires gold regardless of its price and of expectations concerning increases in the price, whereas the speculator buys because he expects the price to increase. He would probably sell again after the expected increase has taken place or after he has resigned himself to the fact that his expectation had been wrong.

The stupidity of persistent gold speculators is incredible. If a speculator bought his gold in 1954, his investment by the end of 1965 would have been worth less than one-third of what he would have owned had he purchased an average portfolio of American industrial stocks. A speculator who bought his gold only in 1960, would have found at the end of 1965 that his investment was worth less than one-half of what he could have had if he had purchased a Dow Jones mixture of industrial stocks. Even if his hope of a doubling of the price of gold had come true at the end of 1965, he still would not have made as much as an investor in American stocks.

I have not carried my calculations to December 1967, but they would unquestionably put the gold speculator still further behind the average investor in the New York Stock Exchange; the gold buyer of 1954 probably has now only one-fifth of the shareholder's present worth.

If speculation on a rise in the price of gold were to stop, in the sense that no further speculative purchases would take place but that those who have bought gold for speculative reasons were (foolishly) holding on to their not so precious possession, the private demand for gold by industrial users and by traditional hoarders would fall substantially short of present gold production. Thus, the present price of $35 an ounce could be maintained only if the price support extended by the United States and other monetary authorities is continued.

It is true that this situation would change after a few years. As incomes rise and as other prices increase, private demand for gold, quite apart from speculation, increases. And since gold production is expected to decline in coming years, the time will come when private demand catches up with new production, and thereafter overtakes it.

Whether this will be the time for an increase in the price of gold will depend on what happens to the monetary stocks of gold. They are now in a magnitude of about $40 billion. Even if all gold production stopped completely and even if the industrial use and traditional hoarding of gold were to double, the present monetary gold stock would suffice to feed private demand for about 20 years.

Since the monetary gold stock serves chiefly to satisfy old superstitions, there is hardly any reason against using this enormous buffer stock for gradually supplying all that private users might demand in the foreseeable future.

MEANS OF PAYMENT FOR PRIVATE GOLD PURCHASES

The effects of private purchases of gold upon the financial position of the United States depend to some extent on what funds the buyers use to pay for the gold. It is one thing if the purchases are made out of current incomes in all sorts of currencies; it is another if they are paid for out of dollar balances no longer demanded by their holders.

The United States is to some extent involved no matter how the private gold purchases are financed. If the present gold pool—United States, United Kingdom, Germany, Italy, Belgium, Netherlands, and Switzerland—supplies the gold, the share of the United States in the loss of gold will initially be 59 per cent. Eventually, however, it is not unlikely that under present arrangements the United States will have to shell out all of the gold, because the other monetary authorities may not be willing to have the metallic part of their reserves reduced.

If the purchase of gold is at the same time as a flight out of dollar holdings, the effects upon the United States position are more serious. Paradoxically, they need not show in any change of the liquidity balance, since both the gold stock and the liquid liabilities to foreigners decline *pari passu*. (The reduction in liabilities to private foreigners leads first to an increase in liabilities to official foreign holders of dollars; their increase in dollar holdings is then cancelled when they use the dollars to pay for the gold sold by the United States.

The erosion of the United States gold stock occurs in any case. It is, therefore, necessary to change international arrangements so that not all private gold purchases, even those not connected with reductions in the demand for dollar balances, cut into the reserves of the United States.

DOLLAR OVERHANG AND DOLLAR OVERFLOW

It would not be difficult to deal with speculation against the dollar and with speculation on an increase in the price of gold if the excess supply of dollars were not constantly replenished by our continuing payments deficit. In other words, one could deal with the overhang from past accumulations of dollar balances if there were not always an overflow of dollars pouring into foreign markets. (The opposite, incidentally, is also true. It would be easier to deal with the current overflow were it not for the overhang that threatens to come down on the exchange markets in a crisis of confidence.)

In view of this predicament and in view of the impossibility of stopping the overflow in the near future, action to seal, brace, or otherwise secure the overhang of dollars is of utmost urgency. It is sufficient to confine this action to the dollar holdings of monetary authorities since only they can present their dollars in New York for conversion into gold.

Let us then consider what kinds of action might be taken with regard to official dollar holdings.

FIVE APPROACHES

In principle, five approaches can be used to solve the problem of confidence and, in particular, the problem of conversions of official dollar holdings into gold. All have been recommended in some quarters. They are

(1) To make the dollar scarcer;

(2) To increase the price of gold;

(3) To "lock in" the official dollar holdings under so-called harmonization agreements;

(4) To "take out" the dollars from official reserves by having them exchanged for deposits in an international conversion account (settlements account); and

(5) To cut the link between the dollar and gold.

I may be quite brief in disposing of the first, the most orthodox approach. It is practically impossible to make the dollar sufficiently scarce. Scarcity is always relative and, with present expectations of a future scarcity of gold, only a very drastic deflation in the United States would do the job. Such a policy is out of the question.

The second approach is the one most widely discussed. The "gold lobby" seems to be getting increasing popular support. I reject the recommendation of an increase in the price of gold, chiefly for two reasons. One is noneconomic: it would be morally indefensible to hurt those who have helped us by carrying large dollars holdings and to reward those who have hurt us by converting them into gold. The other reason is an economic one: a sharp increase in the price of gold would lead to large, highly inflationary profits. Even if the profits of official holders of gold could somehow be sterilized, those of private holders of gold would be monetized and the consequent increase in the reserves of commercial banks and in the cash balances of countless speculators would drive up prices and incomes everywhere.

The third approach calls for an international agreement on "harmonization of monetary reserves." The monetary authorities would have to commit themselves to hold certain minimum ratios or minimum amounts of their total reserves in the form of dollar assets. They would probably be more agreeable to such a plan if the limits were stated in absolute terms and if it were agreed to that there must not be any further accumulations of dollars in official reserves. The plan would provide a solution of the problem only if it were combined with firm arrangements about joint sales of gold. (The present gold pool, as we have seen, does not distribute losses of gold reserves in a way that would be tenable in the long run. Speculators, therefore, cannot expect the present arrangement to last.)

The fourth approach calls for an isolation and concentration of all official dollar holdings in one central pool. Earlier plans to this effect, such as those proposed by Keynes, Triffin, Bernstein, and Maudling, have not found official support. One of the objections has been that these plans allowed for continued accumulations of reserve currencies (dollars and pounds) either by the central reserve agency or by national authorities. There can be no solution to the problem of confidence if continued accumulation of gold-convertible dollar assets by monetary authorities is permitted.

The fifth approach is recommended chiefly by those who have given up hope for a cooperative or collective solution. To cut the link between dollar and gold, that is, to stop the practice of the United States of buying gold when it is offered and selling gold when it is demanded, would be an action vehemently opposed by most foreign governments.

The implications of this approach must be examined carefully, because it may turn out to be the only one that is really practicable. But, before I undertake such an examination, I wish to describe a plan which I regard as feasible and much more desirable. It is a plan that pursues the fourth approach in a more comprehensive fashion than has previously been proposed.

A GOLD-AND-EXCHANGE CONVERSION ACCOUNT

My proposal combines features of the plans proposed by Keynes, Triffin, and Bernstein, but it differs from these plans in various respects. Instead of discussing similarities and differences, I shall confine myself to a description of the essentials.

The United States deposits all its gold reserves in a new Conversion Account (or Settlements Account) of the International Monetary Fund and will treat its deposit with this account as a reserve asset (its largest, under present circumstances).

Other countries, especially those in the Group of Ten, deposit all their gold reserves and all their holdings of reserve currencies (dollars and pounds), except for small working balances, in the new conversion account of the IMF and will treat their deposits with this account as part of their monetary reserves.

The monetary reserves of the participating countries will thereafter consist only of deposits in the conversion account, reserve positions in the General Account of the Fund, and special drawing rights recorded in the Special Drawing Account of the Fund. Neither gold nor national currencies will be carried as monetary reserves of the participants. Working balances in foreign countries will be strictly limited to amounts needed for transactions and intervention purposes.

The conversion of gold and reserve currencies into deposits with the conversion account is a one-time procedure (at the time of its establishment or of joining the group of participants) and is irreversible. The deposits with the the conversion account may have gold-value guarantees but will not be convertible into gold. These deposits can be held only by national monetary authorities which undertake to accept transfers of such deposits in settlement of payments balances and in payment for their own currencies (or for currencies of third countries in day-to-day transactions).

The conversion account gives no credit, it makes no loans or investments, and it acquires no currencies beyond the amounts deposited by countries at the time they open their accounts.

The conversion account will keep its gold stock in vaults on the soil of different countries, so that participants need not be apprehensive concerning emergencies in time of war.

The future of gold need not be determined at the outset. In principle, it would be possible to leave the gold market entirely free, the Fund neither selling nor buying gold, regardless of the price gold might fetch in the free market. (Any gold-value guarantee of deposits would be in terms of the official accounting price of gold maintained by the Fund.) Alternatively, the Fund might be authorized to stabilize the price of gold by purchasing gold when it is in excess supply and by selling gold when an excess demand exists. It would also be possible to set a pair of prices for bids and offers, allowing the Fund to make a profit from the spread between selling and buying prices.

The Fund would receive income from interest on the dollar and pound assets acquired when the accounts were set up. These assets would preferably be in the form of consols. If some governments negotiating these arrangements should be unwilling to give up their anachronistic views concerning the repayment of debts that serve as a monetary base, gradual amortization may be conceded. In this case, provision must be made for replacing reserves destroyed in the process with reserves deliberately created (perhaps in the form of Special Drawing Rights).

All deposits in the conversion account carry interest. The income of the Fund from interest earned on its dollar and pound assets and from eventual profits through transactions in gold should be adequate to cover the interest paid on its deposits.

The Fund should facilitate the process of adjustment not only by advice and admonition given in connection with conditional drawing rights on its General Account under present rules and practices, but also by greater adjustability or flexibility of foreign-exchange rates. In order to prevent power politics from interfering with this function, a more mechanistic system should be considered. For example, it might be provided that any country that persistently loses monetary reserves at a conspicuous rate will have its exchange rate reduced by small monthly steps; and that any country gaining reserves persistently and at a fast rate will have its exchange rate increased. By limiting these adjustments to steps not larger than, say, one-fourth of one per cent per month—except in instances of serious inflation which would require faster adjustment—the fears of disequilibrating speculation would be allayed.

The elimination of gold convertibility would make such a system of flexibility or increased adjustability of exchange rates possible. However, certain governments might so strongly resist this recommendation, that one should not insist on its being made a necessary part of the arrangement from the beginning.

While it can hardly be denied that we have at present no effective adjustment mechanism, and that the problem of adjustment demands solution, one may concede that the problem of confidence is more urgent. Hence, we should not block collective solution of the confidence (convertibility) problem by insisting on solving the adjustment problem at the same time.

Fortunately, if the adoption of a plan to establish a gold-and-exchange conversion account stops speculation on the rise of the price of gold, and thus stops the gold rush, the present imbalance of payments will be alleviated. This supports the argument that, if the inclusion of greater exchange-rate flexibility should not be negotiable at this time, postponing a solution of the adjustment problem may not cause excessive harm.

We learn slowly, and older people usually learn more slowly than younger ones. In most countries, the men in charge of monetary affairs are mature persons, whose ideas have hardened and have become unchangeable. It may take some time, until the old guard retires and younger men take over, before it will be recognized that greater flexibility of exchange rates is indispensable for a workable international monetary system.

CUTTING THE LINK BETWEEN DOLLAR AND GOLD

A comprehensive plan to solve the problem of confidence, or indeed any new plan requiring collective action on international monetary arrangements, may not be negotiable at the moment. To resign oneself to this fact of life, shrug one's shoulder, and do nothing—is possible, is easy, is realistic. But it is irresponsible.

There are those who believe that temporizing is the only intelligent conduct, simply because anything else is "politically impossible." What this means is, before all, that in an election year no administration likes to press for the adoption of unpopular measures. It means also that the politician prefers to wait until the need for action is more widely understood. And, in terms of the concrete case, it means that we must wait until we lose another three or four billion dollars worth of gold.

I am not a politician and I believe I have a responsibility to advise against temporizing. I recommend that we take action when action can do most good. It is useless and wasteful to wait until we have dissipated several more billions of gold. Not that we need the gold but, if we dispose of it, we ought to give it to those who have a moral claim to it. That is, not to speculators, not to hoarders, but to governments to whom we have said in effect that they would not regret it if they held dollars rather than gold.

Thus, if we cannot get the governments of the Group of Ten to negotiate an agreement for a comprehensive plan, I propose the following course of actions:

(1) We announce that within a few months—say, three or four months—we shall stop selling gold to anybody, including foreign official holders of dollars.

(2) We announce to all official holders of dollars that, if they want to purchase some or all of our gold, they are welcome to it, but they must take it within the period indicated. Just as a caution, we shall limit the offer to any one country to the amount of dollars it held on a certain day prior to the announcement.

(3) We announce that we shall not purchase any gold now or in the future, or repurchase any gold that we sell, either at the present price or at any other price. In short, we are through with gold as a monetary base.

(4) We announce that we shall have no objection to any country (a) continuing to maintain the present, fixed exchange rate between its currency and the dollar, (b) reducing the exchange value of the dollar at which the country is pegging its currency, or (c) allowing the exchange rate to float.

In other words, we shall not undertake to influence other countries regarding their policy vis-a-vis the dollar. We shall leave it to them to decide what they think is best for them.

If any country decides to keep the exchange rate unchanged, this will imply that its monetary authority stands ready to sell and buy dollars at the present exchange rate. If, because of our payments position, the dollar remains in excess supply, the foreign monetary authority will have to increase its holdings of dollars.

Any country that decides to adjust the exchange rate so that at a reduced price of the dollar its monetary authorities have to acquire only smaller amounts of dollars, or none at all, will thereby avoid extending "involuntary loans" to the United States; its decision will contribute to the adjustment required for restoring balance in international payments.

If a country decides to let the exchange rate float, it evidently has concluded that it will neither accumulate dollar balances nor dispose of any that it owns, and that it will let the price of the dollar be determined in the free market. This excludes the possibility of further deficits and surpluses in its transactions with the United States (if the balance of payments is calculated on the basis of "reserve transactions"). It does not exclude the use of fixed exchange rates vis-a-vis the currencies of other countries (some of which may be more significant in the trade relations of the country concerned).

The three possibilities do not exhaust the range of options open to a country. Another option involves the use of multiple exchange rates. A country may decide to maintain the present fixed exchange rate for current-account dollars, that is, for dollars arising from, or used for, trade in goods and services, but to let dollars arising from inflows of capital depreciate. The execution of this decision to split the market would probably require foreign-exchange controls of the most stringent sort, because capital transactions can be disguised as payments for goods and services. The introduction of such controls would be regrettable, but from the American point of view one may say that controls abroad are less objectionable than controls at home. Still, this outcome would be deporable and one can only hope that most foreign governments would realize how much harm can be caused by such measures.

The chief purpose of the link-cutting action would be achieved no matter what other countries decide to do. For, convertibility of dollars in gold having been abolished, the confidence problem as a threat of reserve destruction would no longer exist.

The use of the dollar as an international transactions currency would not be impaired by the action. Banks and trading firms hold dollar balances because they need them in their business and because the reservoir of goods which the dollar can buy at relatively stable prices is larger than that of any other currency. With the fear of "convertibility crises" removed, the usefulness of the dollar in international trade may even increase.

Some traditionalists fear that the abolition of gold reserves and of a firm link between dollar and gold would invite inflationary policies; they believe some monetary discipline is exercised by the link to gold. In fact, gold-reserve requirements and gold-convertibility rules do not give us more discipline—we do what we would do in any case—they only create guilt feelings.

One genuine drawback of this solution of the confidence problem is that the link-cutting action is unilateral and, therefore, offends the spirit of international monetary cooperation. For this reason, this approach should be regarded as inferior to a negotiated, multinational arrangement. Some economists though, believe that, in the absence of convertibility of dollars in gold, the United States would have less need for international cooperation.

The Liquidity Problem

We now come to a much happier subject. While we still grope for solutions of the problems of adjustment and confidence, we have found and agreed on a solution of the liquidity problem. And a very neat, most satisfactory solution it is.

I have just completed a long study—over a hundred pages—of the Rio Agreement with all its details and implications. I have concluded that the scheme is superior to any of the alternatives that have been discussed in the last ten years, and that it should work well once it is activated.

New Principles

The system of Special Drawing Rights embodies novel features based on sound principles of monetary economics.

The Special Drawing Rights (SDR) are deliberately created and distributed among participants in agreed proportions. They will be owned reserves—not borrowed reserves. They can circulate only among the participating monetary authorities—hence, cannot go outside the group of participants. They cannot be extinguished or destroyed—what one holder loses another gains.

The SDR's are not created by acts of lending or investing, nor by decisions to borrow or to make use of an overdraft facility. They do not constitute anybody's debt, indeed, the Special Drawing Account owns nothing and owes nothing, but acts merely as a bookkeeper and a source of information. Finally, the age-old myth of "backing," which economists for hundreds of years have vainly tried to exorcise, has at last been punctured. There is no asset that could be said to "back" the SDR's. Their acceptability rests entirely on the participant's commitments to accept them and on their knowledge that all other participants will actually accept them in payment for convertible currencies, their own or that of the payor or that of a third country.

If the plan is ratified and activated, it can provide for adequate annual increases in total monetary reserves. The international monetary system will no longer depend on uncertain gold production, unreliable gold supplies from the Soviet Union, or erratic private demand for gold, nor on deficits of reserve-currency countries, reserve needs of other deficit countries, or the willingness of surplus countries to accumulate reserve currencies. At last, there will be some rationality in the creation of reserves. Contrary to some misgivings that inflationist attitudes will prevail in the decisionmaking about the creation of SDR's, it seems more probable that decisions will err on the side of excessive caution.

The future of SDR's—assuming ratification and activation of the scheme—looks bright. Whether gold and reserve currencies remain ingredients of national monetary reserves or whether they will be replaced by deposits with a Conversion Account, the share of SDR's in total reserves is going to increase from year to year. It may not be long before SDR holdings will be the most important part of thee monetary reserves of the world.

ONE DOWN, TWO TO GO

The new scheme has not been developed as a boon to any particular country or group of countries. It is a truly cooperative and collective arrangement to help all. The men who have long labored on it, and have patiently and skillfully steered the negotiations to a happy end, deserve our thanks.

My only regret is about the single-mindedness with which the experts have devoted themselves to solving the problem of liquidity, leaving the other two problems, of adjustment and confidence, unsolved and almost untouchable. This single-mindedness has left the international monetary system in a terrible mess.

TABLE 1.—GROSS NATIONAL PRODUCT, FOREIGN TRADE, AND VARIOUS FOREIGN BALANCES OF THE UNITED STATES, 1950-66

[In billions of current dollars]

Year	GNP	Goods and services, excluding military expenditures			Financial transfers to foreign countries					Transfer Gap	Liquidity balance	Changes in gross reserve position
		Exports	Imports	Balance	Military expenditures abroad	Remittances and pensions	U.S. Government grants and capital	Private U.S. capital (net)	Total			
1950	284.8	13.8	11.4	2.4	0.6	0.5	3.6	1.2	5.9	3.5	−3.5	−1.8
1951	328.4	18.7	13.7	5.0	1.3	.5	3.2	1.0	6.0	1.0	−.8	0
1952	345.5	18.0	13.7	4.3	2.1	.6	2.4	1.2	6.3	2.0	−1.2	+.4
1953	364.6	17.0	14.0	3.0	2.6	.6	2.1	.3	5.6	2.6	−2.2	−1.3
1954	364.8	17.7	13.3	4.4	2.6	.6	1.6	1.6	6.4	2.0	−1.5	−.5
1955	398.0	19.8	14.8	4.9	2.9	.6	2.2	1.2	6.9	2.0	−1.2	−.2
1956	419.2	23.6	16.5	6.9	2.9	.7	2.4	3.1	9.1	2.2	−1.0	+.9
1957	441.1	26.5	17.6	8.9	3.2	.7	2.6	3.6	10.1	1.2	+.6	+1.2
1958	447.3	23.1	17.5	5.6	3.4	.7	2.6	2.9	9.6	4.0	−3.4	−2.3
1959	483.7	23.5	20.2	3.3	3.1	.8	2.0	2.4	8.3	5.0	−3.9	−1.0
1960	503.7	27.3	20.2	7.1	3.1	.7	2.8	3.9	10.5	3.4	−3.9	−2.1
1961	520.1	28.6	20.2	8.4	2.9	.7	2.8	4.2	10.6	2.2	−2.4	−.6
1962	550.3	30.3	22.2	8.1	3.1	.8	3.0	3.4	10.3	2.2	−2.2	−1.5
1963	590.5	32.4	23.5	8.7	2.9	.9	3.6	4.5	11.9	3.2	−2.7	−.4
1964	632.4	37.1	25.7	11.4	2.9	.9	3.6	6.5	13.9	2.5	−2.8	−.2
1965	683.9	39.1	29.3	9.8	2.9	1.0	3.4	5.3	12.6	2.8	−1.3	−1.2
1966	743.3	43.0	34.2	8.8	3.7	1.0	3.4	4.2	11.3	2.5	−1.4	−.6

TABLE 2.—FOREIGN TRADE AND VARIOUS FOREIGN BALANCES AS PERCENT OF GROSS NATIONAL PRODUCT OF THE UNITED STATES, 1950-66

Year	GNP	Goods and services, excluding military expenditures			Financial transfers	Transfer gap	Liquidity deficit
		Exports	Imports	Balance			
1950	100	4.8	4.0	0.8	2.1	1.2	1.2
1951	100	5.7	4.2	1.5	1.8	.3	0
1952	100	5.2	4.0	1.2	1.8	.6	.3
1953	100	4.7	3.8	.8	1.5	.7	.6
1954	100	4.9	3.6	1.2	1.8	.5	.4
1955	100	5.0	3.7	1.2	1.7	.5	.3
1956	100	5.6	3.9	1.6	2.2	.5	.2
1957	100	6.0	4.0	2.0	2.3	.3	+.1
1958	100	5.2	3.9	1.3	2.1	.9	.8
1959	100	4.9	4.2	.7	1.7	1.0	.8
1960	100	5.4	4.0	1.4	2.1	.7	.8
1961	100	5.5	3.9	1.6	2.0	.4	.5
1962	100	5.4	4.0	1.4	1.8	.4	.4
1963	100	5.5	4.0	1.5	2.0	.5	.5
1964	100	5.9	4.1	1.8	2.2	.4	.4
1965	100	5.7	4.3	1.4	1.8	.4	.2
1966	100	5.8	4.6	1.2	1.5	.3	.2

Chairman PROXMIRE. Thank you, Professor Machlup.
Mr. Butler?

STATEMENT OF WILLIAM F. BUTLER, VICE PRESIDENT AND DIRECTOR OF ECONOMIC RESEARCH, THE CHASE MANHATTAN BANK, NEW YORK

Mr. BUTLER. Dr. Machlup has made many of the points that I have made in my paper.

It seems to me that our balance-of-payments situation is an extremely serious one at the moment, that we have to move to deal with it. In my terms I think there are four ways one can move. The first way is through the rule of controls, which is the rule we have adopted. I agree with Dr. Machlup that controls do not solve balance-of-payments problems. At best they buy time to work on more fundamental problems. I think if we use this time wisely to adopt responsible monetary and fiscal policies, to check inflation at home, which I think we need to do for both domestic and balance-of-payments reasons, then the price paid through these direct controls may be justified, and the so-called temporary controls may prove truly temporary. There is an old saying that there is nothing so permanent as a temporary tax, but I hope that these balance-of-payments direct controls can be made temporary.

I think that the best course for the United States and for the world is for us to cure domestic inflation by holding down spending, raising taxes, and reducing the increase in the supply of money and credit to viable proportions, and in addition reviewing and reducing our overseas Government commitments. I think that if we pursue these policies, we would help ourselves domestically and one could see an end to our balance-of-payments difficulties, with a cessation of fighting in Vietnam.

I think this is by far the best course for the United States to pursue, and a key element of this proposition is that we should maintain the price of gold at $35 an ounce.

If we do not pursue these policies, we have some other alternatives. One is more controls, which I think would be only putting the finger on the pipe that Dr. Machlup talked about, and would lead sort of inevitably to successive crises and perhaps even to a world financial collapse at some point. I think this would be the worst possible thing to do.

Another alternative would be to raise the price of gold. This has been suggested by various sources. I think again I would agree with Dr. Machlup that this would be a great mistake. It would flood the world with liquidity. While in theory central banks could sterilize this, it seems to me that the temptation to inflate further would be irresistible. This would apply to the United States as well as to other countries that hold a lot of gold. A rise in the price of gold would reward some people whom I do not think it is in the interests of the United States to reward, and possibly penalize in some sense some people who have supported us.

I think there is no way to be completely sure that an increase in the price of gold might not set off a set of competitive devaluations, and beggar-thy-neighbor policies. I doubt that this would happen, but one cannot rule out the possibility.

Another alternative is to suspend our commitment to buy and sell gold at $35 an ounce. While, as I have said earlier, I think the best alternative is to do what we have to do to defend and develop and perfect the present system, keep the price of gold at $35 an ounce, I think if we do not pursue these policies, the best alternative would be to suspend our commitment to buy and sell gold at $35 an ounce. I think this would put the question to other countries as to what their policy should be. If they chose to let the dollar float or to let it devalue against their currencies, they would give our exporters a very great advantage, and would hamper their own exporters. I think their decision would have to be that they would peg their currencies to the dollar, to present exchange parities. I think this would be a viable system for the world financial structure. However, I think it is a less good system and a more risky system than the one we have now. I think again about all it does is to buy us some time. It does not relieve us from the charge of getting our balance of payments back into balance at some point.

I think this is the essential thing. I think we can do this. If we do it, we can contribute incredibly to the future prosperity, growth, and high employment of the world economy. If we do not do it, whatever gimmicks we invent are going to be very harmful to the cause of high employment and prosperity throughout the world.

Thank you very much.

Chairman PROXMIRE. Thank you, Mr. Butler. Thank you for your concise statement.

(The prepared statement of Mr. Butler follows:)

PREPARED STATEMENT OF WILLIAM F. BUTLER

Mr. Chairman and members of the committee, I appreciate very much this opportunity to appear before you to discuss the balance of payments and policies with respect to gold.

Let me try to make it completely clear at the outset that I believe firmly that the existing gold-exchange standard is the most efficient, equitable and powerful international monetary system in the world's history. It has served the world well, and has made a most significant contribution to the unprecedented growth in world production, trade and investment in the postwar era. I believe our objective should be to preserve the present system, while working to improve it by gradually supplementing it with some new source of international liquidity. The key to this proposition is that the official dollar price of gold must be held at $35 an ounce.

Holding these beliefs, I am deeply concerned by recent policy developments at home and abroad. The world is in the process of turning full-square away from the policies of liberalizing trade, investment and travel which have contributed so importantly to prosperity and growth during the postwar period. The road we and other industrial nations are now traveling can lead only to successive, and cumulative, policies of restriction which will surely jeopardize our prospects for prosperity, economic growth and high employment.

Yet I believe there is still time to turn back to the high road of liberalism. The most urgent requirement is that the United States pursue policies which will deal effectively with the fundamental causes of our balance-of-payments deficit, and make the temporary set of direct controls to which we have resorted truly temporary. At the same time, we need to seek the cooperation of other nations, particularly those in persistent balance-of-payments surplus. It will be extremely difficult, if not impossible, for the United States to eliminate the deficit if other nations cling to policies which bring them payments surpluses. And we must avoid actions on our part, such as quotas, border taxes and other devices, which provoke retaliatory actions abroad.

In the situation as it existed at the close of 1967 the United States had to come up with a program strong enough to reverse the deterioration in our external payments. To be convincing, the program probably had to include direct controls over private investment as well as restrictions on overseas travel. But controls of this character are in no way a lasting answer to our real problems. They do buy time, at a heavy cost. If this time is used wisely to mount programs which deal effectively with the basic causes of our deficit, the cost may be justified. But if the temporary improvement they are bound to produce is used as an excuse for inaction on fundamental matters, the consequences for the United States and the world economy could be extremely serious.

Our balance-of-payments problem stems from two basic sources: domestic inflation and heavy government overseas commitments. It is our failure to face up to these problems that underlies the erosion in confidence in the dollar. While there is no questioning of the vast wealth and strength of the United States, there is a growing feeling abroad that we will take the easy way out, through an increase in the price of gold, rather than making the hard choices required to get our domestic house in order and tailor our international commitments to our ability to finance them.

I believe that, for both domestic and international reasons, the United States must move to contain inflation. From the end of 1958 to the end of 1965 we had a remarkable period of price and cost stability. Our competitive position in world markets improved, and our basic trade surplus widened. In contrast, we slid back into inflationary habits in 1966 and 1967, and the inflationary spiral is accelerating this year. As a result, our trade surplus shrank from $6.7 billion in 1964 to less than $4½ billion last year. Unit labor costs in manufacturing, which on the average had been stable in the years 1959 through 1965, have gone up more than 7% since the end of 1965.

The root-cause of this inflationary upsurge lies in the enormous rise in federal defense and non-defense spending after mid-1965—an increase at annual rates of over $45 billion in cash outlays, of which defense accounts for $24 billion. In the absence of a major tax increase, the federal cash deficit soared into the $20 billion plus range. The process of financing these huge deficits without pushing interest rates even higher involved Federal Reserve policies which supported an increase in the supply of money and credit of some 15% last year.

Under the precepts of both the new and the old economics, the combination of large federal budget deficits and rapid increases in the supply of money and credit, at a time of low unemployment, will yield inflation. And the inflation will be aggravated, and made more intractable, by an upward spiral in wages and salaries. Postwar experience shows clearly that the average of wages and salaries goes up at a rate equal to the advance in productivity *plus* the increase in the cost of living. So the initial demand-pull inflation leads to an upward cost-push spiral which will keep spinning so long as it is financed.

If this process is not halted it threatens to undermine both domestic prosperity and our balance of international payments. Inflationary policies involve heavy risks of creating a boom that could lead to a severe slump. As inflationary psychology spreads, it enhances the incentives to build inventories, expand capacity, go along with large wage increases and speculate in goods, land and securities. Such a boom would come to an end at some point, as booms always do. But with the erosion of confidence, the ensuing slump might prove quite difficult to deal with. If we fund federal deficits of $20 billion or more in a period of high employment, it seems to me that we are seriously constricting our ability to deal with any recession by applying the procedures of the new economics. The long-run costs of inflationary policies in terms of unemployment seem to me to be far more serious than any short-term effects from policies directed toward price stability.

The international costs of a failure of the United States to bring domestic inflation under control and correct the imbalance in our international payments could prove even higher. The stability of the world financial structure rests essentially on confidence in the dollar. This confidence is engendered in part by our commitment to buy and sell gold at $35 an ounce, and in longer part by the stability and strength of the dollar. Dollars are held and used widely around the world because their purchasing power has dropped less in the past decade than any other major currency. The only international asset that can compete with the dollar is gold, and gold can compete only because of the speculative possibility of an increase in its price because of a failure of the United States to put its house in order.

If confidence in the dollar should be severely shaken, and I do not believe it has been as yet, my fear is that we might run into a world-wide economic crisis. There could be a world-wide rush to liquidity which could only lead to a downward spiral of production, employment and trade. The results could be a return to the controls and restrictions which contributed so much to the stagnation of the 1930's.

It is my firm belief that we can avoid these undesirable consequences if we move to deal decisively with the problems we confront. I believe we need to act on three broad fronts:

First, we must reduce the federal deficit sharply by a combination of rigorous restraint on spending and a tax surcharge;

Second, we must restrict the rise in money and credit to a rate which is in line with the potential real growth of the economy;

Third, we must reduce our overseas military expenditures.

These are not easy steps to take. Yet I believe the costs and travail involved in taking them will prove incomparably less than will our failure to do so. Prompt and resolute pursuit of these policies can get domestic inflation under control and pave the way for an end to our balance-of-payments deficit, once there is an end to the fighting in Vietnam. I do not believe such policies need lead to an intolerable increase in the unemployment rate. Nor need they lead to any abatement in the war against poverty—with resolution, there is ample room to cut back government programs of lesser priority.

In short, of all the alternatives facing the nation, I believe the course I have just outlined is far and away the best one. Let me try to embellish that conclusion by discussing some of the alternatives.

One, which I have considered above and rejected, is to slide further down the path of direct controls and restrictions. This is, in my judgment, the clear path to worldwide stagnation.

A second alternative which is receiving wide attention is that of increasing the price of gold. It is argued that such action would bring a quick and easy solution to our current problems. The speculators would cash in their gold and retire to the wings awaiting another crisis. Confidence in the dollar would be restored as the nominal value of our gold stock increased. No one would be upset, the argument runs, since all major nations would follow our lead in marking up the price of gold.

My personal view is that there are a number of serious drawbacks to any increase in the price of gold:

(1) It would take a big increase—possibly a doubling of the price as many have suggested—to convince speculators that the new price would be held for many years.

(2) A doubling of the price of gold would add at one stroke a plethora of liquidity to nations holding large gold reserves, a category which includes the United States. While in theory central banks could sterilize this liquidity, I fear that the temptation given sovereign governments to inflate would prove irresistible. If the United States continued to follow inflationary policies, it would only be a matter of time before the dollar came under pressure again.

(3) An increase in the price of gold would reward Soviet Russia, South

Africa, the leading gold-producing nations, as well as central banks which have shifted from dollars to gold, and speculators and hoarders. It does not seem to me to be in the interests of the United States to give such nations or individuals a windfall gain. Moreover, those nations which have cooperated by holding dollars would be penalized—certainly a most unjust reward.

(4) There is no way to be completely sure that an increase in the price of gold would not set off a round of competitive devaluations and beggar-thy-neighbor trade restriction policies.

It seems to me that an increase in the price of gold is another palliative, like direct controls, rather than a solution to our basic problems.

A third alternative would be to go off the international gold standard by suspending our commitment to buy and sell gold at $35 an ounce. If we do not display the wisdom and fortitude to deal with our problem of domestic inflation and curtail our international commitments, we may be forced to contemplate this alternative.

As I have said earlier, I hope things will not come to such a pretty pass. It is my firm belief that the best course for the nation, both domestically and internationally, is to do what is required to set our balance of payments right.

If we do not pursue the responsible fiscal and monetary policies necessary to work back to a viable balance-of-payments position. I would argue that we should choose the third alternative I mentioned—suspending our commitment to buy and sell gold at $35 an ounce. Since it is not in the interest of the United States to raise the price of gold, and since no one can force us to take such action, I believe we should, and would, cut loose from gold. In that unfortunate event, we could maintain the present exchange parities with other currencies. We could use IMF credits, swap arrangements or sales of part of our remaining gold stock to finance any payments deficits. Other nations would have a powerful incentive to keep the dollar from depreciating in terms of their own currencies.

The main point I am trying to make is that the United States has alternatives other than simply raising the price of gold, a move which to me does not appear to be in the best interests of the nation or the world. Our best alternative in my view is to do what is necessary to bring our balance of payments back into balance, and I believe we can do this with policies which are also needed to ensure domestic prosperity. Lacking such responsible policies, I would maintain that it would be better to suspend gold purchases and sales and maintain the present parity of the dollar than to raise the price of gold.

Finally, it seems to me to be in the best interests of the United States and other industrial nations to cooperate in the task of preserving the present system of international finance and adapting it to the future requirements of supporting world prosperity and progress.

Chairman Proxmire. Our last witness this morning is Professor Behrman.

STATEMENT OF JACK N. BEHRMAN, PROFESSOR OF INTERNATIONAL BUSINESS, UNIVERSITY OF NORTH CAROLINA

Mr. Behrman. I appreciate this opportunity to give to the Joint Economic Committee some of my views and particularly the control schemes which have been worked out on capital investment. While I am interested in the other aspects I will focus on this, if you will, Senator.

By way of introduction I see five contradictions which have developed in U.S. economic policies over the past several years. The first is that we have been talking about temporary solutions to problems which we have not identified the temporary causes of, and I think this is the point Mr. Machlup was making.

We have stated that the controls would be temporary, but as I indicated in 1965 when the voluntary controls came out, nobody was identifying those temporary causes that we were going to remove and how we were to remove them. That still remains the case.

The second contradiction is that we have just gotten through an extensive and difficult negotiation on the liberalization of trade, a major element in the balance of payments, and have been moving in the past several years in exactly the opposite direction on other aspects of the balance of payments through restriction of capital and now travel.

A third contradiction I see is a shift in the U.S. posture toward the adjustment process, depending on its own situation vis-a-vis the rest of the world, and that is the responsibility which we now say the surplus countries have to correct our deficit. This was a responsibility which we foisted on them and in fact continued for the first 20 years after World War II: to say that the deficit country had the major responsibility, and that we would help them out under certain circumstances if in fact they were pursuing policies which we approved.

In fact, we gave considerable aid as you know, Senator, to the European countries including aid to France during its pursuit of the war in Vietnam. In other words, we were willing to help though we were a surplus country, if in fact we approved of the policies of the other countries.

What some of them have been saying to us in effect is: "We are unwilling to help you because you are pursuing policies which we do not approve."

The fourth contradiction I see is that as the Council report states, countries whose competitive position and domestic demand levels are satisfactory may have deficits due to excessive capital flows. This is a phrase, "excessive capital flows," which Secretary of the Treasury Fowler has used in the past. I know no way of determining what an excessive capital flow is as compared to an excessive element in any other of the balance-of-payments items. That is, the balance of payments is a mixture of economic factors which meld together in a single balance, and I do not know precisely how one can be excessive as compared to another. This is a contradiction in the treatment of the elements of the balance of payments.

Finally there is a contradiction in what we say we want to do and what we are doing. As the report of the Council of Economic Advisers states, the United States must carry out its responsibilities as the major world bank. It reiterates again that the U.S. dollar is the key international currency, and yet it has been moving repeatedly to weaken the role of the dollar as Professor Machlup indicated with successive partial devaluations and now controls.

In fact, what we are saying is that the dollar is not strong enough to bear the burdens which it must bear if it is to be an international currency.

May I make one footnote on the controls, and that is that I hope that the committee has asked for the legal justification for the controls. They were imposed under the 1917 Trading With the Enemy Act. Incidentally there should be a correction there. My copy says 1947, it is the 1917 act which permits control of U.S. persons, companies, or subsidiaries involving financial transactions with an enemy country. I know no particular way, myself, how we can declare that all the banks outside the continental United States are enemy banks, but I am sure that the Attorney General has made such determination which is satisfactory to the administration. I hope the committee asks for that justification.

Let me turn now to the adjustment process, and how we apparently are handling it, as compared to the ways in which Professor Machlup pointed out. One of the ways of handling a deficit is to employ reserves, and by employing reserves I mean permitting them to flow out to meet the deficit.

This is a role which we have almost denied gold. We have stated that we would use the gold to meet deficits, but have acted repeatedly to indicate to the rest of the world that we feel very very badly if we use gold, if we lose it, and, therefore, have signaled to the rest of the world that we ourselves consider that gold is more valuable than the dollar.

Now, of course, Congress has before it a bill to remove gold from the dollar, and again in a sense we are contradicting ourselves. We are saying we really do not need it to back the domestic currency, but we do need somehow to hold it—not to be given up but to be held in order to strengthen the dollar internationally. Not even the Europeans accept this particular construct of the relationship between gold and the dollar; and, in fact, the reason why they have voted for gold and against the dollar is not because there is any particular relationship between the two, but because they distrust the United States handling of the dollar more than they distrust the value of the gold in the world market.

Let me turn now to some of the specific factors which the Council mentions as being the cause of the deficit and, therefore, subject to some kind of correction. They indicate some special factors, the $500 million loss for Expo 67; they mention the cost of the Middle East crisis. They do not, so far as I could find anywhere in the report, mention the copper strike and its effect of $300 million to $500 million cost of additional imports on an annual basis. It has not run to that yet. It has not been a full year but on an annual basis it would run between $300 million and $500 million of imports of copper.

They do go on to blame, however, direct investments, asserting that there has been a disappointing performance on the part of the return of earnings, in 1966–67, particularly; but so far as I could read in the report, they do not mention that the return of earnings was affected by the voluntary constraint program. In fact, the earnings themselves are dictated more by foreign factors than by anything the companies can do.

Additionally, they indicate that there are cyclical forces which contributed to an indicated total drop in U.S. direct investment outflow during 1967 of about $500 million. I have been studying direct investments now for about 15 years, and I know of no evidence which indicates that there is a cyclically affected flow of direct investment from the United States to the rest of the world.

On the contrary, our experience is too short. We have only about 15 years of experience in outflows, and this is not enough to tell us about the cyclical effects on direct investment, and we certainly know nothing about the shifts from one country of destination to another according to economic cycles, and we know very little about the cyclical effects of the U.S. economy itself on an outflow of direct investment. So, I would like to throw some doubt on that proposition.

Turning now to the controls, the Council's report states that the new mandatory controls are necessary for the purpose of injecting equity into a control scheme; that is, voluntary controls were not equitable, but mandatory controls will be equitable.

But the mandatory controls are themselves based on 2 years of experience under voluntary controls—1966 through 1967—and, therefore, compound the very inequities which are supposed to be avoided. Many companies tried to do their best to meet those control levels. In fact, they operated in such a way that there was a zero-net outflow of funds for some, who contributed to the U.S. balance of payments through a reduction of capital abroad; that is, they actually decapitalized in some cases. They, therefore, are left under the mandatory control system with a zero base, and even if you are permitted to export capital equal to 65 percent of your base, that is still zero from any companies.

In addition, there are some companies who were standing in the wings in 1964–65 planning investment who were literally cut out through the voluntary controls, because they had no base, and are still in a position of having no base. Although exceptions are permitted, these exceptions have to be given authorization by the Department of Commerce, and as you know, Mr. Chairman, if exceptions have to be granted, you begin immediately to remove equity. Therefore, I see no particular way in which the controls will operate to gain the one major thing which they say mandatory controls will gain over voluntary controls.

As to the effect of the controls themselves, I have worked out a table which I will not go through in this presentation, but will only indicate that the best that we can tell, an outflow of dollars in a normal pattern, a normal aggregate pattern of investment, will be paid back in the balance of payments within about 2½ years. Now this is an aggregate experience taken from the data of the Department of Commerce, and is not a specific investment project. But, if that is true, I think we are already now in 1968 bearing the burden of 1965 restrictions in a loss of exchange, to meet our balance-of-payments deficit.

Each year, of course, as the controls proceed, we are continuing to lose the payback from past investments which were not permitted.

Now then, the average, as I quite well admit it, is made up of a variety of specific projects, and, therefore, of varying financial outflows and inflows. I have tried to detail in the table a few examples and as many of the complex factors as one could get an even estimated grasp of. They show that even a direct acquisition might well be repaid in 2½ years, and any expansion of investment after that 2½ years might very well give rise to an immediate payback.

For example, General Motors has reported that over the past 20 years no dollars have flowed out to support its investments abroad. If that is in fact the case, all of the returns, which normally run about 60 to 65 percent of earnings have been on top of a zero base of outflow; that is, they are a net contribution to the balance of payments.

This is largely the case for an expansion of existing investments, which occurs largely without any outflow dollars. Therefore, in order for us to get the largest paybacks, what we need is to expand existing investment. That, however, means that there must have first been a base somewhere, and, therefore, we are now beginning to pay additionally for the fact that we have discouraged investment literally since 1962, not since 1965, but since 1962, with the Revenue Act of 1962, which displayed, at least, an aura of disapproval by the Government of foreign investment not only for balance-of-payments reasons, but, because of tax reasons, tax inequities and so on.

We are, therefore, I think, now beginning to pay fairly seriously for our follies in the way in which we looked at foreign investment outflows.

There is another aspect which I wish to close on, and that is that our handling of the investment controls, including the portfolio on direct investment, particularly now, indicates to European and other countries that we are willing to slap them very hard for the purpose of showing them that they are in fact dependent on the United States. It is, in my view, almost a spite action, an action which says to them, "If you do not really understand how important we are, we will show you by pulling the props out from under you." That, to me, is an irresponsible action for a country as strong as we are.

Not only that, but that and the various devaluations we have gone through, the control schemes, feed even more the growing desire in the United States for a type of economic isolation, for a type of withdrawal from economic responsibilities which I see growing in magnitude, and which I regret greatly, since they may turn us back toward the thirties.

That is all, Mr. Chairman. Thank you very much.

(The prepared statement of Professor Behrman follows:)

PREPARED STATEMENT OF J. N. BEHRMAN

U.S. DIRECT INVESTMENT RESTRAINTS, 1965–68

1967 was a year of contradictions for U.S. international financial policy, and early 1968 has seen an intensification of the basic conflict between the principles of a free society and controls which are appropriate only with a wartime economy. These controls have not been justified as necessitated by war financing but as required by the economic forces. The Government has, moreover, insisted that the controls are temporary, without indicating the temporary causes which may later be altered or offset. Without an identification of the temporary factors justifying departure from free economic institutions, it is difficult to assess the ability to generate measures to terminate the controls.

A further contradiction arose in the successful negotiation of the Kennedy Round, liberalizing trade, while controls were imposed on capital flows. There is no clear justification for interference in these aspects of international payments rather than or exclusive of interference in the area of trade. One fears that the only justifications for differential policies on trade and investment is that of administrative nicety—that is, it is easier to turn on and off controls over capital than controls over goods.

These comments are directed at the present control policies which are carrying the U.S. not towards but away from those "broad economic objectives that all nations hold—such as high employment, sustained worldwide economic growth, a high degree of freedom of international trade and capital movements, and an adequate flow of capital to the less developed nations." (*Econ. Report*, p. 165.) The *Economic Report* asserts that "there was no choice but to move, in part, in ways that are restrictive and thus not fully compatible with the long-run aims of expansion and efficiency in the world economy." (p. 166.) This is the washing of hands by the deficit country in the face of an asserted lack of responsibility on the part of the surplus countries. The Report cites the OECD Report on the Adjustment Process which calls on the surplus countries to assume a special responsibility to maintain their pace of economic growth. But the OECD does not impose upon the surplus countries the responsibility for deficits in international payments. Such a concept of causation is too simple and one which the U.S. Government has refused to accept since 1945, throughout the Marshall Plan, and during its aid to developing countries.

While the U.S. accepted the burden of relieving the pressures of reconstruction, recovery, and more rapid growth from many countries over the world, it not once agreed that the pressures were generated in part by its own economic policies—even though at times U.S. growth rates were low and nearly stagnant. For it now to claim that others should assume some responsibility for U.S. deficits is a tactical switch and highly unrealistic politically. No government is yet ready to assume *responsibility* for what is happening in another economy or to the other's international payments. The causes are too complex and the remedies difficult to accept when they involve "donations" to another country. While they may agree not to fight to maintain their surpluses, even this agreement will be contingent on the circumstances. But the U.S. Government has been asking for more—a sharing of its burden, though there are no principles of burden sharing yet accepted.

The reason why the U.S. Government assumed the earlier responsibility of assistance to relieve others' deficits was that it approved of the objectives of those countries—including the French pursuit of the Viet-Nam war in the 1950's. Had it disapproved—as it sometimes did with the developing countries—it would have (and did) withhold aid. Other countries are saying the same thing to the U.S. now: "while payments are obviously two-way, we do not approve of the purposes of your expenditures."

Consequently, we have selected an element of payments to control—capital flows—which Europe has at times complained about and concerning which there is some question within the U.S. as to its usefulness. The rationale is that even "countries whose competitive position and domestic demand levels are satisfactory may have deficits due to excessive capital outflows." But where are the criteria of "excessive"? What capital flows are referred to?—short-term? flight capital? portfolio? direct investment? No distinction is made in the argument, and all are tarred with the same brush. I know of no reasoning that shows how capital movements may be "excessive" while outflows of funds on other accounts in the international balance are all "reasonable," and no effort is made in the report to explain the culpability of capital for the deficit.

But having asserted that capital movements are an appropriate subject of restriction,* especially when other countries do not behave properly, the Report turns to the record of U.S. international payments and the impact of the deficit. In brief, the policies to treat the deficit are aimed at making the dollar sound and returning it to that position of strength which will permit "the United States to carry out its responsibilities as the major world bank . . ." This role, however, is undercut by the necessity felt by the policymakers to achieve balance. They are going to demonstrate that "The dollar is a world currency" by prohibiting it from performing the functions of such a currency. At the same time, the Government proposes creation of SDR's which will supplement the role of the dollar, internationally. There is an underlying current that somehow the U.S. dollar can both be an international key currency and yet not have to bear the burden of being one—even permitting the authorities to place controls over its use, at times, despite the fact that such action denies it an effective role as a key currency. Thus we come into a strange world of controls for the purpose of strength—a tactic we strongly opposed on the part of others—and of a "world bank" which seeks to give up that role.

ADJUSTMENT PROCESS

Among adjustments to a deficit examined by the Council, little attention is given to the use of reserves. (Its discussion of removing the gold cover is in a later section of the Report.) There is even an implication that reserves should not be used in the statement that "every nation—particularly the one that serves as the world's bank—needs an adequate margin of liquidity" (p. 167). Further, the U.S. Government has tried for 8 years to prevent others from asking for gold while saying that the entire gold stock is there to back the dollar.

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*I must raise a question concerning the legal basis of the present restrictions. They are imposed under the 1917 Trading With the Enemy Act, which grants power to control financial acts of U.S. persons, companies or subsidiaries involving "enemy" banks. I suggest that it is a strain of the word to declare *all* banks outside the continental U.S. as in enemy hands. And I hope that the Congress has asked the Attorney General for a copy of his opinion on this matter which he undoubtedly provided the President.

Historically, the role of reserves performed the function of providing an alternative to currency *and* goods. If the former was uncertain of value (lack of confidence) and goods were not desired, gold provided the alternative. Gold, then, was an acceptable import or export when goods were not and when some currencies were weak. Countries with weak currencies needed to hold gold for contingencies. Contrarily, as long as the British pound was considered sound, the level of reserves needed by England was quite small. And, if the U.S. dollar were "as good as gold" there would be little demand for gold save from private hoarders. So long as the dollar is sound and more desired than any other competing currency, the gold reserves *needed* by the U.S. are practically nil—witness the decade 1945 to 1955 when gold reserves were little called for. When the dollar is weak and there is lack of confidence, large reserves are needed—more than the U.S. can command without drastic shifts in economic policies which would be detrimental to all. Thus, the crux of the matter lies in the policies directed at maintaining the strength of the dollar, which cannot include controls, for they automatically attest to its weakness.

The *pressure* of the U.S. deficit, therefore, is intimately related to the domestic strength of the dollar, which is recognized by the Council in its stress on the necessity for firmer fiscal and monetary policies and its statement that the easing of monetary conditions in 1967 widened the deficit. If adequate domestic measures had been taken in 1966 and 1967, if the export drive had been expanded in 1965, rather than relaxed, and rather than waiting until 1968 to re-emphasize it; *and* if the gold reserves had been let go freely, rather than attempting to hoard them, the situation would be much improved today. Rather than make certain to maintain stability of the dollar and use the gold, we cried the weakness of the dollar when in fact it was strong. The U.S. Government has acted for 8 years as though the dollar would be weakened by a loss of gold, as though the gold were more precious than the dollar, and as though holding gold would somehow strengthen the dollar. It has been obvious to the rest of the world that these suppositions are not correct. The projected untying of the dollar from gold domestically is our own recognition of the fact that gold does not give strength to the dollar. Rather, the rest of the world voted for gold against the dollar, when it did, on the ground that the U.S. did not know how to manage its own economy so as to maintain the value of the dollar.

The Council attests to this point itself in noting that the worsened deficit in 1966 was a result of the foreign exchange costs of the Viet-Nam war, and "the strains placed on our domestic economy." (p. 169) These strains were exemplified in the increased import demand in 1966 and particularly in the last of 1967. It is interesting to note that among the "special factors" explaining the deficit are a $500 million loss because of Expo 67 and costs of the Mid-East crisis, but no mention is made of the $300–$500 million (annual) loss from the copper strike, which occurs from greatly expanded imports. But the Council does blame direct investment for an increase in the deficit on the grounds of only a slight increase in income from investment in 1966 and an inadequate return in 1967: "This disappointing performance reflected an actual decline in income from investments in Western Europe during the last two years, despite the further substantial buildup of assets there." (p. 170)

There is in the above statement a lack of recognition of the fact that voluntary controls existed on direct investment in 1965–67 and that companies retained earnings abroad in order to expand production rather than send dollars for new investments. This action built up assets but the return of *earnings* was determined first by factors abroad, which were not favorable, and is not the whole story on the payments accounts of direct investment. The avoidance of emphasis on the voluntary controls is evident also in the statement that direct investment outflows dropped in 1967 because of cyclical forces: "Along with other influences [not named], the cyclical forces contributed to an indicated total drop in U.S. direct investment outflow during 1967 of about $500 million." (p. 170). We have not had enough experience with large direct foreign investment outflows since World War II to know whether they are cyclically affected and whether, if so, they are affected more by the parent country cycle or that of the host country—and whether they shift among countries of destination according to the pattern of economic growth cycles. The evidence of the past decade provides little evidence of cyclical behavior, and to claim such a correlation at a time when companies were responding strongly to constraints by the Government which forced a reduction in outflow is certainly to focus on the wrong factors.

Controls

This voluntary program is now substituted by a mandatory one, despite admitted "excellent business cooperation" with the former. Besides the stated necessity to curtail outflows, a justification for the new controls is "to insure equality of burdens among all direct investors." Such an objective is hardly accomplishable. Not only have inequities already been built in, but the history of foreign investment precludes equal treatment now. Inequities have been built in by assuming a given base period as appropriate—one under which voluntary controls existed. But, some companies tried to do more than their share and even paid out dividends greater than earnings, taking funds from surplus, and making no new investment. Their base is thereby restricted to zero and 65% of zero is still zero. A company which delayed investment, as requested, in 1965–67, also reduced its base; only those that invested to the limit are not discriminated against.

Companies that were projecting their first foreign investment abroad have no base at all, while companies having invested over 20 or more years have long since stopped sending dollars overseas and need no base; having established a policy of returning 60 to 65% of earnings anyway and borrowing locally as needed, the 35% limitation on the "moratorium" countries is no constraint. Nor can the medium and small-size businesses borrow readily abroad to make their investment. Thus, there is discrimination based on who was abroad first and how long. And exceptions granted by Commerce merely intensify the possibility of inequities, for administrative judgments are seldom equal nor circumstances similar.

The effect of controls whether under the voluntary or mandatory system is always discriminatory; it is impossible to determine whether situations are equal or to treat the new-entrant equitably. Further, what is equitable among companies may not be the best policy for the economy, if it *must* reduce outflow and increase inflow. Such an objective would argue for a careful selection of projects to be approved which would require the least outflow and provide the largest and most prompt return to the U.S. of funds. The discrimination which will result from present procedures will produce a warping of the foreign investment flows and future returns which will certainly be different from that without controls, but with what precise damage we cannot now tell.

Both government and business officials have said since 1965 that the controls should not be continued for long and that the damage to company operations and the U.S. balance of payments would be large if restraints remained. We cannot know precisely the impact of the past constraints on the present payments position, but the longer they remain the better we can estimate for the impacts to begin to fit the average pattern of investment flows and returns. Thus, we may use the aggregate statistics to show the effect of continued controls over foreign investment.

As recognized in the Council report, capital outflows account for between 30 and 35% of capital outlays abroad, 20% comes from re-invested earnings, long-term borrowing abroad about 8%, with short-term borrowing and depreciation allowances constituting the remainder. Thus, on the average and including expansions of existing plant and new enterprises, expenditures for plant and equipment abroad of $1 million require no more than $350,000 of outflow. This outflow is immediately reduced by sales of capital equipment and patents owned by the parent, as well as technical assistance, to the affiliate. These will amount on the average to $50,000 each—often higher for countries outside of Europe. Thus, the net outflow will be on the order of $250,000. Exports may have been stimulated by realization in the market that a local supply would soon be available, but some exports may also be substituted by foreign production. Apart from these shifts, the affiliate will soon return income from earnings and sometimes management and R&D fees.

The accompanying table illustrates data from different investment situations. The first, relying on the aggregate data on manufacturing investment abroad, demonstrates that the payback period for outflows of U.S. dollars is about 2½ years—on the average. But this average is made up of different projects—some returning funds immediately to the U.S. and without any outflow and others draining dollars for several years before they are offset by earnings and exports through the affiliate. The extreme unfavorable situation is that of a company making a mis-calculation as to whether its exports would decline and investing abroad when it did not have to in order to maintain its market. It is unlikely that it would ever repay the lost exports.

EXAMPLES OF PAYBACK FROM U.S. DIRECT PRIVATE FOREIGN INVESTMENT

Item	Aggregate data (period)				Acquisition and expansion (period)							New facility and loss of exports[1] (period)						
	0	1	2	3	0	1	2	3	4	5	6	0	1	2	3	4	5	6
(1) Capital expenditure of which	$100				$100				$50.0			$100.0						
(2) Local borrowing or depreciation	45				65				40.0			30.0	$30.0					
(3) Retained earnings	20					$3.5	$3.5	$3.5	10.0	$7.5	$7.5							
(4) Dollar outflow of which	−35				−35							−20.0	−20.0					
(5) Equipment	5				5				2.5			2.5	2.5					
(6) Patents, technical assistance, and management	5				5								5.0					
(7) Net outflow (−)	−25				−25							−17.5	−12.5					
(8) Income (8 percent of book value)[2]		$4.5	$4.5	$4.5		3.0	3.0	3.0	4.0	5.0	5.0			$3	$3	$3	$3	$3
(9) Exports: direct												10.0	10.0	−20	−20	−20		
(10) Exports to affiliate:																		
Products		4.0	4.0	4.0		4.0	4.0	5.0	6.0	6.0	6.0			5	5	10	10	10
(11) Components		2.0	2.0	2.0		2.0	2.0	2.0	3.0	3.0	3.0			5	5	5	5	5
(12) Exports: Other[3]		2.0	2.0	2.0		1.0	1.0	1.0	1.0	1.0	1.0			2	2	2	2	2
(13) Imports		−2.0	−2.0	−2.0											−2	−2	−2	−2
(14) Net effect in year	−25	10.5	10.5	10.5	−25	10.0	10.0	11.0	14.0	15.0	15.0	−7.5	−2.5	−5	−7	−2	18	18
(15) Cumulative payback (−) drain	−25	−14.5	−3.0	7.5	−25	−15	−5.0	1.0	20.0	35.0	50.0	−7.5	−10.0	−15	−42	−24	−6	21

[1] Assumes that exports of $50 would have continued if there had been no investment; in years 1 and 2, exports rise in anticipation of local supply.

[2] Book value equals U.S. dollar outflow plus retained earnings. In the "new facility" example, there are no earnings to retain for investment to begin with.

[3] Assumes a marginal income propensity to import by the host country of 1/10 and a U.S. share of 20 percent—or, 2 percent of marginal income; in the acquisition case, it is assumed that former sales are doubled, so that only half of sales are new income.

But, this last result is highly unlikely because U.S. businesses are basically reluctant to invest abroad unless they are losing the market or stand in grave threat thereof; or, unless a company has not entered the market as yet and fears never to be able to enter through exports. In such cases, the substitution of local production for exports merely holds a market and gains some return when export earnings would have fallen to zero or never arisen. We can feel fairly certain that exports are not completely substituted by foreign investment by the fact that exports in the areas of high investment activity have not declined. They have not risen as fast as foreign production, but some categories have risen faster than the average of all industrial export. In the main, it is the technically advanced sectors which supply both exports and investment. Thus, in the aggregate, what is occurring is either an expansion of market opportunities by investment, raising the level of former exports through the establishment of selling affiliates or manufacturing and selling units, *or* widening the types of goods sold by the company as a result of extensive promotion of the company name and line. One cannot know from existing data whether the situation could have been more favorable with less investment and more export promotion. But, given the freedom of companies to decide which is the more profitable route, it seems highly unlikely that they would take the investment route if the export channel were effectively open on an intermediate or long-term basis.

As noted above, these conclusions from the aggregate data—and we shall have much better data from the current census on foreign investment—can be contradicted on either the optimistic or pessimistic side by reference to specific cases. The other cases in the accompanying table show that the payback period for an acquisition might well be 2½ years also but that of an expansion (which involves frequently no U.S. funds at all) provides a payback immediately. And, of course, a prior investment is necessary to reap the gains of an expansion of outlays on facilities.

The case in which exports were significant but expected to decline provides more complexities but still can be estimated to pay back the outlays as well as the loss of exports within a period of 4½ years from start-up of operations and 5½ years from the first outflow of capital, assuming a 2-year construction period. The conclusion rests heavily on several assumed relationships, and any alteration of these can produce quite different results. It is necessary to keep one's estimates relevant to business practice and expectations, however, if policies are to be made on the expectations of gaining returns for the payments deficit.

Restraint of investment in the case concerning a loss of exports provides a significant gain for the payments deficit over 3 or 5 years. But, prevention of the others will damage U.S. payments within 3 years. And, if one may assume that exports are often generated by expectations of the market of a continuous supply, the payback may have actually been achieved *before* start-up of foreign production—even if earnings are not gained for some years.

Another aspect which is quite hypothetical but significant is that concerning the indirect impacts of economic growth resulting from foreign investment on export and import patterns and volumes and on interest rates and thereby again on growth rates and trade and investment flows. The outflow of capital from the U.S. will tend to slow down its own growth through a reduction in capital supply (and demand for capital goods), raising the interest rate; this in turn reduces import demand and improves the balance of payments. The converse occurs abroad; in addition, the differentials in interest rates tends to draw short-term capital to the U.S. and out of Europe and other countries—unless offset by monetary policy. These secondary and tertiary impacts are not quantifiable but must be considered in determining the effects of capital restraints.

Given the admission that some countries need the inflow of U.S. capital and the fact that even European countries have come to depend in part on repeated infusions, despite the heavy local borrowing by foreign enterprises, there is something of a "spite action" in the capital controls. It is almost as though the U.S. were saying—"We'll show you how dependent you are on us and then you'll recognize how much you need to hold dollars, even if you don't want to." This is hardly the way for the most powerful country in the world to behave; it is petty rather than responsible. It demonstrates an eagerness to toss off the burdens of leadership, which is precisely one of the causes for lack of confidence on the dollar, for that leadership requires monetary and fiscal rectitude on our part as well as maintenance of a strong economy.

Some economists argue, however, that the U.S. must look to its domestic problems first, maintaining full employment even by inflation. Yet this prescription will tend to remove the dollar from its role as the international currency, for continued U.S. inflation relative to others will bring strong pressure to devaluation. But the key currency—if the dollar so remains—cannot be the subject of devaluation; others will merely follow, and the consequent disruption from such an attempt would be a firm signal that the U.S. has abandoned its role of world leadership in economic affairs. Not only will it have abandoned that role, it will have done so through the route of controls and the abolition of trade and capital movements, pushing the world back to the 1930's.

Chairman PROXMIRE. Thank you, Mr. Behrman. Thank you, gentlemen, for your most stimulating presentations.

Mr. Behrman, I would like to start with you. Your analysis indicated that a $1 million investment abroad may, on the average, require a capital outflow of only about $250,000, as I recall it.

Mr. BEHRMAN. That is correct, on an aggregate basis; yes.

Chairman PROXMIRE. And you conclude that the payback period of U.S. investment abroad is about 2½ years in an average or normal situation?

Mr. BEHRMAN. Yes, sir.

Chairman PROXMIRE. If this is true, it is obvious that some investments must pay back in 12 months or 18 months or you have some examples of very, very big and important areas where you have no outflow at all in the payback?

Mr. BEHRMAN. Yes, sir.

Chairman PROXMIRE. In view of this would it be possible to administer a program that follows up on your interesting suggestion on page 8 when you say, "A careful selection of projects be approved which would require the least outflow and provide the largest and most prompt return to the United States of funds."

In other words, would it be possible to say that you would make investments that would pay back in 18 months or 24 months or maybe even 12 months? Is this a feasible alternative or not?

Mr. BEHRMAN. No, sir; I would not think so, for this reason: The decision of a company to pursue an investment project takes about 2 years in gestation. I am talking about a new project, an acquisition or an establishment of a new project, not an expansion of an existing one.

If the company had any idea at the end of a year and a half or 2 years with the cost of investigation being several hundred thousand dollars, that the Government would say "No," the initiative on the part of the board or any other official is going to be seriously damaged.

Chairman PROXMIRE. Are you saying that you simply cannot determine in advance?

Mr. BEHRMAN. You cannot determine quickly in advance.

Chairman PROXMIRE. You cannot determine what?

Mr. BEHRMAN. Quickly in advance, what the payback will be. In fact, some of the payback which I have indicated—that is, an expansion of exports before construction—comes only after an announcement of the fact that the investment will take place. You cannot be sure of that, that the demand for imports in the foreign country will go up until the announcement is made. You can guess it, but you could not prove it to the Department of Commerce.

Chairman PROXMIRE. Then I take it that in view of your very convincing argument—you have had an enormous amount of experience in this since you have been studying it for 15 years, and I doubt if any competent expert or economist has made the kind of exhaustive studies you have—would you conclude that it would be wise not to approve the President's proposal. I do not know if we can do anything about it except, as you say, examine the legal authority, because the President does not come to Congress asking to restrict investment. As I understand it, he is acting under a law passed many years ago.

Mr. BEHRMAN. In 1917.

Chairman PROXMIRE. At any rate, as far as your position is concerned, do you think it is an unwise policy on the part of the President to impose this restraint? If this is true, would you go further and repeal the interest equalization tax and would you go further and repeal the Commerce Department's so-called voluntary program, and would you also repeal or rather reverse the Federal Reserve Board's restraint on banking institutions as to lending abroad?

Mr. BEHRMAN. Senator, if we were in 1965 I would have said—as I said at the time, or in 1962 or 1963, when the interest equalization tax went on—we should have done none of those things at that time.

Representative RUMSFELD. Would you repeat that? I am having trouble hearing you.

Mr. BEHRMAN. I am sorry. I say if we were in 1965 when the voluntary controls went on or if we were now in the period when the interest equalization tax was imposed—was it 1963, Fritz? I have forgotten—I did say then that we should not have done any of those things. On the contrary, what we should have done, having a strong dollar as we did at that time and a strong economy with an inflation rate much lower than anyone in Europe, instead of crying the weakness of the dollar, which we did officially all over the world, have declared the strength of the dollar and used our gold reserves to meet the deficit, and continue to maintain the dollar strength, we would not be in the position we are in now.

Chairman PROXMIRE. What would you do now?

Mr. BEHRMAN. Now? All right. Now you can save by constraints, as we are now doing on controls, an amount of money from a capital outflow, let us say $1 billion or whatever else, which is what they are after, you can save $2 billion, 1 year at a time. To me this will not solve any of the problems which Fritz Machlup laid out very nicely. What we are saying is that somehow $2 billion can do something to solve fundamental problems of confidence. I do not think it can.

On the contrary, we are building up problems for the next few years which, in my view, are equally or more serious, because we will not get back the plus flow we would normally get back in 1970–1971, and additionally we are telling the rest of the world that we are somehow not strong enough to maintain our responsibilities. My answer, Senator, is "Yes;" I would ask that these not be continued.

Chairman PROXMIRE. Not be continued?

Mr. BEHRMAN. Not be continued.

Chairman PROXMIRE. All right. You say you could not quantify it, but could you give us any ball park estimate on your very interesting observation that the outflow of U.S. capital tends to slow down our economy and speed up the economies abroad, and, therefore, seems to have something of a counterbalancing effect on our balance of payments. This would be most helpful if you, or any of the other gentlemen here, could give us some notion of those dimensions.

You have already made a very strong case. There is a payback of 2½ years in our investment abroad. If you can also make a case that this is somewhat equalizing.

Mr. BEHRMAN. I am not sure that Fritz had the paper earlier. Let me just brief a point. Fritz, you probably have been working on it much more than I, but what we are getting into now are the secondary and tertiary effects of capital flows among nations. This has not been thoroughly studied, I think, even on the theoretical basis.

Chairman PROXMIRE. Doesn't it assume a rigid monetary policy?

Mr. BEHRMAN. Yes; it assumes a given monetary policy.

Chairman PROXMIRE. Which is not realistic?

Mr. BEHRMAN. Which is not realistic.

Chairman PROXMIRE. In other words, it can be offset?

Mr. BEHRMAN. Yes, sir; it can be offset on either side.

Chairman PROXMIRE. Yes.

Mr. BEHRMAN. But as long as the United States is not itself inflating, a capital outflow is advantageous to the United States, initially. Now, what happens with it in the various flows and in the various offsets, as you say, becomes quite complex, and that is why I cannot get into the ball park, because it does yield to varying monetary policies in various places, various countries and there is also a possible flow of funds among foreign countries.

Chairman PROXMIRE. I want to ask Mr. Machlup about this, in just a minute, but I would like to ask you one more point in connection with this, and that is, what you are telling us is that on the assumption that the so-called temporary factors will last more than a couple of years, then the action taken is unwise. It is only on the assumption that the temporary factors might evaporate within a year or so that you can justify the kind of temporary action that is being taken; is that correct?

Mr. BEHRMAN. Yes, sir. That was the administration position, itself, in 1965, but what I asked then and what I ask now, Senator, is, What are the temporary factors?

Chairman PROXMIRE. You list the copper strike. North Vietnam is another one—perhaps temporary we hope—and there are others. I would like to ask Professor Machlup to comment.

Mr. MACHLUP. I would invite you to turn to table 1 of my prepared ent (p. 415). In the fourth column you find the balance of goods and services excluding military expenditures. I show military expenditures separately in the next column, as one of the financial transfers.

I have arranged all financial transfers to foreign countries under four headings: Military expenditures abroad, remittances and pensions, U.S. Government grants and capital (net), and private U.S. capital (net). If you add up these four items, you get the total which I show in the next column and which I call total of financial transfers to foreign countries. Now, we can compare this total with the fourth column previously mentioned; namely, the balance on goods and services excluding military expenditures. This balance may be called real transfer to foreign countries. I invite you, now, to compare the lows and the highs.

In 1953, the total of our financial transfers was $5.6 billion.

Chairman PROXMIRE. What year is that again?

Mr. MACHLUP. 1953. The total of the financial transfers in 1953.

Chairman PROXMIRE. Yes.

Mr. MACHLUP. $5.6 billion. Our financial transfers then increased, and the high was in 1964, of $13.9 billion. Now, if you look at the real transfers, the net transfers of goods and services, shown in the fourth column, you find that these were $3 billion in 1953, but $11.4 billion in 1964.

This indicates to me that the financial transfers created, so to speak, the real transfers. There was, to some extent, an adjustment taking place, a self-adjustment.

Most of the financial transfers were independent of the state of the balance of payments. Military expenditures were surely not increased because of an improved balance of goods and services; likewise, capital movements, governmental or private, were not induced by the trade balance. They were autonomous transactions. But these financial transfers, through economic forces, created their own offset, the improvement in the balance of goods and services. Unfortunately, these improvements were never big enough. They always left us with a transfer gap. The third column from the right shows you the transfer gap.

I want you to note, the transfer gap in 1953 was $2.6 billion, and in 1964, despite the enormous increase in financial transfers, the transfer gap was still only $2.5 billion. This indicates, at least to me, that the rise in financial transfers brings with it a rise in real transfers, and likewise, and—this is the point that Mr. Behrman has been making—a reduction in financial transfers is likely to bring with it a reduction in real transfers. So, if we transfer less to foreign countries in the form of dollars, they will also buy less from us and we will buy more from them.

Representative BOGGS. May I ask you a question about those figures?

Mr. MACHLUP. Yes.

Representative BOGGS. I notice you do not have 1967.

Mr. MACHLUP. That is right. They are not yet available in full detail.

Representative BOGGS. Obviously, one of the big items in your whole table are military expenditures abroad. How much increase was there in 1967 over 1966?

Mr. MACHLUP. I called Walter Lederer this week, and he could not yet give me the final figure. There was an increase.

Representative BOGGS. How much?

Mr. MACHLUP. I could not tell. I think the increase was less than $1 billion.

Representative BOGGS. That is probably what is wrong with your figures. They do not reflect the increase in Vietnam, which is certainly a most significant element.

Mr. MACHLUP. These figures come from the Department of Commerce, and 1967 is not yet included. The Economic Report has a figure which is only for the first three quarters of 1967. Taking the first three quarters at an annual rate, you see an increase of between $500 and $600 million for 1967 over 1966. It was from $3.7 to $4.2 billion, hence, a little over $500 million. There may have been a further increase in the fourth quarter.

Chairman PROXMIRE. My time is up.

Congressman Rumsfeld, you are next. We will come back to Congressman Boggs.

Representative RUMSFELD. Let me clarify one thing, Mr. Machlup. In your statement, page 27, where you discuss these five approaches to solve the problem.

Mr. MACHLUP. Yes.

Representative RUMSFELD. I take it from the remark you made earlier in your statement, it could almost be said that liquidity and adjustment are to be considered together?

Mr. MACHLUP. The problems, you mean?

Representative RUMSFELD. Yes, the problems.

Mr. MACHLUP. The three problems. Unfortunately they were not considered together in official negotiations. They should have been considered together.

Representative RUMSFELD. This is your position with respect to your recommendations?

Mr. MACHLUP. At this stage we must take it for granted that we have not dealt with the adjustment problem and the confidence problem, and hence, we must now ask what we can do. On page 27, I have listed the five approaches to solve the confidence problem. The confidence problem means the danger of massive changes from dollars into gold that threaten to wipe out a large amount of world monetary reserve.

Representative RUMSFELD. First, let me say, I thought all the statements were excellent and I appreciate the time you gentlemen have taken. In each case your statements have been properly on a broader subject than the one I am going to raise, but I would like to have each of you comment on the proposal for removal of the gold cover, and with specific reference to what the possible results might be in the event it is done or it is not done, once it comes before the Congress. What I am asking is, do you see any particular impact in the event that Congress considers it and decides against it?

Mr. MACHLUP. If you want me to start the ball rolling, I think the removal of the gold cover for the Federal Reserve notes is an absolute necessity, if we are all looking at the problem intelligently. We should have done it years ago. It is a complete anachronism to hold gold behind banknotes. It is something which people in the 19th century insisted upon. For that period it was a proper requirement.

In the 20th century, or at the present time, for anyone to insist on a gold cover for banknotes is ridiculous. We should send him back to school. It is absolutely silly, this whole thing, and I do pray you, sir, that you convince your colleagues that they should not prolong something that belongs, from our point of view, to the Dark Ages.

If gold is of any use, it is to send it to foreign countries when they want it. This is the main use of gold. There is, of course, also an industrial use, and I hope the time will come when the governments will be willing to hand all their gold over for industrial uses.

Chairman PROXMIRE. Mr. Butler?

Mr. BUTLER. I would say that I agree completely with that statement. To the extent we can trade gold for useful things, I think we should do it.

I do not see any great psychological repercussions abroad. I think it is assumed abroad that we will do this. And I would certainly agree that we should do it and do it with the greatest dispatch and the least argument possible.

Mr. BEHRMAN. Yes. I would only add that from the domestic standpoint we have already made the largest step, and that is the removal of gold from the credit liabilities of banks. Gold does have a role to play internationally. Unfortunately what we have been saying for the past 8 years is that it is too precious to permit it to play that role. That, I think, is the big contradiction. We should release it, and we should let it play its role.

Representative RUMSFELD. Then none of the three of you see any legitimate arguments in opposition to this proposal? Could I ask Mr. Behrman and Mr. Butler to comment on Mr. Machlup's proposal on page 27 where he, as you will recall, recommended the fourth approach, and in the event that the leverage from the threat of the fifth was insufficient to achieve the fourth, then his position that the fifth should be the course of action for this country.

Mr. BEHRMAN. Let me say that I agree in principle with the value of this fourth proposal, that is that the best way to use the gold that we do have, and to shore up its international strength, is to put it in a common fund.

The thing which has caused gold to give us so many problems in terms of the rise in price is its redirection over the past several years and its sources of new supplies—South Africa and Russia. The fact that some countries have piled it up has made it even more difficult for us to adjust the price, because it creates inequities for countries that went along with us and did not demand the gold. Therefore, to remove this type of problem, the only thing to do with it is to put it in a common fund. It is even possible in my view to divorce official gold from private gold and, as I think Fritz was implying, not to increase the supply of official gold but just to leave it as a lump behind the international liabilities.

If that were done, it were put in a common fund, it seems to me at least that these special drawing rights would not have been needed, and would not now be needed, if you adopted Professor Machlup's fourth proposition. Having it in a common fund, and having no shifts between official and private gold, it would be even possible to raise the price of gold and, therefore, to provide additional international liquidity if and when it were needed, because then you would have none of the repercussions which we now face.

I would strongly agree that we should not raise the price of gold now.

As to the fifth point, as to whether we should use that threat, I myself would prefer a different tactic which I think is feasible, and that is to try to get ourselves back in the position which we held in 1964, of a very strong economy with a rate of inflation much less than in the other industrialized countries of the world. Make it quite clear that we intend to maintain the strength of the dollar, for it is really an internal strength that provides the external strength. What Europeans are saying is, "We do not think the dollar is going to be strong internally and, therefore, how can it play a strong role internationally?"

If we demonstrate that, and then use the gold to meet the deficits from time to time, indicating that the dollar is as strong or stronger than gold, then the preference for gold begins to die out. The problem is that nobody is quite sure that our economic policies even from one administration to the next will be stable enough and strong enough to maintain that commitment. That I think is the burden of an international currency, that the country sustaining that international currency must handle its domestic policies in a way to maintain that strength. That is a burden which some economists say they do not want to bear. They would rather have creeping inflation and let the international dollar go.

In a sense that is what Professor Machlup's final proposition is. We will just untie it. We will let it go and let it flow. To me, from a business standpoint, and a financial standpoint, that is a very harsh alternative, and I would hope we would find the other one easier to follow.

Representative RUMSFELD. Thank you.

Chairman PROXMIRE. Mr. Butler?

Mr. BULTER. You will find very little disagreement on this panel on these matters. My only disagreement with Jack Behrman would be that a generation is somewhat longer than 4 years.

Mr. BEHRMAN. Yes; I would accept that.

Mr. BUTLER. You will find very little disagreement on this panel on I think Dr. Machlup has indicated, it would have to be negotiated. The chances of negotiating it, your point 4, are fairly slim at the moment. So, I think we have to pursue other alternatives, and the best one to my mind is to do what we have to do to defend the dollar, to check domestic inflation, validate the argument that the dollar is better than gold. The dollar is better than gold so long as we run our domestic affairs properly. We have less inflation than any other country in the world. Then gold is better than dollars only under the assumption that we will double its price at some point, which I do not think we should or would do.

Representative RUMSFELD. Because of your judgment that the prospects to achieve No. 4 are very slim, you, as a fifth alternative, would prefer Mr. Behrman's approach?

Mr. BUTLER. Yes.

Representative RUMSFELD. To the ones indicated in the statement?

Mr. BUTLER. I think that all of these things do nothing more than buy us time; that we have to do the things required at some point to check domestic inflation, to maintain the integrity of the dollar. That all of these gimmicks that have been recommended do really nothing more than give us a little more time, and they run the risk always, and the very great risk, of at some point leading to some sort of international collapse of possibly frightening proportions. I do not think this country or the world should run these risks. I think it is far better to do what we should do and to do it quickly, properly, with resolution.

Representative RUMSFELD. Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Boggs?

Representative BOGGS. Thank you very much, Mr. Chairman. I appreciate Mr. Rumsfeld asking the questions about gold cover, because as members of the panel might know, that bill will be considered by the House of Representatives tomorrow. The Democrats have a meeting on it.

I would like to state the question negatively. What do you think the impact would be if the Congress did not pass the bill that is now pending?

Mr. MACHLUP. Well, no one can know for sure, but there may be an impact on gold speculation. We cannot know what the gold speculators think and whether there will be another gold rush, another wave of gold buying as we had in December. As you know, in December, $900 million of gold were lost within 4 weeks. It is quite possible that another such wave would come in February and March, if Congress turned that bill down. I do not forecast. I merely say it is a possibility.

On the other hand, if Congress were voting against the bill, and refused to pass it, I believe there is a way around it. The Federal Reserve banks would simply pay the penalty and allow the banknotes not to be covered by 25 percent in gold. They would have no practical alternative. We will not refuse to sell gold under present circumstances nor will we refuse to increase the amount of Federal Reserve notes if there is a demand for banknotes in the economy.

Now, since these two things are quite clear, there simply is nothing else that they can do. Of course, you could say that we should stop selling gold. That would be an alternative, and it might be a good alternative.

Representative BOGGS. Would any of the other members of the panel care to comment on the negative aspects of failing to pass the bill that we are to vote on tomorrow?

Mr. BUTLER. Again, I would agree. I think it does run the heavy risk of leading to another gold rush. As Dr. Machlup said, you cannot be sure of this, but I think the assumption in Europe, the assumption on the part of people in Europe with whom I have talked, is that we will remove it. Now if we do not remove it, then this changes their view of the future, and I think it could very well add to speculation against the dollar.

I think it is a provision that should have been removed at least 10 years ago. But having not done it then, I think we should do it now, and we should not run the risk of losing another $1 billion of gold merely because of that anacronistic provision.

Mr. BEHRMAN. I would like to add that in a sense not acting on the bill, that is refusing to pass it, may encourage a run on the dollar as well.

Chairman PROXMIRE. Would you say that again? I did not hear it.

Mr. BEHRMAN. It may encourage a run on the dollar as well for this reason. It is widely recognized that gold is not needed for the domestic cover. What will be assumed, therefore, abroad, in my estimation, would be that Congress considered gold more valuable than the dollar; that is, we should not sell it. Not to remove the cover is saying in effect, "Congress says, 'Do not sell it'" period! "We need it more than we need dollars and it is too valuable to let you have."

Since the Federal Reserve can, in fact, go ahead and sell it anyway, it appears to me the reaction might very well be, "If it is that valuable, we want it," and, therefore, accelerate the demand for it.

The reason why there would be a run on the dollar now, if the bill is passed, is that, relatively, the dollar is weak compared to gold. We are not taking the cover off at a time of strength, and I want to add a caution that we should have done it when the dollar was strong. We are now doing it when it is weak and, therefore, we run some risks.

Representative BOGGS. None of you can see any happy results if the Congress fails to pass the bill?

Mr. BUTLER. That is right.

Mr. BEHRMAN. Correct.

Representative BOGGS. Mr. Chairman, I want to congratulate you for having this hearing today. I came here specially because the very subject that we are discussing is now being considered before the legislative committee which has jurisdiction, the Ways and Means Committee. The committee is meeting now, so after my little time is over I am going to have to make my departure, but I would like to ask a few questions about the balance of payments, because, as I say, the legislative committee has the subject before it right at this moment.

I want to talk to my good friend Professor Behrman. I have worked very closely with him for many years and have great respect for him. I do not quite understand what you recommend.

In the testimony that I have heard so far, I have heard a great many witnesses against the regulations which have been issued relative to capital investment abroad. Already the mail is coming in in great volume on the proposal with respect to travel in the developed countries. Tariff barriers are being erected to American exports all over the world. I went into this subject very closely last summer in my subcommittee on this committee, meeting with all kinds of protests everywhere. What alternatives do you give?

If I may say so myself no person has worked any harder for freer trade between the nations of the world. Yet, I must say, I am terribly concerned by these artificial barriers that our European partners are erecting to American goods, and I am not certain that this total investment abroad, which certainly does have an impact upon domestic employment, is the answer to this question, so what I would like you to do is to tell what you are for. I think I know what you are against.

Mr. BEHRMAN. As far as where we should move from right now——

Representative BOGGS. That is where we are.

Mr. BEHRMAN. Right. I agree. Let us take it from there.

Representative BOGGS. Politics is always the possibilities of the present.

Mr. BEHRMAN. Yes. The first thing which we need to do is to lay out a program domestically.

Representative BOGGS. What program?

Mr. BEHRMAN. Including the ones which Congressman Mills has insisted on.

Representative BOGGS. That means reducing expenditures?

Mr. BEHRMAN. Yes, sir.

Representative BOGGS. Where?

Mr. BEHRMAN. In the total budget.

Representative BOGGS. I know; but what programs?

Mr. BEHRMAN. You want to know exactly which items in the total budget?

Representative BOGGS. Surely; and how much.

Mr. BEHRMAN. How much? That is a difficult thing for me to say. I would have to study that, Mr. Boggs.

Representative BOGGS. I know, but we are right up against it right now, today, so you tell me where.

Mr. BEHRMAN. All right. If you will give me a little time to study the total budget and exactly where it has been increased——

Representative BOGGS. I thought maybe you had done that before you came.

Mr. BEHRMAN. No; I did not come to talk about the domestic budget.

Representative BOGGS. How can you separate them when you say the domestic economy is the answer to these foreign problems?

Mr. BEHRMAN. Simply because the dollar strength is determined domestically, Mr. Boggs.

Representative BOGGS. OK, then give me the answer domestically.

Mr. BEHRMAN. All right; the answer domestically is to reduce the inflationary pressure, the expansion of credit and the Government expenditure and to raise taxes, all four of them. Now, it has to be done to the point where the result is a rate of inflation under that of European countries, and that point is not determinable in advance; it has to be done by several methods; the piano has to be played with several notes and continuously—not one at a time.

Representative BOGGS. Let me understand exactly what you are saying. You are saying that travel restrictions, capital restrictions, withdrawing troops abroad, reducing foreign aid commitments will have no impact?

Mr. BEHRMAN. No, sir; I did not say all of those. I am saying that the capital restraints will have a minor impact, much less than has been claimed.

Representative BOGGS. What about travel restrictions?

Mr. BEHRMAN. Travel restrictions; I do not think we will get more than $200 million or $300 million out of that and it is at very heavy cost in terms of restrictions and——

Representative BOGGS. What about——

Mr. BEHRMAN. Withdrawing troops.

Representative BOGGS. Just a minute—the growing percentage of the export-import gap?

Mr. BEHRMAN. I am sorry, I do not get the question.

Representative BOGGS. The fact that our exports relative to our imports are now showing a considerable decline, almost alarmingly so in the fourth quarter of 1967.

Mr. BEHRMAN. Well, the gap has been cut largely by a rise in imports, Mr. Congressman.

Representative BOGGS. Of course.

Mr. BEHRMAN. Right. Well, not "of course." It could have been a drop in exports as well. But exports have continued up, not as much as——

Representative BOGGS. Not proportionately.

Mr. BEHRMAN. Right, and this is exactly what Professor Machlup is pointing out.

Representative BOGGS. I did not hear his full statement.

Mr. BEHRMAN. Well, the drop in our financial outflows has been matched by a partial drop in exports.

Representative BOGGS. Let me ask you this question because my time is so limited. Assuming that Congress reduces all of these items that you will recommend to us later, and we still do not pass the surtax, will we strengthen the economy?

Mr. BEHRMAN. No, sir; I would not think you would strengthen the economy sufficiently.

Representative BOGGS. In other words, you are saying that the cornerstone of the whole problem is passage of the surtax and reduction wherever possible of domestic expenditures?

Mr. BEHRMAN. Expenditures and financial rectitude as well; that is, a reduction of financial pressure, inflationary pressures.

Representative BOGGS. What?

Mr. BEHRMAN. Reduction of inflationary pressures from the monetary system as well. These things have to be played together. But, Mr. Congressman, you cannot strengthen the dollar by playing around internationally. You must strengthen the dollar domestically.

Representative BOGGS. I am afraid you do not help us very much, professor.

Mr. BEHRMAN. The choice is a difficult one, Mr. Congressman.

Representative BOGGS. Unfortunately, you are dealing, as so many of us are trying to do in generalities. You have to spell these things out. You have to say where you are going to make these cuts. You know, you have had a lot of time to study this. If this is your position you should have given us some recommendations on where to cut, not just say "Cut." Anybody can say "Cut." It is like being for peace. Everybodoy is for peace, but the question is how you get it. That is all, Mr. Chairman. Thank you.

(Mr. Behrman later submitted this material for the printed record:)

In response to questions by Representative Boggs, I would like to offer three alternative approaches to reducing expenditures, in order of my own preference:

(1) Congress should promptly place a ceiling on total government expenditures for FY69—say, $2 billion above FY68. It should then appropriate only the FY68 levels for each agency, giving the increase wholly to DOD.

But, to assist the administration to expand programs which it considers highly desirable and to cut the less desirable ones, authority should be granted to shift funds from one Department or agency to another, up to (say) 5% of the agency's funds—that is, any one could obtain a 5% increase or sustain a 5% decrease. If military spending were to rise more, some other agencies would have to sustain a cut.

Further, a 10% shift of funds among bureaus of any given Department should be permitted so that higher priority projects could be expanded—but only at the cost of cutting elsewhere.

Finally, I would insist on a 5% cut in personnel levels (not payroll), within each agency, to be taken at the discretion of the agency head.

The objective of this technique is to provide a quick decision so that the public, business, and foreign countries can know promptly that the Government is acting strongly to reduce inflationary pressure. Most critics care less where the cuts come than that they come promptly. The transfers authority would reduce public criticism, as would the cuts in personnel. Of course, the administration might cut programs strongly desired by Congress, but this is a risk the Congress must take if it cannot determine itself where to make the cuts.

(2) As an alternative, I would insist that the Budget Bureau have all agencies rank their programs as to priority and then that the Bureau do the same for all programs. Congress could then focus on those of lowest priority, cutting sufficiently to keep total expenditures to only $2 billion over FY68. Again, the administration might select for down-grading the projects more widely supported by Congress, but such an action would nearly force the Congress to accept the first approach above.

The problem with this approach is that it takes time to make the determinations. I would, therefore, urge the Congress to agree quickly to a range within which total expenditures will fall—say $2 to $3 billion over FY68, so that all can see that the final result will be anti-inflationary.

(3) If the Congress feels it must select the specific programs to sustain cuts in order to raise military spending, two principles should be followed: one, that no cuts be made in those programs directed toward meeting social ills—poverty, health, slum clearance, urban renewal, etc.—but the Congress should give strong guidance toward the specific goals it expects to be achieved by these; two, that the primary cuts should be in programs which can be delayed without serious damage to any vital area of the economy in the short-run: highway construction, rivers & harbors, subsidies to shipbuilding, space exploration, SST, and oceanographic research and development.

If these are insufficient to cut the proposed budget by $8-$10 billion, Congress should accept that the quasi-wartime situation demands a delay in some longer term programs of educational assistance and should insist also on a careful husbanding (if not reduction) of military support programs which are not closely related to the effort in South Viet-Nam.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Gentlemen, I want to commend you all for very constructive statements. It seems you all agree, No. 1, that the gold cover should be removed, No. 2, that the measure taken by the administration to stabilize our balance of paayments are ineffective, actually, and only borrowing time.

I refer, Mr. Butler, to a statement that you make on page 2. You are speaking about controls of the character—you say, "Controls is in no way a lasting answer to our real problem. They buy time at a heavy cost."

You go on to say that the root cause of our troubles is inflationary pressures, inflationary upsurge due to the enormous rise in Federal defense and nondefense spending after 1965, and so on.

I have the same question, of course, that all of us must face here in the Congress: What do we do to reduce these inflationary pressures? The question has been put by Mr. Boggs about the reduction in taxes. I wish the rest of you would address yourself to that. Do you believe that the Budget can be reduced, that spending can be reduced, and if so, where?

Mr. BUTLER. Well, I believe that it can be reduced. Certainly, the increase in spending can be held down. One way to do it is just to put a ceiling on the rise in expenditures and a ceiling on every Government agency. I think you have to pay for whatever rise there is in the cost of fighting in Vietnam. You probably have to pay for the rise in interest costs. But I think it is perfectly feasible to set a ceiling on other Government expenditures, and I think a rise of $2 billion in spending would cover what is now contemplated in Vietnam, and interest, and that Government agencies could live with a ceiling.

I think a more sophisticated way to do it would be to go through each Government program, item by item, looking at the cost versus the benefits. I think this a very time-consuming and difficult process, but I do not see any reason why you cannot just impose a ceiling for a year, and I think this would be extremely beneficial.

I think in addition you probably need a tax increase. We have a deficit of $20 billion plus. This is what is raising questions around the world as to the integrity and viability of the dollar. We, in my opinion, need to take action to get this deficit worked down perhaps not to zero but down to a very small figure.

The combination of tax increase plus some ceiling on spending I think would bring this about. There has been a tremendous increase in Government employment in the past 2 years. I wonder whether——

Senator JORDAN. Would you care to put a dollar figure on it? What are you talking about when you talk about cutting expenditures? What kind of dollar figure?

Mr. BUTLER. The Budget has gotten so complicated that I must confess I do not understand it any more. But, if you take in effect the old administrative budget, which comes, under one line in the new sort of budget, I would say a $2 billion increase for fiscal 1969 over fiscal 1968.

Senator JORDAN. $2 billion is your estimate of what could be——

Mr. BUTLER. I would hold the budget, the spending increase to that figure.

Senator JORDAN. Hold the spending increase to that figure over the prior year?

Mr. BUTLER. That is right. This, as I understand it, would be $8 billion less than the administration is asking.

Senator JORDAN. Yes; it would be an $8 billion cut?

Mr. BUTLER. That is right.

Senator JORDAN. Of the amount of the President's requested budget of $186 billion?

Mr. BUTLER. That is right.

Senator JORDAN. Mr. Machlup, what would be your estimate of the amount that could be cut, if any, from the Federal expenditures, and where would you cut?

Mr. MACHLUP. I must beg off on the question of where to cut. I am not really a student of the Federal budget. What I do know is that it usually takes a long time for such measures to become effective. If we need quick action, then I think the tax increase is the only remedy that can be applied on the fiscal front.

I know that our chairman has expressed himself very much in opposition to it, but I must beg his pardon if I disagree with him on this question. We do need this tax increase very quickly, if for no other reason than for the effects on the balance of payments. Calculations have been made to show that, even if the tax increase should not reduce the rate of price inflation, it would have a balance-of-payments effect of about $1 billion. This $1 billion would be very helpful. So, even without any dampening effect on the wage-price spiral, the tax increase could lead to a $1 billion relief for foreign payments.

But there is in addition the effect on the wage-price spiral. The point is that, if business corporations are weakened by higher taxes, they are strengthened in their holding out against trade union demands. In other words, a business that has to pay a higher tax will have less funds and will be less capable of making concessions in the next wage negotiations. So, we actually retard the inflationary updrift of money wages. The best wage-price guideline would be to show business that it will not have a chance to pay the higher wages. I am strongly in favor of the increase in the income tax surcharge, because that is where quick and decisive results can be achieved.

Senator JORDAN. Professor Behrman, would you care to address yourself to the business of cutting the budget?

Mr. BEHRMAN. Well, Congressman Boggs put that monkey on my back a few minutes ago. I tried when I was in Government to cut the budget or parts of it. As far as the details go, again, Mr. Jordan, that I think has to be worked out in the bargaining of Congress with the

Executive. I would only say that the objective which we have before us is to make certain that the combination of fiscal and monetary policies pulls the inflation down to about $1\frac{1}{2}$ to 2 percent a year.

Now, that may mean more of a cut or more of a tax or whatever, but it is the combination that has to be worked out with the Executive and Congress for that objective. To specify any one cut is to me not necessarily the answer.

Senator JORDAN. Administration witnesses appeared before the committee last week and said that a combination of tax increase and spending cut would result in overkill. Would you care to address yourself to that?

Mr. BEHRMAN. That in my view would depend on the magnitude of each, Senator. I do not know exactly what magnitudes they were testifying to at the moment, but it is certainly conceivable to me that a small increase in the budget as Mr. Butler indicated with a tax increase is not an overkill, but if you have a larger tax increase, 14 percent or whatever, and a substantial cut in the budget, you might have overkill. But this has to be played in an orchestration.

Senator JORDAN. Would you say that your suggestion of an $8 billion cut in the President's proposed budget plus a 10-percent surtax charge would result in overkill, Mr. Butler?

Mr. BUTLER. No; I certainly do not think so. I think it is a pretty big moose that we are shooting at, and that you need a fairly large-caliber weapon to deal with it.

Chairman PROXMIRE. Did you say "moose" or "mouse"?

Mr. BEHRMAN. Moose.

(The following letter was subsequently received from Mr. Behrman:)

THE UNIVERSITY OF NORTH CAROLINA,
SCHOOL OF BUSINESS ADMINISTRATION,
Chapel Hill, N.C., February 22, 1968.

Senator WILLIAM PROXMIRE,
Chairman, Joint Economic Committee, New Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: I would like to respond more fully to Senator Jordan's question as to the possibility of an overkill through too much taxation or too heavy a cut in expenditures, and to Congressman Boggs' questions on where to cut expenditures.

What is needed to meet the problem of overkill is to introduce, through the surtax, some flexibility in the fiscal techniques. This could be done by passing a surtax of, say 8 percent, imposing 2 percent each quarter. Then, if evidence developed that the tax was acting too harshly on the economy, it could be removed or reduced the second quarter, and reimposed or left in abeyance the third, etc.

It would be better, however, to provide for automatic response in the tax to the economic changes, so that the imposition, reduction or removal of the tax for each quarter did not have to be debated each time by Congress and the administration. Automatic removal or adjustment could be stipulated according, for example, to the rate of inflation; thus, removal of the surtax could be provided if the price level remained stable for a quarter; or the surtax could be cut to 1 percent in a succeeding quarter if the inflation fell to an annual rate of merely 1 percent during a quarter. The surtax would be at its maximum if inflation occurred at an annual rate of over 2 percent in the preceding quarter.

With such flexibility, it is conceivable that Congress could be persuaded to pass a larger surcharge, say 12 percent, with 3 percent added in each quarter, leaving the law on the books for a longer period than a year. This would avoid the necessity of determining now when the surcharge should be revoked, and a higher surtax would assure the doubters that the U.S. Government fully intended to make the dollar internally sound.

I hope these comments may be useful to the committee in writing its report, and I would be glad to discuss them with you or the staff if desirable.

——— ———.

Senator JORDAN. Mr. Butler, would you be concerned with the January report that industrial production showed a decline of six-tenths of 1 percent, indicating that the economy is not so buoyant as has been anticipated by some of the people who have prepared the budget?

Mr. BUTLER. I think one can never take a 1-month change in the index of industrial production, or any of these other economic statistics as making a trend. Our view is the gross national product in the first half of the year will rise, a somewhat slower rise in the second half, but nonetheless, a rise. I think that one of the basic reasons for seeking fiscal responsibility here is in addition to its repercussions on confidence abroad, which I think are very important, but also this would get the Federal Reserve out of the business of financing inflation. With the size of the deficits that we face and we have had in the past year, the Federal Reserve has had to make it possible for the Government to finance the deficit, and in doing so, the Federal Reserve has increased the supply of money and credit in a very inflationary fashion.

One of the main reasons for asking for restraint on spending plus a tax increase is to enable us to slow the rise in money and credit to tolerable and reasonable proportions.

I think there is plenty of what new economists call aggregate demand around to keep business moving ahead, even with these measure of fiscal restraint and with proper monetary policies, I think you could slow down, over time, the rate of inflation, while not, hopefully, bringing on any recession.

I think the danger in not taking these fiscal measures is that at some point you will have to jam on the monetary brakes, and run very great risks of a recession which could be more difficult and intractable than the ones we have had recently.

In particular, if you run into a recession, with a $20 billion budget deficit, I think your ability to deal with the recession through fiscal measures is severely restricted, and I do not like to see our country running these risks.

Senator JORDAN. Thank you.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman. I, too, want to express our gratitude to these three excellent witnesses for the help they are giving us. I think a lot of the public may not realize that witnesses like this are very busy men, that the papers which they prepare for us are a labor of love, and I am very grateful.

Chairman PROXMIRE. If the Congressman will yield, I join in that wholeheartedly. I know they have spent a lot of time on their excellent papers; they are most useful.

Representative REUSS. I want to state that Mr. Butler and Mr. Behrman, particularly, have indicated their belief that it is essential that we keep our domestic economy from becoming inflated, and I certainly agree. I am ready to spend less, tax more, create less money, or whatever is necessary to do it, and I gather that Mr. Machlup agrees with that, too. However, I guess I may have the same minor quarrel with Mr. Behrman and Mr. Butler that I think Mr. Machlup has. Suppose we do all these things. Let us just stipulate that from here on out, domestically, it is going to be full employment without inflation. We are just not going to have any more 3- and 4-percent increases in the indexes. Do you gentlemen really think that we can keep on running a $4 billion external military deficit in our balance of payments, and make it all up on our composite of our conventional accounts, that we can be mercantilist enough to run that kind of a trade surplus, and that somehow American tourism patterns are going to change and Americans won't want to go abroad any more, and, hence that we are going to get our tourism in kind of a balance somehow, or that American investors won't want to invest abroad?

I just cannot see how in the long run or in the short run we are going to get our balance of payments into shape just by pursuing the sound internal spending, taxing, and money policies that we all stipulate we need to start pursuing.

In other words, aren't we overlooking the biggest thing, namely our meddlesome propensities in the world, and as long as those propensities continue at the level which they are now at, aren't we in bad trouble on our balance of payments? Mr. Butler?

Mr. Butler. If I could speak first to this, hopefully briefly, I think you have a real point. We put out, as I remember it, $8 billion last year in economic aid and overseas military expenditures. I think we cannot conceivably, no matter how good our domestic policies are, support at this time $8 billion of overseas Government spending.

Now, $1.5 billion of this, or something like that, was directly related to Vietnam. Some of it was offset by tying aid to exports or foreign purchases of military things here, but, nevertheless, it seems to me that, short of greater agreement on the part of other countries to aid in the support of the defense and economic development of the free world, we cannot afford $8 billion.

I think if we could get an end to the conflict in Vietnam, we would save roughly $1.5 billion. I think if we were to review our other overseas commitments, that we might find some way to reduce them by, say, a half billion dollars. In balance-of-payments terms every billion dollars counts, obviously. I think we could probably assume that we could support $6 billion of military expenditures plus economic aid at the moment. I think this could increase, over time, in a very useful way.

I think this does not necessarily mean reduced support on our part of economic development. I think it can increase the flow of private investment, and that you can improve the efficiency of the moneys we would then spend under economic aid. But I would agree that prerequisite for getting our balance of payments under control is some review and reduction in what we are trying to do overseas.

I do not think that this need means a reduction in travel or international investment. Our international investment, I think, pays off very, very handsomely. I would like to support what Jack Behrman said. We did an extensive study of the balance-of-payments impact through the operation of international oil companies which showed a very big and very quick payoff for the moneys that we put out in terms of investment in international oil. I think we can support the travel drain. I think we need to do what we can to encourage people from other countries to travel here. As their incomes rise I think this will naturally increase. I do not think we have to, as you put it, reduce our propensity to invest in travel overseas. But, I think we have to reduce, at least for the time being, some of our military and perhaps economic aid commitments.

Representative REUSS. Mr. Behrman, would you agree that, though you manage the domestic economy ever so well, nevertheless the trade, investment, and tourism accounts—the conventional accounts, so-called—are not likely to yield a sufficient surplus to enable us to live in the imperial military style to which we are currently accustomed?

Mr. BEHRMAN. Mr. Reuss, I would say that if that volume of expenditures continues to increase as it has in the short term recently, that we could get into serious trouble. I would argue, however, that we could sustain some pressure had we done what your prescription states, that is, to maintain inflationary levels in the United States less than had occurred in Europe in the past 2 years, 1966–1967, as the importance of which was stressed even by the Economic Report of the President; the inflation had a very strong impact on the balance of payments.

Representative REUSS. Although you yourself did a pretty good job of debunking that when you pointed out the effect of the copper strike and the effect of steel purchasing and so on?

Mr. BEHRMAN. Certainly, they had an effect, but there is also an inflationary impact in the sense that the export surplus declined because of imports.

Let me put it this way. My first point is that even if we are in trouble, controls won't do the trick.

On the second point, I have to agree with you, we can get ourselves in deeper trouble if we continue to accelerate Government expenditures which have no payback whatsoever.

But the third point is that, if the United States were doing what you prescribe, and I think this is an absolute necessity, the dollar would be held abroad in larger amounts than it has been in the past, the dollar would have supplied international liquidity which the SDR was to supply, we could afford assistance to less developed countries—private investment has a quicker payback there than my table indicates—and the gold outflow would have been less because the dollar would have been a stronger dollar.

Further, I would say that we would be in an even stronger position today had we not cut back the export drive in 1965–1966 which we did, and had we not been giving signals to business all along that you may export but you may not follow it with an investment. But the data show quite clearly I think that investments pull exports and that in fact the same industries are both high exporters and high investors. They are the technologically advanced industries. There is almost a cyclical development as an industry goes overseas with exports: as your new items begin to die a bit in terms of their usefulness in the United States, you begin to pick them up in investments abroad, so that there is a pull two ways. Exports will mean investments later, if exports do go up; and investments pull exports.

So expansion would put us in a better position than the controls have done and will do; even if we have the pressures you talk about from military expenditures, we would be in a better position to reverse our current policy.

But I would have to agree with you that we can put ourselves into great difficulty if we continue public expenditures abroad with fiscal irresponsibility at home.

Representative REUSS. Thank you. Now, let me turn to Mr. Machlup, who like myself does not believe that merely ridding our domestic economy of inflation, desirable though that is, will in and of itself cure our balance-of-payments troubles, and I gather that Mr. Butler and Mr. Behrman do not hold out that hope either.

Let me ask Mr. Machlup this. Even if we went to your fourth alternative of a gold conversion account in the IMF, and thence to less rigid exchange rates, wouldn't the United States still have a problem if it persisted in its grandiose, swollen, meddlesome, costly political-military adventurism around the world? If we are going to spend $4 billion-plus in military adventures alone, do you think that we are likely to be able to recoup offsetting surpluses in our conventional balance-of-payments account?

Mr. MACHLUP. Yes, sir; I believe this is possible. Don't forget that $8 billion is only 1 percent of our gross national product. For a long time this 1 percent figure has been mentioned as the minimum foreign aid that a nation should grant. So, I definitely believe that we ought to be able to afford it. It is only a question of the relation between the income and price level here and the income and price levels abroad. That relation will be the strategic variable in allowing the adjustment of the trade balance to the financial transfers.

Representative REUSS. Aren't you advocating something awfully mercantilist though? Here you want the United States to run stupendous surpluses on trade.

Mr. MACHLUP. Yes, I do; but it would not be mercantilist.

Representative REUSS. You said in your paper that the Europeans are not going to do idiotic things, that they are pursuing anti-inflationary policies, some even more successfully than the United States. But let us assume we all manage our economies successfully and do not have inflation at home. Do you really expect that the United States can run trade surpluses of almost infinite amount?

Mr. MACHLUP. This is not so much of a trade surplus compared with the gross national product.

Representative REUSS. Is that the proper thing to compare it with?

Mr. MACHLUP. I think it is.

Representative REUSS. I should think it is the amount of trade done in the world.

Mr. MACHLUP. I think it is the proper thing, and I think it is likewise for the rest of the world to make these comparisons. It is quite true that some other nations have not made enough appropriations for foreign aid, though others have been doing better than we.

Now, there is no doublt that some nations of Europe have been very much in surplus on current account, much more than they should have been, compared with their outflow of capital. So, I think they will have to get used to smaller current-account surpluses. But they may continue to have current-account surpluses because, after all, it is the developing world that will have the current-account deficits.

Mr. BUTLER. Could I add a point which may be useful? I mean this is not a sort of mercantilistic approach. We are trying to run a surplus to finance what we give away in support of the defense and economic development of the free world. If we ran a surplus to pile up gold or to pile up reserves then it would be mercantilistic, but what we are trying to do is to run a surplus big enough to support this outflow. This does not necessarily, well, it does not reduce world production and trade. It indeed enhances world production and trade, so that I think it is a perfectly viable sort of situation. The problem really is the level at any one time. My argument would be that it is a little too big at the moment. But I would hope it would be as big very shortly as it is now, in a viable sort of way.

Representative REUSS. Could I have another minute or two?

Chairman PROXMIRE. Without objection, go right ahead.

Representative REUSS. To all this I say "Yes" to Mr. Butler and Mr. Machlup, but it seems to me you do not sufficiently differentiate between the mirror image of our deficits; that is, somebody else's surpluses. Foreign aid to Ecuador comes back to us. That is great. I am all for that. But keeping troops in surplus Germany? Just talking economically, I do not see how that bread on the water comes back to us in balance-of-payment terms.

Mr. MACHLUP. I think, sir, we should not decide our foreign policy in terms of balance-of-payments considerations. It would be a very severe restriction on our foreign policy if we always said "before you do anything, look whether our present balance of payments can afford it."

I cannot say as an economist whether it is the right policy or the wrong policy to keep troops in Germany. But if it is right for other reasons to keep troops in Germany, we should not say that the balance of payments is such that we cannot afford it.

It is a question of the foreign-exchange rate or, alternatively, it is a question of the rate of inflation here and the rate of inflation abroad, and these things can be adjusted.

Representative REUSS. While you may not want to stop doing a thing otherwise determined to be wise and necessary——

Mr. MACHLUP. Right.

Representative REUSS. From the standpoint of foreign policy because of its balance-of-payments impact, certainly the statesman making this decision should know what the balance-of-payments impact is; should he not?

Mr. BEHRMAN. Yes, sir.

Mr. MACHLUP. He should know what the impact is, but still he should also know what it is in relative terms. The present deficit in our balance of payments is only one-fifth of 1 percent of the gross national product. This makes a difference.

Mr. BUTLER. Somebody said it is a small thing but like an inch on the end of your nose.

Representative REUSS. In large part the recent proposals of the President seek improvement through measures involving private investment and private travel. In addition, the President has promised renewed negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Western Europe and in an altered context, dollar expenditures in Asia as well. The results of such negotiations will depend upon the cooperation of our allies; but if the private sector is to be asked to reexamine and curtail its plans there is an even greater obligation on Government to put its own part of the international accounts in the best possible order.

Dr. Joseph Aschheim, of George Washington University, has prepared a memorandum entitled "The Dollar Deficit and German Offsetting." His memorandum cannot help but throw light on the Government's place in the foreign exchange picture and thereby contribute to the discussion of remedies for the overall balance of payments problem. I, accordingly, ask that it be included in the record.

Chairman PROXMIRE. Without objection, it is so ordered. (The memorandum referred to appears as part 4 of these hearings.)

Senator Miller?

Senator MILLER. Thank you, Mr. Chairman. Professor Machlup, you stated that there are some who believe that 1 percent gross national product ought to be about the amount of foreign aid. Do you share that belief?

Mr. MACHLUP. This is a normative statement, sir, and the question is whether, for humanitarian reasons and from a world outlook, we believe that more should be done for the development of backward nations.

Economists usually eschew taking such a normative point of view and confine themselves to analyzing the implications.

If you ask me, as a citizen, whether I believe that a rich person should give to the poor and that a rich country should give to poor countries, I would say "Yes." As a citizen, I approve of such policies. And, as an economist, I can say that the economy can make it possible to pursue such policies.

Senator MILLER. Well, as an economist you certainly recognize that there might be other factors to be taken into account in determining whether in one particular year this should be 1 percent or 5 percent or 3 percent or possibly even none, wouldn't you?

Mr. MACHLUP. As an economist I would say that the reduction of such items will not necessarily lead to a reduction in the balance-of-payments deficit. Sir, this is similar to what we hear now, constantly, about the effects of our Vietnam expenditures. As a citizen, personally, I am not happy about the whole Vietnam situation, and probably few people are. But, as an economist, I would not expect that a termination of our military operations in Vietnam will lead quickly to an improvement in the balance of payments. There may be strong offsetting changes. If we spend less in Vietnam for military purposes, we may spend more for economic aid. But, if we spend neither for economic aid nor for military purposes, then the Vietnamese will buy less, and other people will buy less, and our exports will decline. In addition, we will probably increase expenditures at home, and our imports will increase. So there may be offsetting changes in our balance of trade.

Thus, while the administration and others have great hopes that a cessation of our operations in Vietnam will quickly lead to an improvement in the balance of payments, I do not share this hope. I expect some slight improvement, but the improvement will probably be only a part of our reduction in military expenditures.

Senator MILLER. Do you have any figures on how much the Vietnam war means in terms of the balance-of-payments deficit?

Mr. MACHLUP. No, sir; and no one can have exact figures. We have figures for direct expenditures. That we do know. But we do not have the figures for the indirect effects for all that the military expenditures abroad and the defense expenditures at home do to other accounts of the balance of payments. These indirect effects we can guess, but we cannot know them.

Senator MILLER. It seems to me I have heard a guess by some administration officials that the figure of $2 billion is the impact on the balance-of-payments deficit of our expenditures in the war in Vietnam.

Assuming the validity of the guess, it would appear that if the cessation of hostilities would mean almost a complete drop or a very large drop—let us say over half of the outflow of funds to Vietnam—that this would perhaps have a $1 billion impact, which would be rather substantial; would it not?

Mr. MACHLUP. I do not know whether the guess of $2 billion is a good guess.

Senator MILLER. I know. That is why I said assuming the validity of that.

Mr. MACHLUP. Assuming the validity means trusting the guesses of the feedback effects, and this makes it all so hazy. We do not know the feedbacks. We do not know, if we spend $2 billion, how much of it comes back in the form of payments for American goods and services. On all these things we are very much in the dark, and we could not say what the impact of a cessation of military operations will be.

I would like to repeat that I very much hope for a cessation, even if I do not think that this would have such an enormous effect on the balance of payments.

Senator MILLER. You are covering your statement by saying "such an enormous effect," and in all fairness I do not know of anybody in the administration who has made the claim of an enormous effect. The only point I want to bring out is that it could be a substantial effect, in the neighborhood of $1 billion, and if it would be in the neighborhood of $1 billion this would certainly be a substantial impact on our balance-of-payments deficit.

Mr. MACHLUP. You are quite right; $1 billion is a lot of money.

Senator MILLER. You stated that there are other nations that are doing better than 1 percent of GNP. They are doing better in relation to their economies than the United States.

Mr. MACHLUP. Yes.

Senator MILLER. Are any of those nations involved in a war?

Mr. MACHLUP. No, sir.

Senator MILLER. Well, then you recognize that the impact of a war on the economy of a country can make a lot of difference in whether it can do as well or better than this 1 percent, do you not?

Mr. MACHLUP. I agree fully with that.

Senator MILLER. Another question: In the last 7 years, according to the figures from the Treasury Department, the purchasing power of the dollar has declined from approximately 47 cents to approximately 40 cents. Would this not have an impact on the desirability of foreign dollar holders to turn their dollars in for gold?

Mr. MACHLUP. To answer this, we would have to make certain distinctions. First of all, between official dollar holders and private dollar holders, and secondly, among different reasons for which these private dollar holders hold their dollars.

Most of the private dollar holders would not be greatly concerned by price increases within the limits that we have had during the last few years, because their own countries have had much greater price increases in terms of their currencies. In other words, they would not have fared better if they had held French francs or if they had held Italian lire. The point here is again——

Senator MILLER. Wouldn't they have fared better if they had held gold?

Mr. MACHLUP. They would not. The people who have held gold have made the most terrific loss. I have made calculations which show that someone who bought gold in 1954 holds now approximately one-fifth of the amount of wealth that he would have if he had bought American stocks on the New York Stock Exchange, of an average composition, the one used for the Dow-Jones index. So, anyone who bought gold was an absolute idiot. I cannot take it back. He was just an idiot. He has now only one-fifth of what he would have had, had he invested in the American stock market.

I do hope and pray that he will be an idiot also in terms of the future, because that depends only on you, gentlemen. If you will not raise the price of gold, then the price of gold will not be raised, and the gold speculators will turn out to have been very stupid indeed.

Senator MILLER. I do not want to interrupt your thinking, but you were talking about a foreign dollar holder.

Mr. MACHLUP. Yes.

Senator MILLER. Who in 1952 had invested in American stocks as distinguished from his investment in gold?

Mr. MACHLUP. Yes.

Senator MILLER. Now, what about an American dollar holder who had invested in stock? Would he have been as idiotic as his foreign counterpart?

Mr. MACHLUP. No. The American dollar holder would have been very right to invest in American stock.

Senator MILLER. Well, instead of that, suppose he transferred funds to Switzerland and ended up owning gold bars in Switzerland?

Mr. MACHLUP. He is a capital idiot.

Senator MILLER. Would he have been just the same as your foreign counterpart?

Mr. MACHLUP. He would have been not only an idiot but he would have broken the law of the United States at the same time.

Mr. BUTLER. Even if he had invested in Treasury bills, which are sort of the lowest yielding assets, again I made some computations. For the past 10 years, had you held gold, the value of your holdings would have gone down something over 20 percent. Had you invested in Treasury bills, it would have gone up by some 20 percent.

Mr. BEHRMAN. I would like to get into calculations, too, Mr. Miller, if I may. I made a few about what would have happened in the United States, if we had sold our gold right after the war to the rest of the world and held francs and lire and pounds. We would have come out, even with the revaluations, now holding $20 billion worth of assets and could have met all of our deficits out of the interest.

Mr. MACHLUP. In other words, to get rid of gold is the best business.

Senator MILLER. You made a comment which indicated that we ought to have, as a target, the management of our ecnomy so that we would have inflation of 1½ to 2 percent a year, I believe.

Mr. BEHRMAN. Yes, sir. I picked that figure simply because that would put us below the rate of inflation of the European countries and that is the comparative level that is important internationally.

Senator MILLER. You are thinking in terms of the balance-of-payments deficit proper when you make that statement?

Mr. BEHRMAN. Yes, sir.

Senator MILLER. That does not mean that you would advocate as far as our own citizens were concerned an economy that would result in a 1½- to 2-percent inflation rate a year; does it?

Mr. BEHRMAN. It is not that I suggest that we ought to have that high a degree of inflation for domestic purposes; no. I am saying that even that high a degree of inflation I think would put us internationally safe because it would be lower than the others.

Senator MILLER. Wouldn't it be preferable just not to have any inflation at all?

Mr. BEHRMAN. Well, as an economist I like a stable price level.

Senator MILLER. Sir?

Mr. BEHRMAN. As an economist, and as a citizen, I like a stable price level. I recognize at times it may be economically desirable to inflate a little to move the economy along, but this is a policy decision which is against the principle of a stable currency; yes.

Senator MILLER. That is one thing that bothers me when you say at times it might be desirable, because to me the Federal Government can take purchasing power away from the people either by inflation or by taxes.

Mr. BEHRMAN. Yes, sir.

Senator MILLER. And I am wondering why there would be times when it would be better to take it away by inflation than by taxes, especially in light of the statement by the President of the United States that inflation is the cruelest tax of all. Why would it be desirable to use the cruelest approach of all?

Mr. BEHRMAN. Well, this goes back to the impact of monetary and fiscal policy in a situation of relative depression or of stagnation where you want to move it up, and if one of the reasons why you are having a stagnation or a slight recession is people's desire for money, just plain liquidity, then one thing you want to do is to give them that liquidity, which means an inflating in the money supply, and that itself may lead at times to some inflation just to sop up the liquidity. We see the same thing internationally now.

Senator MILLER. What you are really saying it that there are times, in a situation like this, when we should use the cruelest approach of all.

Mr. BEHRMAN. I am suggesting that taxation at that time will not solve the same problem. In fact you are removing liquidity at that time when you should be supplying it.

Senator MILLER. Do we have any other choice except to use the cruelest tax or the cruelest approach at all? Is that the only alternative?

Mr. BEHRMAN. What I am saying is that in times of a depression, Mr. Miller, that the inflation is not a cruel tax, taxation might be even crueler at that time.

Senator MILLER. In other words, the statement by the President that it is the cruelest tax of all does not mean that there might not be occasions when we should use the cruelest tax of all approach; is that what it gets down to?

Mr. BEHRMAN. I am suggesting that the "cruelest" adjective applies to certain situations, not to all situations.

Senator MILLER. I see. Well, I do not remember that the President qualified that.

Mr. BEHRMAN. No; I am sure he might not have in this circumstance.

Senator MILLER. My time is up, but I hope I can ask a few more questions and I do appreciate the fine answers.

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman. The few questions that I will ask I propose that all of you answer. I think they are pretty much in point. Would you support imposition of a temporary import surcharge or a system of border taxes?

Mr. MACHLUP. No, sir; I would certainly not. I would say that this could even increase the deficit in our balance of payments, because it could lead to retaliation. Except, of course, if you can, in advance, secure agreements from our major trading partners. If they agree through GATT that we will be permitted to do this as a balance-of-payments measure, and the other nations accept it and will not retaliate, then it might be of temporary use. But let me immediately add that it would be a most inequitable and most unfair measure to take, because it would increase the protectionist effects of our tariffs and, therefore, the distortions in the use of our productive resources.

If you were saying you would like to have a tax on all imports, that would be something else, but a surcharge on import tariffs is very different, because there you change the differences between prices of different imported goods and homemade goods, and the products that already have protection would get more protection. So that would be a very harmful thing to do, and I would hope that the Congress would never consider such a move.

Representative WIDNALL. Mr. Butler, what is your reaction?

Mr. BUTLER. I agree completely. I think it would be a great mistake.

Mr. BEHRMAN. I also agree.

Representative WIDNALL. What would be the impact of the curbs on foreign investment on U.S. interest rates and on interest rates abroad?

Mr. MACHLUP. The impact of our curbs on capital outflows?

Representative WIDNALL. On U.S. interest rates and on interest rates abroad.

Mr. MACHLUP. Well, there is no doubt that any reduction in the outflow of American capital must make interest rates abroad higher than they otherwise would be, and if these interest rates should rise substantially, that would lead to an outflow of foreign capital from the United States, which would partly defeat the purposes of the initial restraint.

Mr. BUTLER. Interest rates in Europe have not risen since the imposition of these controls. Euro-dollar rates are down from the level that they were. I think this is important because foreign central banks have been feeding money into the Euro-dollar market. I would agree with the longer term impact that Dr. Machlup suggested, and there has been an increase in American companies borrowing in Europe, and in time I think this will lead to higher interest rates, but it has not to date.

Representative WIDNALL. Mr. Behrman?

Mr. BEHRMAN. There is an ancillary impact, and maybe Mr. Butler will indicate agreement in the same analysis, but there is an impact through the diversion of flow of capital. For example, Canada sustained a substantial outflow after our recent mandatory controls, which the Secretary of the Treasury indicated came to the United States, but it also is indicated by the reduction in European interest rates that it flowed to Europe. This increased their supply substantially, keeping the interest rates down, but this put a terrific burden on Canada. So what we did was to say capital shall not flow from the Untied States, causing it to flow out of Canada, and now causing us to be concerned with the Canadian balance of payments. So these things have various repercussions which need to be traced out.

Representative WIDNALL. How much of a serious decline in our trade surplus during the fourth quarter of 1967 do you think is accounted for by deterioration of our competitive position in the world? What were the key factors?

Mr. MACHLUP. I would attribute it chiefly to two things. First to the increase in business activity and employment in the United States, the increase in incomes and spending within the United States, which increases our imports.

I attribute it, secondly, to the slack business activity in some of our European markets; especially Germany had a very bad year and, therefore, their purchases, their imports, fell, which means that our exports could not rise as much as they would otherwise have. So I attribute the recent decline in our export surplus less to a permanent deterioration of the competitiveness of our industry, and more to the changes in business activity here and abroad.

I must, however, add immediately that we have had a rate of wage increases during 1967, and expect a rate of wage increases for 1968, which may actually lower our competitiveness relative to foreign countries.

Representative WIDNALL. Mr. Butler, the figures that you have been compiling show enough to indicate where our competitive position has deteriorated. There are a number of items as against where our competitive position has held firm or has improved. Do you have any figures on that?

Mr. BUTLER. I am afraid I do not have them in mind. I think there has been a clear deterioration in steel, for example, in shipbuilding, some lessening of our competitive position in the general machinery area. I think it has not as yet affected things such as business machines. In the so-called high technology areas I think we remain very competitive.

Part of our problem in the fourth quarter was the copper strike and to some lesser extent the forthcoming labor-management discussions in steel which led to an increase in steel imports, but these two things can be fairly big in a fairly short time.

I think our problem is not that our competitive position has eroded so very greatly so far. It is that if we continue these policies and continue the rise in our costs, our competitive position in a few years will be very seriously eroded. If we could check it now, then I would have quite good confidence in the future. But, if we do not check it, I think we are clearly headed for trouble, and the time to deal with it is now and not 2 or 3 years from now.

Representative WIDNALL. Isn't there almost an alarming increase in the amount of services furnished as against goods produced? With the production of goods going down in many areas but balanced to some extent by the furnishing of services, that part of our economy is the healthiest as against the production of goods?

Mr. BUTLER. I do not know. I engage in production of a service which I think is quite valuable.

I think one can go too far in making this distinction. I mean, I think services can be as valuable as goods, that services we perform overseas bring us, in many cases, very good returns. I have never found this a very useful sort of distinction. I think what you want to produce are the things that contribute to your material well-being and your quality of life, and that many of these are services. I do not find it at all uncomfortable to see the relative production of goods decline while the relative production of services increases.

Again to some extent we are into statistical problems. One can never be quite sure what a goods is as opposed to what a service is. But I do not see any way in which this contributes to our basic, say, balance-of-payments difficulties or other difficulties.

Representative WIDNALL. Hasn't a lot of our trade surplus in the last few years been dependent upon the sale of airplanes?

Mr. BUTLER. Yes.

Representative WIDNALL. The sale of agricultural products, sometimes at subsidized prices?

Mr. BUTLER. Yes.

Representative WIDNALL. As I look at the figures, I am just worried that we seem to be getting ourselves out of the market in more than one field. We just concentrated and depended upon just one or two items for our trade surplus.

Mr. BUTLER. Yes. I think the sale of airplanes is a perfectly competitive deal. We produce better aircraft than other industrial countries. We sell these aircraft for dollars.

Now, we have given away a lot of argicultural products, and we continue to give away some. In looking at our trade surplus, and I think one has to take account of this and in effect take out what we give away from the real surplus, and to the extent that one does not do this, the overall figures can be misleading. A friend of mine in the Agricultural Department said that the problem now is to give it away cheaper than anybody else.

Representative WIDNALL. That is probably true. My time is up.

Chairman PROXMIRE. I would like to ask each of you gentlemen to take a crack at what is my bias perhaps, but one which is, I believe, shared by the overwhelming majority of the American people and by many Members of the Congress; it is that we should not pass the surtax; but I would like to ask you to confine your remarks strictly to the balance of payments. I feel that the argument is especially sharp and clear against the surtax on this issue.

I want to say why. No. 1, the sure and swift impact of a surtax would be to reduce the profitability of American investment. Obviously, if you imposed a surtax on corporations of 10 percent of the present tax, it sharply and directly and immediately cuts their profitability and discourages investment here and encourages investment abroad and results in an outflow of capital.

In the second place, the argument has been made that the one thing the surtax will accomplish—it was made here by Mr. Butler I think and it is often made by bankers—that the one thing the surtax would hope to accomplish would be to reduce our interest rates.

This may be true and it may be very beneficial and desirable but from the standpoint of balance of payments I cannot see why that would be an advantage. If our interest rates were lower than they are abroad, obviously capital tends to flow out. People would be less inclined to invest here, and more inclined to invest abroad.

In the third place, I think there is a clear case that to the extent that profitability is not reduced—that is, that the tax is passed on to the consumer—it will increase the cost of American goods, and, therefore, tend to diminish our advantage in competition with goods produced abroad and imported here; so, it will tend to discourage our exports and encourage imports.

Now just one other aspect to this question, and that is, let us see what it seems the surtax is designed to do. No. 1, the administration witnesses always say it is going to cut our imports. Is it? It will only cut our imports, it seems to me, if it reduces spending by our consumers. It will reduce their income but will it reduce their spending? Spending patterns are stubborn. They are hard to change. They change only over a period of time. The propensity to save was great last year. It is perfectly possible that the reduction in spending is going to be slow and gradual and not very sure.

But I think that the weakest part of the argument that you need a surtax in order to help our balance of payments is the kind of inflation the surtax is supposed to slow down. How is the pricing made on commodities that we sell overseas? Many of them are foodstuffs. In fact, a very large portion that we sell overseas is food. You are not going to reduce the price of wheat or the price of feed grain by any kind of a surtax. We all know it is not going to have any effect on that.

You take chemicals and machinery; there, I think, you cannot make a very strong case that the surtax is going to reduce the price in view of the pricing practices that we have found in those industries.

As far as imports are concerned, with steel, and the kind of foods we take in—coffee, tea, and so forth—the others that we do not have in this country—paper base stocks—which we are going to import in greater amount without much regard, really, to small change in price—rubber, minerals, fuel—and, of course, machinery and autos that come in; here again you have, it seems to me, a very weak argument that our surtax, by stemming our inflation, is going to have a retarding effect on imports or a beneficial effect on exports. Now, what is the case in favor of the surtax from the standpoint of balance of payments? Let us start off with Mr. Behrman.

Mr. BEHRMAN. Well, may I start off with encouraging investment abroad, your first point? Reduction of the profit rate here by surtax will certainly make a comparative difference in the profit rates. But, from my own investigation, Senator, I cannot find any good or clear correlation between the profit rates in the United States and Europe, and the flow of direct investment.

Most companies look at investment on a very long-term basis, and not at the immediate, this year or next year, profit return. There are even those who would indicate that a tax on their investments would not slow it down significantly. It is too important a long-term objective to get there to worry about differences in profit rates for any definite given period of time. I do not think it would have a very serious effect one way or the other on the outflow of investment. It might cause some companies to look at it.

Chairman PROXMIRE. If I could interrupt at this point—isn't it true, however, that the deterioration of the profit ratio by European firms in the last year or so dropped from 1966—the 1967 figures apparently are not available—and the increase in investment here tended to be a good, natural free enterprise factor in encouraging more investment here and somewhat slightly perhaps discouraging investment abroad?

Mr. BEHRMAN. Sure. This is a free enterprise reaction. What I am suggesting is that we do not have enough information about the commitments of companies and what caused them to go to say that the decline of profit rates in Europe causes a decline in investments in——

Chairman PROXMIRE. Yes; I was not talking so much about the Ford Motor Co. or United States Steel. I was talking about an investor, sophisticated enough and so forth to invest here or abroad?

Mr. BEHRMAN. A portfolio investor looking at stock? Certainly, this would have an effect. Now, as to the reduction of interest rates: certainly, the increase in interest rates abroad and the decrease in interest rates here is going to pull capital out of the United States into Europe. By the same token, if—and this gets to the heart of your presentation—if the inflationary impact of the surtax or rather the deflationary impact of the surtax is adequate this would bring the money back in terms of export sales, services, or whatever else. The real question, as I see it, is one that you pose, and that is, Can the surtax itself have an adequate dampening effect on the inflation of items which affect the balance of payments?

Let me address myself to the two: the exports and the imports. I would tend to agree with you that our export structure, given the fact that there is a heavy element of agriculture and on the other hand a heavy element of technologically advanced goods which are priced on almost a tailormade negotiated basis dampens the significance of inflation or deflation on exports of the United States; that is, United States prices. What is more significant are the foreign prices, and the competitor's prices vis-a-vis the United States itself. If their prices are going up rapidly vis-a-vis the United States then there is pressure to look at the U.S. supplier. I would count that more significant from the selling standpoint than the U.S. price level, because, as you say, it is often an administered price.

But, by the same token, reverse it and put the United States in a situation of having inflation. This creates a pull on imports, on a variety of things which are not in the raw material area alone nor even in the agricultural area, but are in the consumer line; and this is why I think we have, besides this copper strike, a substantial increase in imports, notably even in December, as a result of successive inflation.

Now, if you could dampen consumer spending by the surtax, then this would also have an impact on the imports particularly. This is where I think the balance-of-payments effect is more likely.

It is also likely in terms of inflationary effect on tourist spending. If you can have a reduction of prices in the cost of vacation here, as compared to the other areas, then there is an impact on tourism. I would like the others to go on from there, or contradict me if they wish.

Mr. BUTLER. Again, I agree in general. I think that if you continue the sort of inflationary policies that we have run for the past 2 years, you are bound to have unfavorable impacts.

Chairman PROXMIRE. If I could interrupt at that point, Mr. Butler. I am refering to your prepared statement which I thought was very interesting because you have really suggested four proposals: (1) to cut spending sharply; (2) to pass the tax surcharge; (3) to restrict the rise in money and credit; and (4) to reduce our overseas military expenditures. I agree with three out of four with great force, but it is the surtax as far as the balance of payments is concerned that seems to me to be peculiarily unadapted to meeting our problem.

Mr. BUTLER. Well, I do not necessarily insist on the surcharge. I mean if you could do enough through cutting Government spending to get our deficit down to manageable proportions, then I think you would not need the surcharge. I think the important thing in terms of our balance of payments is the rate of inflation which will be necessarily associated with the size of the deficits that we are running and will continue to run unless we take action on cutting spending, raising taxes, or some combination. But it is the size of the deficit that I think is the critical thing.

If you can find ways to cut it down by reducing spending, then I would say that you do not need the surcharge. I am enough of a skeptic about our ability to cut spending that it is my personal belief that you need both, but you need them to reduce the overall deficit, the inflationary pressure that is inevitably generated by this deficit, and its longer term effects on the balance of payments. I think it does not hit the balance of payments very quickly, although there is some evidence in the figures of last year that it had an impact. I think if we could stop the inflation fairly quickly, that we would not suffer permanent damage, but I think if we do not stop it, we will have permanent damage, and it will not take very much longer to lead to this damage.

Looking at the surcharge itself, and there are many ways that one can raise taxes, at the moment I suppose that an across-the-board increase is perhaps the simplest and clearest way to do it. It will have effects in many ways, and in some of the areas you mentioned it will not. I mean I do not think it will have any immediate effect on foreign prices as you indicate.

On the other hand, I think it will, in combination with other measures of reducing the deficit, so reduce overall demand and overall inflation as to have a beneficial effect on our balance of international payment.

Chairman PROXMIRE. Mr. Machlup?

Mr. MACHLUP. Let me first pay you my respects, Senator, for the openmindedness and scholarly attitude with which you invite criticism of your own position. I think this is really most fair, and I bow to you.

But let me then proceed to that criticism. I agree with Jack Behrman about the rate of profit or profitability of American industry, and its effect upon capital movements.

We have had experience with such matters in the past, when we argued for a tax cut in 1963, and in 1964, when we actually cut taxes. Then it was argued that the tax cut would increase American profitability relative to that abroad, and that this would invite capital flows to the United States, which would offset the effects upon the trade balance. This was said by two Presidents and by their Secretary of the Treasury, and several advisers—but, it was palpably wrong. It did not do it in fact, and I think it was a poor argument in theory.

Chairman PROXMIRE. Were you able to isolate that factor? How do you know it was wrong? The balance of payments improved when taxes were cut. He was right then. He must be wrong now.

Mr. MACHLUP. Well, we have seen that capital outflow increased after the tax cut.

Chairman PROXMIRE. But there are always so many elements involved.

Mr. MACHLUP. That is correct; but they said they would expect capital outflow to decline and capital inflow to increase, and we know that on both accounts the opposite took place. American capital had a bigger outflow and foreign capital had a smaller inflow, so we have definitely seen that the argument was at least not supported by the experience that we had soon thereafter. I would say, moreover, that on theoretical grounds the argument was not too strong.

Chairman PROXMIRE. That coincided at the time with a number of other things.

Mr. MACHLUP. I grant you that.

Chairman PROXMIRE. Including the Vietnam escalation, including a tremendous boom in plant and investment here, and so forth.

Mr. MACHLUP. Exactly. The investment boom here ought to have attracted foreign capital according to the argument, but it did not. I would say one should never rely on these supposed probabilities. Take your point about interest rates. The argument that interest rates will rise if we do not get an increase in taxes is correct, but you say, "all the better, the higher interest rates will invite an inflow of capital."

I would say that this would be a help in financing the deficit in the balance of payments for a very short period. We cannot, through short-term variations or differentials of interest rates, reduce the deficit. They may temporarily lead to movements of capital which, however, have no longrun influence on the balance of payments.

Your third point was about the incidence of the tax increase. We know so little about that. We know not enough about whether there will be a shifting of the increased corporate income tax onto the consumer. We do not know. I am doubtful about it, but I could not possibly take a strong position on this question.

Mr. BUTLER. In the short run?

Mr. MACHLUP. In the short run, certainly not. In the long run, shifting would be likely. But now comes the main point against which you argued. You questioned that the tax increase would really cut imports, that it would really cut domestic spending. I cannot see how it could fail to do that. If you take billions of dollars away from individuals and corporations, at least the individuals have no way of recouping that. They cannot all go to loan associations and get all the money that they are paying out as taxes. Hence, the effect upon individuals is practically certain. The effect upon corporations——

Chairman PROXMIRE. At that point, just recall the fact that up until 1966 people had been saving at a rate of about 5.2 percent. Last year they saved at 7.1 percent. If they go part way back to the 5.2—they went back to, say, 6 or even 6.5—it would wipe out virtually all of the diminution in their incomes from the surtax. The surtax would have no deflationary effect.

Mr. MACHLUP. Yes.

Chairman PROXMIRE. And the spending would be the same. There is a strong argument that one of the reasons why people have been saving as much as they have, according to the Michigan Survey of Consumer Intentions, is because they anticipate inflation. In doing so, they think they might not be able to have the income they need to meet their most important needs. If this is assuaged by a tax increase, then they would be more likely to relax and spend more.

Mr. MACHLUP. If they can. You see, there is the willingness to save and spend, on the one hand, and there is the ability to save and spend, on the other hand. If you take away more tax money from the people, the consequent changes in their saving will not equal the changes in their disposable net income. When disposable net income falls, there may be some decline in saving, but there will certainly be a larger decline in spending. So, the effects on saving are not likely to offset the effects of the decline of disposable income upon consumer spending.

Now, as far as corporations are concerned, it would, of course, be conceivable that they borrow all the money that they have to pay out in additional taxes. The question is whether they can get it and whether they want to. This is not very likely, because they will, at the same time, feel a decline in the demand for their products, which is precisely what they ought to feel if we really want to stop inflation.

Your last point was about the small likelihood of price cuts. I agree with you fully, we cannot expect price cuts, or at least not substantial cuts and not many price cuts, to be effected by the tax increase. But what we can expect is that price increases that would otherwise have come about will not come about, thanks to the siphoning off of money and the reduction of potential expenditures. If taxes take away money from people and firms, we avoid an increase in effective demand that would almost certainly lead to increases in prices. One purpose of the tax increase is to avoid that increase in prices, or to make that increase in prices somewhat smaller than it would otherwise be.

The same thing is true with increases in wages. I think we will get, this year, an increase in wages, in wage rates and employment costs, of at least 4 or 5 percent, perhaps more. The tax increase could save us from some of that in further contract negotiations.

Chairman PROXMIRE. My time is up. I would just like to say that the University of Michigan indicated that the surtax would reduce inflation from about 4.1-percent increase to about 3.8-percent increase. The Council of Economic Advisers argues it would reduce it from 4 percent to 3 percent. I just cannot see that either one of these—and especially the University of Michigan model, which I think is more likely to be precise because they have no ax to grind, they are not trying to push for or against a surtax—would have any very significant effect on the balance of payments.

Mr. MACHLUP. The effects on the balance of payments are not entirely price effects. They are chiefly income effects. So, even if prices were not affected at all, the mere fact that you take away some disposable income will have an effect upon the balance of payments.

Mr. BUTLER. These models are wholly misleading.

Chairman PROXMIRE. I know they are.

Mr. BUTLER. Neither of them give as much influence to the monetary factor. We have a model that we have developed which gives—if you give more emphasis to the monetary factor—almost no inflation.

Chairman PROXMIRE. The principal money manager of the Nation told us a few days ago that the monetary policy would be much easier if we had a tax increase than if we did not have a tax increase.

Mr. BUTLER. That is right.

Chairman PROXMIRE. If monetary policy is easier it means that you get your expansion from ease in monetary policy instead of an expansion from fiscal ease.

Mr. BUTLER. But you also get——

Chairman PROXMIRE. And it is perfectly possible in other words that these would tend to balance out. So monetary policy it seems to me would be a factor that would tend to remove the deflationary element of a tax increase. Is that right? It would tend to?

Mr. BUTLER. Yes; to some extent. On the other hand, if you take our model and you put in a reduction in the deficit of $6 to $8 billion, then you put in the monetary policy that would be consistent with such a reduction in the deficit, we come out with substantially less inflation for this year than without the fiscal policy. But more importantly we come out with virtual price stability for next year. I think what we are talking about is not so much this year as next year. A lot of these wage increases are going to go on, regardless of what you do, other than great depression.

Chairman PROXMIRE. You are right when you talk about the model. That is right. You cannot prove anything with a model. You are absolutely correct about that. I yield to Senator Miller.

Senator MILLER. Thank you. I would like to ask any one of our witnesses this: The point has been made that our apparent favorable balance of trade is really nonexistent; that for 1967 the balance of trade, favorable balance of trade, is listed at $3.8 billion, but that includes $1.6 billion of agricultural exports under Public Law 480, soft currency donations, so that that would reduce the balance down to $2.2 billion.

Further, that the figures on imports of $26 billion do not include the cost of freight, whereas our figures of $30 billion on exports do include the cost of freight, and that if we were to take a reasonable figure of 10 percent to add to the price of the imports, there would be another $2.6 billion which would eliminate the $2.2 billion adjusted figure in the balance ending up as a deficit rather than as a surplus. Do you have any comments on that observation?

Mr. BEHRMAN. It has been that way for years; what is important is yearly changes, so long as we understand what is in the figures.

Mr. MACHLUP. Concerning the cost of freight, may I ask, Do you mean the balance of merchandise or do you mean the balance of goods and services?

Senator MILLER. I am talking about the cost on the merchandise.

Mr. MACHLUP. Just on merchandise. Well, regarding the freight, whatever you do not put in merchandise appears in service. Hence, one really ought to, in order to compare exports and imports, take goods and services together. If you take goods and services together, then the payments for freight are included. So I think it is wiser not to separate the two.

Senator MILLER. I would think so, too. But, the criticism is that we take into account freight on our merhcandise exports, but we do not take into account freight on our merchandis imports, and, therefore, the merchandise imports should be increased to reflect, comparatively, the freight bringing them in just as we include the freight in carrying our exports out, and this would eliminate our favorable balance of trade.

Mr. MACHLUP. We have to distinguish domestic and foreign freight, the freight paid within the United States and the freight paid between the United States border and the points of origin or destination. Which one of the two freights is that criticism concerned with?

Senator MILLER. I cannot answer that question, but I infer from the criticism that the freight is not equalized. In other words, the freight is not equalized in terms of its effect on the outflow of our dollars, and it should be equalized.

If I am not mistaken, I think both exports and imports are recorded on an f.o.b. border basis, and that would make them comparable. That means the merchandise crosses the border, the value that it has in going out or coming in at the border. So I believe that equalization is done.

Now to exclude an item like the agricultural exports under our support program would be quite arbitrary, because we could exclude many other things also with equal justification. We can exclude military expenditures abroad from our current balance. I have done exactly this in my statistical tables, because I felt they are better visible together with our financial transfers.

But, I do not think we can reasonably make the statement that we do not have an export surplus, sir.

Senator MILLER. Well, I take it from what you have said that you have done some experimenting on this, and from the standpoint of true balance-of-payments impact, there certainly should be some adjustment made in these figures that we receive from the Commerce Department; shouldn't there? If we are going to look at our balance of trade from the standpoint of its impact on outflow of dollars and inflow of dollars, there should be some adjustments made; should there not?

Mr. MACHLUP. I think the detailed figures are all available, and I am sure, sir, all figures that you request from the Department of Commerce, including the subgrouping of these figures, will become available to you.

Senator MILLER. I am sure the figures are available. The thing that bothers me is that when we ask for a favorable balance-of-trade picture, we are given a figure of $3.8 billion for last year. No backup detail; no adjustment apparently reflected in these figures along the lines which you have just mentioned. I was just wondering if it would be possible for somebody like you to give us an analysis in terms of the true impact on the dollar of these net figures with the adjustments, so that we would have some basis for evaluating those figures?

Mr. MACHLUP. From my reading of the quarterly reviews in the *Survey of Current Business*, I have concluded that they present a fairly complete picture, with figures sufficiently detailed for me to be quite satisfied with the present statistics. Not satisfied in the sense that I would not like them to show more favorable results, but satisfied with the information that they reveal.

Senator MILLER. Then as far as you are concerned, when we receive a figure of a favorable balance of trade of $3.8 billion for 1967, you think that net figure has been refined enough for purposes of discussing the impact of the balance of trade on the outflow and inflow of dollars?

Mr. MACHLUP. Yes; I think so.

Senator MILLER. Is it possible that in order to make sure that spending would be reduced by a surtax, that there should be some kind of credit controls to accompany this?

Mr. MACHLUP. We do have credit controls by the Federal Reserve System all along.

Senator MILLER. I am talking about retail credit, for example.

Mr. MACHLUP. I do not believe very much in selective credit controls. I think the most general controls are more efficient, the one through Federal Reserve policy—through open market policy and interest rates—and the other through fiscal policy, particularly taxation.

Senator MILLER. I understand that, but if I gage Senator Proxmire's concern correctly, he suggests that even though a taxpayer's income is reduced by a surtax, that that would not necessarily prevent him from either going into his bank account to get the money or going to some credit agency to get the credit to engage in purchases, and if you want to cover that base, would it not be important to consider credit controls of some kind with respect to the individual consumer?

Mr. MACHLUP. I would warn against such a policy, which would lead us to more and more restraints and Government interventions. I would rely on the tax increase to do its job without being reinforced by selective credit controls.

Senator MILLER. You see we have received some intimations from some people of concern over the tremendous expansion of consumer credit, and at a time when we are trying to reduce spending and hold down inflation. This kind of a suggestion naturally is something that should be considered. I do not say it should be followed, but I would like to get your evaluation of it. I think at least we ought to give the tax surcharge a chance to work.

Mr. MACHLUP. Right.

Senator MILLER. Before we go to something else.

Mr. MACHLUP. Yes, sir.

Senator MILLER. Thank you. Now, Mr. Butler, quoting from your statement, you say:

> * * * and we must avoid actions on our part such as quotas, border taxes and other devices which provoke retaliatory actions abroad.

Do I infer from that statement that you would be agreeable to saying that we need not avoid actions on our part such as quotas, border taxes, and other devices which do not provoke retaliatory action? I mean, is the converse of this statement applicable to you?

Mr. BUTLER. I am not sure I would go along with that. In revising the text I took out border taxes, I would have to say, which, is a very difficult and complicated question. But, what I am trying to say is, that if we do what we have to do to deal with our domestic problem of inflation, which I think we need to do for domestic reasons as well as international reasons, that if we review our governmental overseas expenditures and commitments, I think we can get our balance of payments back into balance, and this is the real way to do it, and that such policies would not provoke retaliatory actions on the part of those abroad.

Now, if instead we continue down this road toward more and more elaborate controls, one of my fears is that foreign countries will retaliate, that the world will move back toward a system of controls and restraints which I think would be extremely damaging to the world. I mean, that is what I am trying to say.

Senator MILLER. You see, your statement is the kind of a statement which certain individuals in the administration might seize upon to quote when they come over to testify before the Finance Committee with respect to some quota bills which are pending in the Finance Committee, of which some of us happen to be cosponsors, and they might cite that statement as evidence that the Chase Manhattan Bank, at least one of its officials, does not think that these quota bills should be considered.

Now suppose that these quota bills are designed to offset discriminatory action on the part of some countries. Would that change your view a little bit?

Mr. BUTLER. No.

Senator MILLER. Let me give you a classic example. Feed grains imported into the Common Market are subjected to a tariff. The money from the tariff is then used to subsidize exports of canned hams to the United States. There are a few of the producers of canned hams in the United States who think this is a one-way street, and they would like to have countervailing duties imposed against the imported ham, canned ham, from these countries. Not that it is a matter of inviting retaliation on their part but as a matter of retaliation, or, if you do not like that word as a matter of offset on our part. Are you opposed to that kind of action?

Mr. BUTLER. Yes; I am.

Senator MILLER. In 1960, the dairy imports into the United States amounted to 600 million pounds. By 1965, they had increased to 900 million pounds; in 1966, they had increased to 2.8 billion pounds; as of June, last year, there were at the rate of 4 billion pounds, whereupon the President did take some action to cut them down in the year 1967, to approximately the 1966 figure of 2.8 billion pounds. I take it that you would be opposed to this, and would feel that the President made a mistake in that action?

Mr. BUTLER. I am not aware of all the details, but I will stand on the general position that it is to the advantage of the United States and the world to have the maximum amount of free trade.

Senator MILLER. May I interrupt you at that point to tell you that general proposition is shared by, I think, every Member of Congress.

Mr. BUTLER. May I just continue. I think there are circumstances under which you can get disruptive effects from, in effect, free trade, et cetera, and that I would agree that there should be provision to make orderly adjustments in these areas. I have always thought that one of the geniuses underlying the idea of the Common Market was the idea that you went to it over a period of time, say, 10 years, or whatever period, and I would support measures to promote orderly adjustments in these areas, but with clearly the idea that you would not get protection forever, that you would have a period to make an adjustment.

Senator MILLER. Well, I think that I certainly would subscribe to a mechanism for orderly adjustment, but when you do not have that mechanism, and, when, as a matter of fact, you have the discriminatory treatment in some countries overseas, which is causing serious impact on American industry, what are you supposed to do? Are you supposed to tell the affected industry in this country, "We are sorry we do not have any mechanism for reciprocal lowering of nontrade barriers. You will just have to get along in the name of good old free trade even though it happens to be a one-way street in this particular case."

It seems to me, Mr. Butler, that prudence indicates that if quotas are needed to offset discriminatory treatment, if a country is going to levy a tax on our exports of feed grains to them and turn right around and take the money that they collect on that to subsidize their imports into this country, we cannot stand still in the name of so-called free trade.

I recognize the desirability of free trade. This committee just put out a report on the future of foreign trade to the United States, pointing out that nontrade barriers which the Kennedy Round of negotiations had absolutely nothing to do with can be just as harmful and even more insidious than tariff barriers. So, I am just trying to elicit from you a recognition of the fact that while the general proposition of free trade is fine, we have to get down to cases and facts before we can determine whether a particular incidence of quotas not to provoke retaliatory actions but to offset actions, you might say, which are designed to provoke retaliation on our part are taken.

Mr. BUTLER. I would say only this. First, I would hope that whatever we did would be in this category of cushioning an adjustment and not moving in the direction of our erecting a lot of barriers. It seems to me that what we need is to negotiate on nontrade barriers around the world, and that that is the route that will lead to the greatest good of ourselves and other countries.

If we react to these measures, and I agree with you that we have been much more "simon pure" than other countries, although our record is tarnished in some areas, we are so powerful in this world that if we take this route there is the greatest danger that other countries will take it, that we will go back into systems of quotas and controls that will be extremely damaging.

Now, having said this, I recognize the problem of some particular industries, but I would support reasonable measures to ease their transition. I would support every possible measure on the part of our Government to try and reduce foreign nontariff barriers to trade. I do not known whether that is helpful.

Senator MILLER. I must say that I share your attitude. But what do you do in the meantime? What do you do during 2 or 3 years that it might take to negotiate? Do you let the plants close? Do you let the people become unemployed? Or during the interim do you establish some kind of a countervailing offset with the clear understanding that during negotiations you hope that these can both be eliminated?

Mr. BUTLER. First, it seems to me we carry a fairly big stick in the world, and I think we ought to get at the business of negotiating reduction of these barriers on the part of other countries. And, I think one stick we carry is our ability to retaliate, if you like, if they do not agree. I think this is the next order of business in world trade negotiations.

Senator MILLER. Of course, when you talk about retaliatory action, let me make one last observation. Our position before the Common Market of our negotiating team during the Kennedy Round was that the Common Market should give us access for our grains based upon a base period percentage. That was our request.

Now some of these quota bills, vis-a-vis the Common Market, would establish a quota-guaranteeing access based upon a certain percentage of our market according to a base period. There is something that if the Common Market, if we should do this, should retaliate, we might end up getting exactly what we asked them for during the Kennedy Round of negotiations. Might this not be a desired result? This was our position. This was Ambassador Roth's position. They turned us down on it, but maybe this might be one way of obtaining what we asked for by way of retaliation.

Mr. BUTLER. Well, one of the great problems is that world trade policy in agricultural products has made no economic sense for many years, and I doubt that it will, so this becomes a completely political matter of negotiations, and this being the case, you try and get the best deal you can possibly get in the best way you can get it. But, I think, to go down the road of increasing quotas and industrial products would be a tremendous backward step in the development of the world economy, and I hope we would not get it, and I would argue this is true even if we do guarantee access based on a certain base period in the past. It is a bad route to embark upon, and I think the consequences, over time, will be extremely damaging.

Senator MILLER. Do you think it is a bad route to follow until such time as we are able to get into reciprocal lowering of nontrade barriers, which as the committee has found can be just as effective and even more insidious than trade and tariff barriers?

Mr. BUTLER. That is right.

Senator MILLER. You think that until such time that it would be better not to follow any quota route?

Mr. BUTLER. I made a calculation once which is very hard to document that something like 20 percent of the world's production of industrial products of movable goods as some economists call them enter into international trade, and the fact that they do so in view of the difficulties, the obvious difficulties of selling something in another country, I think, is a great tribute to the forces that make trade move. The fact that they do so despite these restrictions, again, I think indicates the tremendous propensity on the part of the world to trade and the very great advantages in trading.

Now, to the extent you can reduce the barriers, you can increase trade and the well-being that goes along with it very significantly, and my only plea would be that we move in this direction and not in the direction of enmeshing trade in control restrictions which I think would not be to the advantage of the world.

Senator MILLER. Thank you, Mr. Butler. I share your policy views in the long run. But, I must say, I think that looking at the hard facts we have to sometimes recognize certain situations which may delay the change of that policy but I do believe that we have a duty to the people who are paying the tax bill in this country not to permit them to suffer under discriminatory duties and nontrade barriers overseas just in the name of the overall policy which you have enumerated. That policy should be a long-range objective and obtained as soon as we can, but in the meantime, I must say, I have to think of some of the people who are paying the bill on this side of the ocean. Thank you very much.

Chairman PROXMIRE. Thank you, gentlemen, for a most competent, stimulating, and provocative morning. I must say that the questioning at the end blends right into what we have this afternoon when we have four experts apearing on trade and investment followed by Mr. William Roth, the President's Special Representative for Trade Negotiations. This has been an excellent morning. Your papers were fine and your responses were most helpful to us.

The committee will recess now, and reconvene at 2 o'clock this afternoon.

(Whereupon, at 1:10 p.m., the committee was recessed, to reconvene at 2 p.m. on the same day.)

AFTERNOON SESSION

Chairman PROXMIRE. The Joint Economic Committee will resume its deliberations. We are honored this afternoon to have four outstanding experts on trade and investment. I have had an opportunity to look at most of these statements—two of the three. They are very good and helpful statements. We will be delighted to have you gentlemen go ahead. We have the President's Representative for Trade Negotiations who is scheduled to come before us at 3:30. That can be somewhat delayed, but I anticipate there will be other members of the committee here to question you gentlemen a little later, and we would appreciate it if you could keep your remarks to 15 minutes or so.

At least one of the statements is extremely short, which will be helpful. And if you other gentlemen hold your remarks down, it will leave us more time for discussion. Your full statements will be printed in the record in their entirety and made available to all members of the committee and to the Congress.

We will start off in alphabetical order with Mr. Cook. Go right ahead, Mr. Cook.

STATEMENT OF EDWARD W. COOK, PRESIDENT, COOK & CO., MEMPHIS, TENN.

Mr. COOK. Mr. Chairman, do you want me to read this or dispense with it? It is hopefully the shortest one. Shall I read it?

Chairman PROXMIRE. Yes; you have a very concise statement. You can handle it in any way you wish: If you want to read it, or summarize it, or whatever you want.

Mr. COOK. In the interest of time, I will just summarize it, if I may.

Chairman PROXMIRE. Fine.

Mr. COOK. I think the thing that disturbs those of us who are engaged in agricultural exports is the discoordination that is apparent in policy, particularly as it concerns the International Grains Agreement, on the one hand, which might require us, under certain conditions, to impose an export tax on the exports of wheat, while at the same time, on the other hand, we are engaged in the exploration of export tax incentives and import tax barriers and travel disincentives.

This curious disparity of the two positions is disturbing to those of us who are engaged in international trade, for the simple reason that it seems to us that any effort to impose import tax barriers and export tax credits or incentives of a direct nature will result in retaliation and the climate for world trade would be substantially damaged insofar as ability to carry on volume of business is concerned.

I would like to suggest a possible tax incentive. I think the thing that induces most businessmen to work hardest is that money which they can keep. So, if I may make a businessman's approach to tax incentives, I have in my paper a suggestion that we expand more or less the idea of the Western Hemisphere trade tax provisions to a worldwide basis, so that if a man has $100 of gross sales, and $25 is export sales, and $75 is domestic sales, that the 75 percent would be taxed at the normal applicable income tax rate, be it a corporation or a partnership or whatever type of enterprise. The 25 percent of the profits would be taxed at, say, 5 percentage points less.

One of the problems encountered in the regional export expansion council work, and in the national export expansion council work, is the number of the export inquiries which are not answered. The reason that they are not answered is because if a man is highly engaged or involved in domestic business and he sits down to budget an export department, he is immediately faced with a sizable sum of money, and he says, "Well, I am doing pretty well as it is. Why should I chase a shadow when I really don't know anything about this business?"

With the proper incentive, I think he would be properly motivated to pursue our goals of expanded export trade, and thus build on the advantages which we have in our economy vis-a-vis the rest of the world.

Chairman PROXMIRE. Thank you very much, Mr. Cook. You have abbreviated a concise statement and have set a fine example.

(Mr. Cook's prepared statement follows:)

PREPARED STATEMENT OF EDWARD W. COOK

Mr. Chairman and members of the committee, I am Edward W. Cook, President of Cook and Co. of Memphis, Tennessee. Our company is specialized in the export of United States agricultural commodities, primarily wheat, cotton, feed grains and soybeans.

Elliot Janeway in his recent book, *The Economics of Crisis*, wrote, "The double base on which the American economy stands, combining world leadership in farm production with world leadership in industrial production, has from the beginning given it a distinctive advantage in world competition."

Without going into great detail let me further dramatize the importance to United States agriculture of world trade by quoting from a synopsis of "Agricultural Trade and Trade Policy," by Oscar Zaglitz, published by the National Advisory Commission on Food and Fiber in August 1967:

"(1) U.S. agriculture is one of the Nation's largest export industries. The degree to which it can use its resources depends on the extent to which it can supplement its domestic sales by sales in foreign markets.

"(2) Its dependence on exports has increased since World War II because, stimulated by technological progress and structural improvements, its productive capacity has grown faster than domestic demand for its products.

"(3) A major expansion of U.S. agricultural exports was achieved after World War II and particularly during the last dozen of years. Food aid has been an important foreign outlet for U.S. agriculture in the postwar period.

But the great expansion in its exports had its basis in the growth of foreign countries' commercial import of agricultural products.

"(4) Full use of the resources of U.S. agriculture will require further expansion of its exports. This will also be in the interest of our Nation; and it will be helpful in improving the U.S. balance of payments.

"(5) The future prospects for the agricultural exports depend largely on our foreign trade policy. In view of the frequent calls from some sectors of the U.S. economy, and also from some agricultural sectors, for more protection, American agriculture must not forget that the spiralling protectionism in the period after World War I, which culminated in the "beggar my neighbor" policies of the Depression, played a decisive role in the decline of the agricultural exports during the late Twenties and early Thirties and in the collapse of agricultural prices which resulted, and which brought distress to many thousands of farmers in all parts of the United States. Government price supports and other governmental measures, under such conditions, could not do more than mitigate the distress."

These observations by Dr. Zaglitz have greater relevance today than when they were written—only a few months ago. Our international balance of payments has worsened. Protectionism in the form of higher tariffs and import quotas is once again being vociferously sought by many segments of the American economy, and there are signs that such policies could rapidly spread to many countries that are important markets for American goods, particularly agricultural commodities.

The Kennedy Round of GATT negotiations failed to make any significant progress toward freer world trade for agriculture. Indeed, in one respect, the results of those negotiations are, in fact, a step backwards in trade liberalization for one of the largest U.S. farm commodities—wheat. I make specific reference to the proposed International Grains Arrangement, which would be an internally self-balanced commodity treaty.

For some 17 years world trade in wheat was in part influenced by the now expired International Wheat Agreement. That agreement sought quite rationally, at least during its early years, to stabilize short-run international wheat prices around the long-run world wheat price equilibrium. Its fault was that, of among the more than 50 member countries, the entire burden of carrying world wheat stocks was left to North America. This inordinate burden of world wheat price stabilization, falling heavily upon the United States, was the one principal reason why the International Wheat Agreement fell from favor.

Now we have proposed a new wheat agreement called the International Grains Arrangement, which sharply departs from the price stabilization objectives of the old International Wheat Agreement. The proposed IGA would raise the minimum world trading price for wheat by 23 cents a bushel from the previous IWA level. Many professional agricultural economists calculate the long-run world wheat price equilibrium as not rising at all, but rather slowly falling, based upon rapid increases achieved in farm productivity in the form of higher yields in response to fertilizers and new hybrid dwarfed wheat varieties. Clearly, the proposed IGA seeks to raise and hold world wheat prices above their long-run levels based upon the dynamics of world supply and demand. Secretary of Agriculture Orville L. Freeman himself, in his remarks before this committee on February 14, observed, "World trade is still an absolute necessity to a healthy U.S. agricultural plant, and world trade and world prices cannot be established by fiat."

Indeed, "The Annual Report of the Council of Economic Advisors," which is an important part of the *Economic Report of the President*, being studied by this committee, states on page 193, "Primary producers sometimes attempt through commodity agreements to raise prices above the long-term equilibrium level. They rarely succeed. Maintenance of a price above long-run cost requires restrictions on supply; the necessary export quotas are extremely hard to negotiate and to enforce."

So we have before us an almost unbelievable anomaly. This government, in struggling with a very serious balance of payments problem, is considering a tax rebate incentive program on exports; while at the same time proposing an international wheat treaty that would require us to raise our export wheat prices, perhaps, if necessary, by the use of an export tax on wheat. We can only lose our export markets by this type of inconsistency.

It is my personal judgment that any consideration, much less enactment, of export tax rebates and import border taxes is ill-advised. The proposed IGA is even more ill-advised.

Consideration might be given to some type of income tax forgiveness on exports. An export tax rebate merely reduces prices, by and large, but provides little real incentive to export. We have advantages which are not being fully utilized to reach our goal of more exports. Income tax forgiveness on export earnings might work this way: Assume an enterprise had total sales of $100, $25 being export sales and $75 being domestic sales. The enterprise's profits would be taxed at the normal applicable tax rate on 75% and 5 percentage points less on the 25% of profits attributable to exports. Exports need incentive more than anything else, and given appropriate incentives business will do an adequate job.

Thank you.

Chairman PROXMIRE. Our next witness is Mr. Lyman C. Hamilton, Treasurer of the International Telephone & Telegraph Corp.

STATEMENT OF LYMAN C. HAMILTON, TREASURER, INTERNATIONAL TELEPHONE & TELEGRAPH CORP.

Mr. HAMILTON. Mr. Chairman, if you don't mind I would rather stay rather close to the text.

Chairman PROXMIRE. All right, it is a relatively short statement. Go right ahead.

Mr. HAMILTON. Yes, sir.

My name is Lyman Hamilton, I am treasurer of International Telephone & Telegraph Corp., ITT, and in that capacity I sit on top of the flow of funds from the United States and to the United States. Happily, there is more of the latter. I welcome this opportunity to appear before this distinguished committee, and I hope to be able to contribute in a positive and constructive manner toward a solution to the serious balance of payments problem in which we find ourselves.

I might begin by saying just a few words about ITT for the benefit of those who may not be familiar with the corporation.

ITT is an American-owned international corporation whose principal business, despite its recent acquisitions, which are somewhat publicized, is the manufacture, sale, service, and operation of electronic and telecommunication equipment and systems on a global basis.

At the time of its founding in 1920, ITT had a total of 1,400 employees and in 1921, its first full year of operation, reported revenues of slightly less than $4 million.

Today ITT is a system of more than 100 affiliated companies and divisions located throughout the world. The system has a total of over 204,000 employees in 62 countries including the United States and Canada.

It will report total sales and revenues approaching $3 billion for 1967.

ITT also, is one of the 700 American companies which took a leading role in the Commerce Department's voluntary reporting program.

ITT is fully aware of the serious financial problems which have led to the regulatory program and we are prepared to do everything in our power to improve the balance of payments.

However, there is one key point regarding the balance-of-payments regulations that should be noted in the national interest. Productive foreign investments are not expendable. They are the very core of our ability to wage war or maintain peace. We assume that the importance of these investments is realized in the highest policymaking circles of our Nation. And, we assume it is also realized that the long-range security of the United States and its allies is very much dependent upon the preservation of those investments. If you curtail investments over a period of time, you limit your external income, and with that your ability to sustain political and military positions abroad.

U.S. private investments and services abroad have been adding about $2 billion a year, net, to our cash receipts; and to relate that to the numbers that have been discussed with the committee that is about $5 billion of income offset by about $3 billion of outflow. In more understandable terms, this amounts to a net inflow to the positive side of the U.S. balance-of-payments ledger of about $5 million a day, every day, 365 days a year. If we allow this to be whittled away, we are going to find that we will be unable to maintain our commitments for collective security and economic development around the world.

There is a classic example of the "whittling away" process. Contrary to currently accepted theories of Great Britain's difficulties, the sole reason for the deterioration of the British balance of payments was not the trade deficit. While Great Britain has generally had a trade deficit, she was able to make up the difference through income on oversea investments and services. Twice—after World War I and again after World War II—British investments were liquidated in the amount of £1 billion or more each time. Her external debts increased at the same time for Government expenditures abroad soared. As a result, the income on her investments was insufficient to meet increased costs. The inadequacy of foreign investment income was a basic cause of Great Britain's recent fiscal retrenchment.

We are concerned now that the administration's short-term solutions to our problem do not cause irreparable damage to American companies and their ability to continue to repatriate earnings in the future.

Two areas concerning foreign direct investment covered by the regulations are:

(1) Restrictions on transfers of capital abroad; and

(2) The repatriation of earnings as fixed by the formula in regulations.

The first of these, the transfer of capital abroad, is directly within our corporate control and we can and will operate fully within the regulations. For example, just last Thursday, an ITT American subsidiary completed the borrowing of $50 million in Europe, which we especially negotiated with no sinking fund for 10 years, with the balance-of-payments problem in mind.

According to the Survey of Current Business for September 1967, compiled by the Department of Commerce, American companies in 1966 incurred outflows of over $3.5 billion of which $1.8 billion was to Europe. Since much of this was for new projects, there clearly would be room to achieve the Commerce Department's $1 billion 1968 improvement target through restraints in this area.

Mature companies like ITT, which have long operated abroad, are able to remit earnings to the United States without having to send large amounts overseas. So that there will be no question as to their moral right to this position, let it be remembered that such companies have at times during war and as a result of confiscation suffered as much as 70 percent of the loss of their company in order to remain overseas today. Certainly, the sacrifices which have been made by these stockholders will warrant treatment to enable them to continue to compete in a normal way with their oversea foreign competitors, particularly when, as noted earlier, they have not been sending capital overseas.

Instead of concentrating solely on restraining outflows, the drafters of the regulations understandably attempted to close any loopholes by which earnings retained abroad could be increased above previous levels to offset reduced outflow. However, the regulations overreached this objective and prescribed repatriation at an increased and inordinately high level, particularly in Europe. Here again mature companies already have been repatriating at high levels like ITT's 54 percent, and have been financing their growth mostly through local borrowings. This compares with 42 percent paid as dividends, as an average, for example, by the top 100 U.S. companies to their shareholders.

On the other hand, the regulations on foreign direct investment announced by the Department of Commerce, January 3, imposed severe restrictions on U.S. companies operating abroad and, if applied literally and over a long period, might well prove detrimental to the national interest.

The regulations are especially harsh on companies that have, over many years, contributed regularly to the surpluses in the United States balance-of-payments account.

ITT has been a large annual net contributor to the U.S. balance-of-payments position for the past 20 years. Based on our 1967 performance, we are at present repatriating to the United States at the rate of $1 billion every 10 years. Based upon our past experience, this figure could double in the next 10 years.

A direct investor, according to the regulations, is required to repatriate annually an amount representing earnings from its affiliated nationals in the various schedules. The amount which must be repatriated from schedule C countries (Western Europe, South Africa, and the Communist countries), for example, is the greater of, and I repeat, is the greater of:

(1) the same percentage of total earnings from schedule C affiliates as was repatriated during 1964, 1965, and 1966, or

(2) any earnings of schedule C affiliates in excess of 35 percent of the direct investment, and note that that includes reinvested earnings, in schedule C countries during 1965 and 1966.

Where dividends have been substantial and capital transfers have been low in prior years, what we call the base years, as in the case of ITT and as called for by the voluntary planning during those same years, application of this second test for repatriation of earnings can force repatriation of so high a percentage of current earnings as to make it difficult for such subsidiaries to compete with foreign companies. Such subsidiaries also would encounter difficulty in borrowing locally because, with forced repatriation of earnings at an abnormally high rate, they would not accrue sufficient equity to support additional borrowings.

Mr. Chairman, if I may, I would like to refer you to the table at the back of the testimony.

In this table we have provided an illustration of three companies: X, Y, and Z, all foreign affiliates of an American direct investor, and to make it simple, we have assumed each is the sole such affiliate. Each of these companies had 1968 earnings of $1 million.

If we start with Company X, whose situation most reflects the subsidiary of a mature company in the United States, a mature direct investor, we find the company had earnings, without any growth, averaging $1 million in the base period, but was paying dividends of 50 percent of distributable income.

By definition, 50 percent also was being reinvested. It is assumed that the U.S. parent was not sending money abroad to that affiliate, and this again would be typical of ITT and other mature companies.

However, by virtue of the requirements for repatriation as they are written, in 1968 that company can only retain 35 percent of the amount it reinvested during the base period. That is, 35 percent of a half million dollars, which is $175,000, as shown lower in the column.

By definition, if you earn $1 million and you retain $175,000 you have to distribute $825,000, that is an 82½-percent dividend payout rate, and I submit that, with this rate, it would be difficult to sustain operations. Nobody in the United States, anxious to continue in business, would consider a distribution at that level, and certainly not if they were going to compete and grow.

Obviously, if the 1968 earnings, instead of being $1 million, hopefully had grown to $1.5 million, then that 82½-percent payout could only increase accordingly.

We have also shown Company Y, just like Company X, except that instead of paying out 50 percent and bringing it back to the United States year after year, it completely reinvested the earnings in expansion and new projects in Europe. Accordingly, Company Y had no dividends, so it retained earnings of $1 million. As with Company X, nothing was sent abroad by way of a direct transfer of capital.

Applying the same formula to the base which is now $1 million, 35 percent of $1 million is $350,000. Therefore, under the program, Company Y, assuming it is the only foreign affiliate of the direct investor, can pay out $650,000, or 65 percent.

Now we come over to Company Z, which is really another case of Company Y, paying out nothing and retaining all. However, during the 1965–66 base period, we assume it received a yearly average of $1 million in additional capital.

Applying the formula provided by the regulations, 35 percent of $2 million is $700,000. Now Company Z has earned, in 1968, the same $1 million. Therefore, simple arithmetic tells you that if it can retain $700,000, it has to pay out only $300,000 of that $1 million, or 30 percent.

Chairman Proxmire. At this point, will you clarify Company Z? What capital transfers could be and could not be? Would they be transfers from foreign accounts or from domestic?

Mr. Hamilton. Well, the most classic example, I think, would be an increase in equity in the foreign affiliate by a U.S. investor or a long-term loan to that affiliate. We are not sure exactly what the regulations mean, but we think it could also mean increases in the current account between the parent and the subsidiary.

Chairman Proxmire. Does it make any difference whether it is from this country or from abroad?

Mr. HAMILTON. Oh, yes; these capital transfers—category (d)—shown in the schedule, would be transfers of capital from the United States by the direct investor to its foreign affiliate as defined in some detail in the regulations. However, transfers to this affiliate from other affiliates of the U.S. investor outside the schedule C area would be similarly treated.

But the point I was leading to is that if capital transfers, during the base years, had been $5 million instead of $1 million, obviously not in compliance with the spirit of the voluntary program, then you can see that the required dividend actually decreases and could approach 10 percent, or in certain cases it could be zero.

We felt from the beginning that this was a helpful way of explaining the effect of the regulations as they are written.

I believe there has been considerable misunderstanding of these regulations. Many persons, in and out of Government, believe they require, on the one hand, repatriation only at the rate existing during the base period, or, on the other hand, at the maximum rate of 65 percent. This latter figure is one that is usually reported in the press.

Because the regulations are complex and difficult to understand, their actual effect has been overlooked. The facts are that, in many cases, they could lead to the extreme results I have described.

It is recommended that, as an alternative, companies be allowed in Europe a target of the equivalent of a 65-percent payout, to be achieved by dividends at a rate no less than the prior dividend rate mentioned in clause 1, plus repatriation through other means available to the company, such as foreign borrowings. Consideration also should be given to bringing all companies at least to the present average level of dividend payout and remittance for foreign subsidiaries of U.S. manufacturing companies.

Gentlemen, these regulations are also being read in Europe and an increasing number of examples are finding their way into the European public press, reflecting mounting irritation for needless interference regarding repatriation of earnings.

Importantly, and as evidenced by the data from the Commerce Department, referred to earlier, there is no need to interfere with any company that is repatriating earnings at a reasonable rate. Nevertheless, because of the high repatriation rate required by the regulations as they now stand, it is essential that they either be modified or administered with extreme flexibility if the reactions in Europe are not to jeopardize the earnings themselves, to say nothing of their repatriation.

Already, the French have warned that if U.S.-owned companies there—which are organized under and subject to French law—are compelled to pay out a disproportionate amount of earnings, the French Government may regulate the amount of payout. The French Government has already discussed this subject with its partners in the Common Market, and if relief is not granted on a judicious basis, it can be expected that not only France but the rest of the Common Market—certainly to be followed by the rest of Europe—may impose restrictions on the amount of earnings that may be returned to the United States.

We have also learned that the Spanish Government is preparing a brief for a change in its classification under the regulations so as to receive the same treatment as Greece and Finland. If not granted, there is danger it may take retaliatory measures.

The foreign governments take the understandable position that the United States has no more right to tell them how companies in their countries should be operated than those governments have to tell the United States how to run companies in the 50 American States.

The European governments, on the other hand, are willing to cooperate within reason.

ITT's oversea affiliates, like many others, are run by foreign national citizens. Our boards of directors are almost wholly foreign national citizens who are often distinguished leaders of business and finance in their respective countries. In carrying out their duties they have and are obliged to follow the rules and laws of the countries in which they are domiciled, in corporated, and operated. These boards are also composed of representatives from labor and minority stockholder interests. It should be noted that in some places in Europe employees by law participate in profits and management.

Because ITT has been reasonable in its manner of operation, these directors have been fair in their manner of dividend declaration. This is shown by their record of 54 percent dividend distribution which is almost one-third better than the average level of domestic dividend declaration in the United States.

In short, in managing these companies we cannot be unaware of local laws, local boards and long-standing supply commitments to their own Government. Indeed there is reason to believe that many of our friends would consider such disregard morally wrong and perhaps indefensible.

The regulations themselves, therefore, if applied literally, would be self-defeating. They would not solve the problem at which they were aimed . . . unless revised and amended on the basis of justice for all concerned.

Under repatriation regulations U.S. companies in Europe, for example, will not be able to expand and grow and compete effectively in the marketplace. They will be under extreme pressure just to stand still—to maintain their previously hard-won positions—while their competitors take over the market. Eventually, U.S. companies may be unable to send back dollars at all. Thus, an absolutely vital source of dollars flowing into the United States—from the American business investment abroad—could be dried up at a time when the dollars are most needed.

If the regulations are to stand, then we believe they should be administered with flexibility so as to alleviate the harsh results I have described. We believe further that companies that historically have contributed to a favorable balance of payments should be the first to receive selective treatment for the practical assurance of continuing their inward cash flow.

ITT has requested an exemption from the repatriation formula from the Department of Commerce on the basis of just this logic. We are asking for permission to continue to contribute to the overall balance-of-payments gain in 1968 through all the means available to us without the damaging consequences which would result from the repatriation targets of the present regulations.

I would like to add that the able staffs of the Office of Foreign Direct Investment of the Commerce Department and the members of the

Inter-Agency Committee have already demonstrated a genuine interest in helping us to solve these problems, including those that would be created by the literal application of the regulations regarding repatriation.

U.S. private investment overseas has generated a continuous surplus for the balance of payments. I hope you will agree that such investment as is already in place especially should not be penalized, nor deprived of the capability to continue generating a net dollar flow into the United States.

A reasonable dividend flow from U.S. earnings in Western Europe would recognize the need for balance between today's dollar inflow and tomorrow's growth and ability to compete, and, therefore, tomorrow's dollar inflow.

There are many searching questions about the new balance-of-payments regulations that have yet to be answered publicly, and in closing I would like to point out just a few today. Gentlemen, what specific changes occurred in the last several weeks of 1967 which caused the administration to impose severe restrictions, in the private sector, and to recommend further restraints to the Congress? What will happen after the overseas reservoir of private earnings is dried up through forced high repatriation if the gold flow problem still exists? Will we repeat the history of the British Empire? Will we lose our position of world leadership because of our inability to pay our way? Lastly, is there a plan—a plan that includes drastic cuts in public spending—in existence now? All the options should be considered before embarking upon a premature and possibly dangerous course of action.

Finally, I would like to say that ITT's interest to strengthen the dollar is just the same as the administration's. This is everyone's dollar—it is a public dollar, a private dollar—it is your dollar, and mine. It would make good sense, then, to give the private sector some encouragement and some leeway while it helps to defend this U.S. dollar.

Thank you.

(The chart referred to follows:)

	Company X	Company Y	Company Z
1968 earnings	$1,000,000	$1,000,000	$1,000,000
Base period averages:			
(a) Earnings	1,000,000	1,000,000	1,000,000
(b) Dividends	500,000	0	0
(c) Retained earnings	500,000	1,000,000	1,000,000
(d) Capital transfers	0	0	1,000,000
1968 requirement:			
Retained earnings (35 percent of (c) plus (d))	175,000	350,000	700,000
Dividend amount	825,000	650,000	300,000
Dividend rate (percent)	82½	65	30

Chairman Proxmire. Thank you.

Our last witness is Mr. Robert M. Norris, President of the Foreign Trade Council of New York. We are delighted to have you, Mr. Norris.

STATEMENT OF ROBERT M. NORRIS, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, INC., NEW YORK; ACCOMPANIED BY MELVILLE H. WALKER, VICE PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL

Mr. NORRIS. Mr. Chairman, I think we can live within the bounds of our time requirements, and we attach sufficient importance to our statement that we would like to go over it with you in full.

We appreciate, of course, the opportunity to appear here in behalf of the council. I think most of the members of your committee and other members of the council comprises a broad cross section of the U.S. companies engaged in all major fields of international trade and investment, including manufacturers; exporters and importers; companies engaged in rail, sea, and air transportation; bankers; and insurance underwriters.

It is my understanding that the emphasis, this afternoon, is upon that part of the President's Economic Report dealing with the balance-of-payments program announced on January 1, 1968, and its implications with relation to our foreign trade and investment policy. The need to correct the recurring deficit position is manifest.

Among the specifics under the programs with which we thus far have had to deal are the foreign direct investment regulations issued by the Department of Commerce, pursuant to Executive Order No. 11387, and the travel tax program proposed by the Secretary of the Treasury in his statement before the House Ways and Means Committee hearings on February 5. Consequently, within the basic framework of our position on the balance of payments, my statement deals primarily with these two matters.

The Council and its membership have long been concerned with the U.S. balance of payments and have been reviewing balance-of-payments data annually since 1951. For some time we have stressed the paramount need for the United States to take meaningful measures to restore a sustainable balance in the U.S. international payments and to assure the integrity of the dollar. In this connection, the Council, since 1914, has annually sponsored and conducted the National Foreign Trade Convention. At these conventions U.S. business executives examine important issues in our foreign economic policy and develop recommendations related thereto.

The 54th National Foreign Trade Convention, in its declaration adopted on November 1, 1967, included the following resolution concerning the balance of payments:

BALANCE OF PAYMENTS

Notwithstanding the encouraging steps toward strengthening the international monetary system, the need remains paramount for the United States Government to take meaningful measures to restore a sustainable balance in the United States international payments and to assure the integrity of the dollar.

The need fundamentally is for the United States to orient its balance-of-payments policies to expansion of both world trade and investment. Remedial measures should be derived basically from an overall integration and consistency of monetary, fiscal, taxation, export financing, trade promotion and investment policies. The Convention regrets the harmful lack of consistency in some measures taken in recent years.

Primary requirements for strengthening the United States balance of payments at the present time are the restraint or offsetting of inflationary pressures, from whatever source, and the preservation of cost-price levels in the United States, compared with other countries, which will enable the products and services of American industry to compete in world markets.

To this end, the Convention emphasizes the importance of collective bargaining settlements and pricing policies which are consistent with price stability, and the reduction of Federal spending that is not absolutely required to support the war in Viet-Nam and other needs of national defense or for domestic programs of urgently high priority.

A particular requisite for the longer run strengthening of the United States balance of payments is the increased availability of export financing and of capital for expansion of the facilities abroad which are required for holding and expanding the United States position in world markets.

When the "voluntary program" was initiated in 1965, the United States Government acknowledged that over the longer term United States investments abroad created substantial net receipts—that inflows from incremental exports, interest and dividends, royalties and fees more than offset the dollar outflow from initial and continuing investments. The Convention holds that these more significant long-term benefits should no longer be penalized and recommends the termination of the "voluntary program" without further restrictive controls.

The Convention urges the United States Government to continue to explore possibilities for export expansion through tax and credit incentives, competitive terms for export financing, and for greater access to foreign markets through further trade liberalization, particularly by removal of nontariff barriers.

The Convention urges continued efforts by the United States Government to persuade other developed countries to assume a greater share of the payments burden of providing military and economic assistance to nations of the free world. It points to the desirability of attracting foreign investment in the United States and to the need for continued action by business and the Government to this end. It supports efforts of intergovernmental cooperation which will assist in bringing about a lasting reduction of the United States balance-of-payments deficit.

Foreign Direct Investment Regulations

While fully recognizing the emergency impact of international financial developments in late 1967 upon the U.S. balance-of-payments position and the need for the U.S. Government to take prompt steps to meet the situation, the National Foreign Trade Council is seriously concerned with that part of the balance-of-payments program which imposes mandatory controls on foreign direct investments as provided in the regulations issued on January 3, 1968, by the Department of Commerce. We have communicated to the Secretary of Commerce the main problems and areas of immediate concern which these regulations pose for U.S. direct investors and their foreign affiliates, and have suggested certain amendments and changes in administrative procedure to minimze as far as possible adverse effects on the normal conduct of international business and the balance-of-payments earnings of the United States.

The points covered in our communication to the Secretary of Commerce on January 15 are:

1. Repayments of Outstanding Loans and Future Borrowing Abroad

Many companies, particularly in their efforts to cooperate under the "voluntary program" since 1965, have had their foreign affiliates raise their capital requirements through borrowing abroad. Many of these arrangements have provided that such borrowings would be repaid out of the foreign affiliate's revenues. Many foreign affiliates will be placed in difficult cash positions when they are mandated to repatriate earnings and also obliged to repay borrowings expended for capital requirements.

This pressure on the cash position of foreign affiliates will be intensified in those instances in which repatriation of earnings, as urged under the "voluntary program," was at high levels during 1965 and 1966, and will be accentuated where companies in order to comply with the "voluntary program" guidelines on repatriation borrowed for that purpose. Under Section 1000.202 a corporation is required to remit at the same percentage as it remitted under the "voluntary program" when that percentage is higher than the prescribed percentage under the mandatory program, whereas a company that did not remit under the "voluntary program" is limited to the percentage prescribed under the mandatory program.

The effect of these provisions, together with the moratorium on new capital inflow into Schedule C countries, will be to force foreign affiliates into further borrowing. Their capacity to borrow, however, will be seriously impaired by Section 1000.312 (e) (1) and (2) of the regulations which provides that any satisfaction of an obligation of a direct investor incurred as a result of a guarantee of an obligation of an affiliated foreign nation, or the assumption of a liability of an affiliated foreign national, is deemed to constitute a transfer of capital. Such transfers are prohibited to Schedule C countries and are otherwise limited for countries in Schedules A and B. Thus, since a U.S. parent would no longer be able to guarantee the loans of its affiliated foreign nationals in continental Europe, these affiliates will be forced to obtain their short and medium capital requirements in the increasingly expensive long-term money markets. this will diminish future earnings available for repatriation to the United States.

These provisions reduce both the capacity of foreign affiliates to repay loans and to secure further borrowings, thus weakening their competitive position and closing the door for required capital to meet their normal growth needs. Accordingly consideration should be given to permitting the net long-term portion of borrowings expended in direct investment to be included in calculating the investment base. In addition, an amendment of the regulations is urgently required to permit U.S. parent companies to perform under their guarantees of the loans of foreign affiliates and to offer guarantees of the loans of foreign affiliates that would be acceptable to foreign lenders. We welcome indications that clarification on this point may shortly be expected.

We take cognizance of the fact that there was an amendment to the regulations on January 23 and a general authorization issued which does permit the entering into and performance under guarantees in accordance with that general authorization. Of course, that is a welcome step to overcoming some of the problems.

Turning now to the next item:

2. PRIOR CONTRACTUAL COMMITMENTS

The regulations present serious problems with respect to work in process and commitments under investment programs which were entered into prior to January 1, 1968. Such commitments, for example, can involve purchase of additional shares of capital, the requirement to supply industrial property, services, equipment, raw material, parts and components. Basically the question is how such commitments and contractual obligations can be honored, particularly in respect of Schedule C countries in view of the limitations imposed by the moratorium on new investments, the limit of 35% of earnings for reinvestment, the requirement for repatriation of earnings and of short-term assets, and the prohibition against satisfaction of an obligation of a U.S. parent company as a result of a guarantee.

The only relief for the foregoing problems afforded by the regulations is by exemption on a case-by-case basis. Is this administratively feasible? Any delays and uncertainties will unduly penalize and disrupt companies in the conduct of international business. Could not some of these issues better be met on a broad policy basis either by revision of the regulations or by issuance of instructions under which companies would have assurance that, under specified conditions or limits, exemptions would be granted to permit carrying out prior investment commitments.

3. REPATRIATION OF DIRECT INVESTMENT EARNINGS

In addition to the adverse effects of the repatriation requirements referred to above, U.S. direct investors are confronted with problems under the following situations:

(a) A direct investor is defined under Section 1000.304 as a U.S. person who owns or acquires 10 percent or more of the voting power or a right to 10 percent or more of the earnings and profits of any foreign national and is subject to the mandatory requirements of the regulations. It is impossible for a U.S. direct investor, owing as little as 10 percent of the stock in a foreign corporation where the remaining stockholders are foreign nationals, to repatriate funds against the will of the foreign nationals. In this connection it should be pointed out that the ability to average out repatriations within a particular schedule of countries will prove of little benefit to U.S. corporations with limited operations overseas or within a given schedule of countries.

(b) A U.S. investor having a majority position in a foreign national who is required to and does repatriate the amounts prescribed in Section 1000.202 of the regulations may be liable to a stockholder's suit by an aggrieved minority shareholder. This problem is aggravated where the U.S. investor can not repatriate all or part of the earnings of a wholly owned foreign subsidiary and, in an attempt to average, repatriates funds from an affiliated company within the same schedule of countries to the detriment of the minority interests.

(c) Many countries prescribe partial or complete restrictions on any remittance from such countries. For example, in Finland dividends may be remitted currently only to the extent of 25 percent of capital stock with the balance being remitted over a 5-year period. In Brazil, there is an excess remittance tax ranging upward to 60 percent of any remittance exceeding a prescribed limit. Other countries prohibit repatriation of current year's earnings until some time after the close of the year in which earned, while other countries may block the repatriation of funds where capital has been impaired in prior years but where the company does have a profit in the current year.

In these situations, the regulations should also provide relief from the mandatory repatriation formulas. Here, too, it should be pointed out that averaging within a particular schedule of countries will, in many instances, prove of little benefit to U. S. corporations.

4. OPEN ACCOUNT SALES TO AFFILITATED FOREIGN NATIONALS

Expansion of U.S. exports is a fundamental objective of the U.S. program for strengthening the balance of payments. U.S. exports to foreign affiliates constitute a substantial percentage of our total exports and have increased significantly in recent years. However, Section 1000.312(d) provides that a net increase in advances upon open account to an affiliated foreign national constitutes a transfer of capital.

Limitations on net increases in open account as governed by the limitations on transfers of capital under the regulations, will inhibit the growth of U.S. exports to affiliated foreign nationals. Provision, therefore, should be made for some growth in outstandings on open account, for example, by allowing such outstandings to grow commensurately with the rate of increase in the value of exports.

Clarification is needed also as to whether advances on open account between affiliated foreign nationals are excluded under Section 1000.312(d).

Our communication was acknowledged by the Secretary of Commerce with appreciation for its clear statement of the problems raised by the regulations, advising that it would be carefully studied and considered by the Department in the management of the new program.

As you have already seen, it has done this with respect to guarantees. We again emphasize that the recurring deficits of the U.S. balance-of-payments position cannot properly be attributed only to direct foreign investments or to any other single item or class of transactions. Nor can restriction upon the outflow of any one item or class of items in itself assure reduction in the overall U.S. balance-of-payments deficit. Even in the short run, as under the voluntary program, gains from restraint of foreign direct investment will be offset by subsequent losses. Strains on international capital markets as well as retarded exports and diminished inflows of investment income will reduce receipts on the credit side of our international accounts. In connection with stemming outflows, action to reduce Government expenditures overseas is a vital element in the program.

Efforts should continue to be maximized to this end and to assure that governmental procurement requirements are met as far as possible from U.S. sources.

Historically, international trade and private oversea investment have been favorable factors in our balance-of-payments. Over a 10-year period through 1966, the cumulative capital outflow for direct investment was $21 billion, whereas, from investments the cumulative income to the United States was more than $29 billion, and fees and royalties have amounted to more than $5 billion. Exports to affiliated companies, and here I am referring to exports of finished goods and services, represent approximately 25 percent of all U.S. exports. There has been a steady growth in the export of goods and services. The controls which have been placed on the direct investor can serve only to make it more difficult for business to make a positive contribution to our admittedly critical balance-of-payments situation. We are concerned with the indications that these controls will lead to retaliation by other countries against the best interests of the United States.

Proposed Travel Tax Program

The National Foreign Trade Council as well as the Declarations of National Foreign Trade Conventions have long emphasized the constructive force of travel in the expansion of foreign trade, and have supported positive efforts both of Government and of the travel industry in promoting travel to and within the United States. Measures intended to restrict or curtail international travel as a means of narrowing the balance-of-payments gap have been opposed as shortsighted since any meaningful curb on tourist expenditures abroad can only constrict exchange receipts and consumer incomes in many of our most substantial export markets which rely on these earnings to balance their own accounts.

The Council is most seriously concerned with the proposals now under discussion by the Treasury Department with the Congress, as described by Secretary Fowler, on February 5, in testimony before the Committee on Ways and Means.

The proposed plan would place upon that section of the business community which is contributing to the positive side of the balance-of-payments ledger penalizing additional taxation on the necessary work of doing business. The inclusion of business travel in any proposed travel tax program would be clearly self-defeating in that it would hamper the efforts of businessmen and companies to increase exports and would increase the costs of maintaining market positions already established and of managing foreign investments which are contributing favorably to the Nation's balance of payments.

Conclusion

Mr. Chairman, in concluding my statement may I revert to our basic position regarding the balance of payments and the paramount need for our Government to take remedial measures to restore a sustainable balance in our international payments and to assure the integrity of the dollar. It is our conviction that the basic overriding task in a balance-of-payments program is to assure that all of its essential related elements involving monetary and fiscal policies will be carried out so as to check inflation, reduce governmental spending, and strengthen the competitive position of U.S. industry in world markets.

We have emphasized to the Secretary of Commerce, and again today we stress to you that the significant longer term benefits of expanding trade and investment should not be penalized by any undue prolongation of controls.

Chairman PROXMIRE. Thank you, Mr. Norris.

Congressman Boggs?

Representative BOGGS. Mr. Chairman, I think these gentlemen have all made very fine statements. I have just one or two questions, because I have a meeting in just a few minutes. Mr. Cook, what measures do you suggest for the expansion of exports?

Mr. COOK. Well, I think the first thing that we should do as far as exports are concerned is to not enter into something like the International Grains Agreement which, as you will note, will raise the trading limits to a point which is out of kilter with the long-range price equilibrium as the professional economists have calculated it.

I think we get into a residual supply position. We are in that area in cotton anyway. We get even more in a residual supply position, and I am afraid that in view of what is being discussed in New Delhi right now at UNCTAD II that this is the beginning of another series of international commodity agreements, such as the famous coffee agreement which has cost us, I believe, something like $500 million to $800 million in excess prices. And I am doubtful that the money ever got exactly where everybody hoped it would get.

So, I would say that the current policies of the administration are excellent insofar as cotton, wheat, corn, and perhaps even soybeans, but anything that tends to restrict trade and step backward rather than look ahead, is a great mistake.

So, to be specific and responsive, do what we are doing, but let's don't turn the clock back.

Representative BOGGS. I don't quite follow you. The coffee agreement, for instance, I believe, was supported by every participating country. While it may have had some small effect upon the price to the consumers of the United States, it in turn has had a tremendous effect upon bolstering the economy of the affected countries, particularly in Latin America. What substitute would you have for that; foreign aid?

Mr. COOK. Well, I don't know that it really has had quite as much effect as you imply, because they are engaged now with a tremendous coffee surplus, and in Brazil they are plowing up coffee trees and putting them in cotton. So, I would argue, Mr. Boggs, a little bit with the statement that it has done quite as much good as it looked like it was going to do on paper, although I hasten to say I am not an expert on the International Coffee Agreement. It has cost us $500 million to $800 million over the life of the agreement in excess coffee payments.

Representative BOGGS. Aside from some of these international agricultural agreements, what other suggestions do you have?

Mr. COOK. Well, as I said before, the thing that gives incentive to a businessman more than anything else is his ability to keep money in his company or in his pocket, and an export tax rebate, which has been discussed, seems to me to be the wrong way to go about it.

What we would be more interested in is getting more people into the act, and taking advantage of the natural advantage we have, which is in the balance of trade, and in agricultural commodities. I think they amount to 22 percent of the total and 50 percent of the net on our favorable balance of trade, and I think the policy is fairly successful as it is. I have no suggestion that it be changed. Rather, I am suggesting that it not be changed as we are threatening to do under the International Grains Agreement.

Representative BOGGS. I don't want to put any words in your mouth, but doesn't it seem logical that we should continue in rather hard negotiation with the import countries? We tried to do that in the Kennedy Round. We succeeded very well in the nonagricultural commodities in the Kennedy Round. I know it wasn't in the agricultural commodities, but it was the question of either negotiate, or erection of new barriers and retaliation. Isn't that just about what it was?

Mr. COOK. Well, I think that is true. Insofar as the GATT negotiations of the Kennedy Round, I really think that nothing was achieved for agriculture.

Representative BOGGS. Nothing was achieved?

Mr. COOK. No, sir.

Representative BOGGS. That is a pretty broad statement.

Mr. COOK. I would be willing to repeat it, but maybe I should say "very little" rather than "nothing."

Representative BOGGS. Mr. Hamilton, I would like to ask you a question or two. First, let me congratulate you on the very fine job that your company has done all over the world for so many years. I would be terribly distressed if anything that is done by our Government would have an adverse effect upon the continued expansion of your company.

But, what really gives me concern is that both before this committee and before the legislative committees which have responsibility in these areas, the Ways and Means Committee, for example, I can't find anyone other than the administration advocating any positive programs.

There is a dollar drain, and the last quarter of 1967 witnessed one of the heaviest balance-of-payments deficits that we have had. We are beginning, it seems to me, to lose in the relative position of exports with respect to the imports.

What I am interested in is what do you recommend to curtail dollar outflows? I know your company has a big dollar inflow, so maybe you haven't thought about it from that aspect, but when confronted with these problems, you always have to have some kind of a solution. What would your solution be?

Mr. HAMILTON. Mr. Boggs, I would really rather not try to deal with all of the aspects of the balance-of-payments problem. You have had far greater experts advising you in other areas.

But, clearly, where you have a source that is contributing regularly, the last thing you would want to do is take shortrun measures, which may or may not be helpful, and in the process actually jeopardize the source. That $2 billion has been very important, and this is not just in 1966 and 1967, but going back quite a few years you find in the Commerce Department statistics the same contribution.

Representative BOGGS. Maybe I should ask you a specific question. Do you know any practical way of resolving the problem that seems to be almost unique with ITT in light of these regulations? Have you gotten any relief from the Commerce Department?

Mr. HAMILTON. Well, obviously, I have gotten to know the administering staff quite well since the first of the year, and there is a general recognition by them that as they apply in any one case these regulations may have some rather unusual and harsh consequences. In effect, they say this merely gives them the right to ask us to come in and sit down and talk about our entire program. What are we going to do during all of 1968 with respect to our net flow abroad?

We are perfectly willing to do that. In fact, the exemption that I mentioned we had filed is an application to do just that and to agree on a level of inflow that shows some progress over last year's, but to permit us to bring it back in all the ways available to us, so that we don't have to rely so heavily on dividend repatriation. Their position is that we should come in and talk about it and they will try to be understanding. I think our complaint——

Representative BOGGS. Try to do what?

Mr. HAMILTON. To try to be understanding about the peculiar problems of ITT. I must say these are able and hard-working men, and they have had a very difficult time since the first of the year. Personally I am grateful that I am not put in their position where I am supposed to have the wisdom to review the international programs of 700 or 1,000 or eventually 3,000 or 4,000 companies, many of whom have the complexities of ITT, and make judgments about them in such a way that there is equity, that there is an understanding of the needs of the companies and their shareholders, and that the long-range interests of the U.S. balance of payments are properly served.

Frankly, this is taking on a tremendous responsibility.

Representative BOGGS. Do you feel under the existing circumstances, with special reference to your own organization, that you may incur some degree of retaliation from some of these other countries?

Mr. HAMILTON. I think ITT is not alone in this. I think any time that seasoned companies in Western Europe which are not now receiving additional financial support from their parents, but are merely repatriating a fair portion of dividends every year, are asked to go from a level of repatriation from, let's say, as in my example, 50 to 80 percent, then I think it is clear that you would be jeopardizing the long-range interests of your company. Part of it would be the relationship of the affiliate with its Government, part of it would be the relationship with its creditors and, finally, with its competitors.

Representative BOGGS. You have built up a great deal of capital, have you not, in these other countries, that you are able to use without any recourse to American capital?

Mr. HAMILTON. This is correct. In our particular situation, these subsidiaries have been over there for 40 and 60 years. As I mentioned, they are staffed almost entirely by nationals. The boards are almost entirely nationals, and their relationships with the local banks are intimate.

These are good bank relationships, and this is why these companies can grow and expand without asking for assistance from the United States. When we do borrow at a senior level as we did in the case of last week's issue that I just mentioned, this is mostly so that we can do new things such as acquisitions and new ventures.

Representative BOGGS. Mr. Norris, I would like to continue with you for a while, but we have a rule on this committee limiting each member to 10 minutes.

Mr. Hamilton, I must congratulate you on a fine statement.

I do have a question that I would like to address to Mr. Norris. I might say, Mr. Norris, as you know, as chairman of the Subcommittee on Foreign Trade Policy of this committee, that I have, I think, worked as hard as anyone to make trade freer between nations of the world. I gather that you are opposed to most of these recommendations, including the proposed travel tax and the others, and in the last paragraph here of your statement, or the second to the last paragraph, you say:

> It is our conviction that the basic overriding task in a balance-of-payments program is to assure that all of its essential related elements involving monetary and fiscal policies will be carried out so as to check inflation, reduce governmental spending and strengthen to competitive position of United States industry in world markets.

I notice you don't say anything about a tax increase.

Mr. NORRIS. There, again, I think it is a part of a basic overall integrated program, Mr. Boggs. I am not here as an authority on fiscal matters.

Representative BOGGS. You know what you are talking about.

Mr. NORRIS. I realize that, but I say this: My basic concern is the fact that we must take steps to halt an increase in the deficit.

Representative BOGGS. Let me ask you specifically, do you think it is possible, to use your own language, to assure "that all of its essential related elements involving monetary and fiscal policy will be carried out so as to check inflation," and so forth? Do you think that is possible without a tax increase?

Mr. NORRIS. I don't think it is possible without a tax increase, sir; but, what I am trying to say is, I think that in invoking a tax surcharge, I think there must be other things done as well.

Representative BOGGS. Spell out exactly, if you don't mind, what we have to do.

Mr. NORRIS. I think there should be every effort made to reduce our Government expenditures abroad——

Representative BOGGS. Excuse me for interrupting, but will you spell out where we should do that?

Mr. NORRIS. I think this can be done by bringing back unnecessary troops from abroad.

Representative BOGGS. From where?

Mr. NORRIS. I would think from Germany.

Representative BOGGS. You think they are unnecessary in Germany?

Mr. NORRIS. I think to the extent that they are maintained there along with their families they probably are.

Representative BOGGS. How many do you think are unnecessary there?

Mr. NORRIS. I don't have that.

Representative BOGGS. I am trying to figure out how much this would save. You see, we are confronted with specific problems, and it is very easy to give generalized answers. I think when you appear before these committees that you should be prepared to give specific suggestions. Now, you say return troops. How many troops and how many dollars would you save?

Mr. NORRIS. I am not in a position, Mr. Boggs——

Representative BOGGS. Then, let me spell out others. Where else would you save money?

Mr. NORRIS. I think we could reduce the number of people we have abroad on behalf of the State Department and certain Government agencies.

Representative BOGGS. They have reduced them considerably. How much more would you reduce them?

Mr. NORRIS. I am not in a position to give you figures because I haven't studied it, sir.

Representative BOGGS. Do you have any specific recommendations on domestic expenditure reductions?

Mr. NORRIS. As we say in our basic position, we think that domestic expenditures should be maintained only for those of high urgent priority.

Representative BOGGS. Do you have any suggestions as to priority? Understand, we are confronted with legislating on these proposals.

Mr. NORRIS. Yes; and I am well aware that this is a problem right within the Congress today.

Representative BOGGS. It certainly is.

Mr. NORRIS. In attempting to reconcile some of the things that the administration would like to do with what the Members of Congress feel should be done, I realize this is a problem. I am not in a position to deal with the specifics. I think that this is a matter of basic policy that we should adopt.

Representative BOGGS. But you are dealing with specifics. You are talking about sound fiscal policy. You are talking about balanced budgets. You are talking about monetary restraints. You are talking about no tax on travel abroad, the removal or modification, at least, of the regulations with respect to investment abroad.

Do you have any recommendations, specific recommendations, in respect to increasing our export position?

Mr. NORRIS. Yes. I think that we must always do everything to increase exports, but we should not curb investments unnecessarily. I recognize at the same time that we are faced with an emergency situation, that we must take immediate steps to do whatever we can to correct our payments imbalance.

At the same time, I think that there should be a full recognition within Government of the very positive inflow and contributions which these investments make, and the fact that these investments do generate considerable exports. Consequently, I would be very reluctant to see any substantial curbing of these direct investment programs. I think that there can be certain tax incentives adopted to promote exports.

Representative BOGGS. Spell that out a little bit. What kind of tax incentives?

Mr. NORRIS. I think that this can be done perhaps by particularly encouraging those who have not entered the export field—to encourage them by allowing some tax credit based upon their export business. That is one approach to the subject.

Representative BOGGS. Would you try to balance that off with some kind of a restriction on imports?

Mr. NORRIS. I think when you talk about restricting imports, you get into all sorts of questions such as quotas, protectionist measures, and so forth.

Representative BOGGS. Of course, that is the other country's exports.

Mr. NORRIS. Sure. I would like to see some specific proposals on it. I have none to make, actually, at this stage of the discussion.

Representative BOGGS. Mr. Chairman, I have consumed my time. I want to thank you gentlemen for being so courteous, and I thank you for your testimony.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Gentlemen, I appreciate the statements you have given here before the committee. They are very helpful to us, I assure you.

Mr. Cook, I just returned from out west, and when I was out there I had a meeting with some of our wheatgrowers, and they complained to me that the world price of wheat was too low, that they could not grow wheat and survive at present world price of wheat.

The International Grains Agreement, as you said in your statement, would raise the minimum world trading price of wheat by 23 cents a bushel. Yet, in your opinion, the way I read your statement, we would only lose our export markets by this type of inconsistency. Is that you position?

Mr. COOK. Yes, sir.

Senator JORDAN. And you believe that it would be self-defeating, if we were to raise the minimum world trading price of wheat by 23 cents, that it would be self-defeating because you believe we would lose our world markets by so doing.

Mr. COOK. Well, sir, I would like to say that it is probably true that the western wheatgrowers cannot survive at the world wheat price. The current loan, as you know, is $1.25, the base loan, and they get a cash subsidy payment of approximately 45 or 46 cents a bushel, so they are not growing wheat at the world level. They are getting paid in excess of that, as you know, I am sure.

That is the problem if we are to keep pressure on the common agricultural policy of the European Economic Community, in particular, France. They sold 500,000 tons of wheat to Red China on credit last week at $47 a ton f.o.b., against an internal support price of $2.87 a bushel, or a little over about $100 a ton. Now this is considerably less than we can sell wheat at, even at $1.25.

I would say that France is probably contributing 25 percent of the funds to the CAP, and getting, say, 75 percent of the benefits, and I think it is against our national interest to take the heat off in this area and induce the production of wheat in other parts of the world where they are relatively inefficient, and run into the same thing in wheat that we have run into in cotton, where we have seriously damaged our world markets.

This is my position on the raising of the levels.

Senator JORDAN. Thank you.

Mr. Hamilton, you made a good case for your company and the effect of these regulations on your foreign operations. What do you think will happen to the competitive position of U.S. companies abroad, if the investment regulations are not modified?

Mr. HAMILTON. I would like to make it clear, Senator Jordan, that I don't think ITT is completely unique in this regard. I think there are a number of mature companies that may fall into the same category.

But, when you have a situation which I have described, where we have really had many benefits of having a foreign national character in terms of our ability to borrow, our ability to sell, and for other aspects of our business, and then apply these repatriation requirements, we would begin to appear like a mainly American corporation pulling out undue portions of our earnings. This would invite retaliation from the governments, perhaps in the form of controls which, in turn, would concern our creditors. It would give our competitors an advantage. In short, you would begin to whittle away and erode what really is an unusual national asset.

But, I repeat, while ITT in many ways is unique, I think there are other mature corporations, operating particularly in Western Europe, that represent the same kind of asset for the United States, and should be protected, really, in the same way.

Senator JORDAN. How do these repatriation requirements affect your company, taxwise? Do you pay more or less taxes?

Mr. HAMILTON. There aren't many countries that have a withholding tax on dividends of less than 15 percent. As Mr. Norris mentioned, many of them operate progressively, so that by the time you get into high percentages of payout, you are not dealing at the 15-percent level, but, rather, at the 35-percent or higher level.

In summary, if you bring more dividends back, not because it is desirable either for affiliates or to the parent but solely to accommodate a regulation, then you will leave, at the very minimum, 15 cents of every dollar on the counter of the foreign government.

Senator JORDAN. Something was said by one of you—and I don't recall who—about the effect of the U.S.-owned production facilities abroad on our balance of payments. Do they tend to reduce exports and increase imports or vice versa?

Mr. HAMILTON. I happened to attend this morning's session, and I heard the comments at that time. I know there was a study made at the time Mr. Behrman was in the Commerce Department that indicated that probably 24 or 25 percent of all American exports were affiliate related. I think, in your testimony, Mr. Norris, you used the same percentage.

When you consider the net contribution of these foreign investments, including the income from dividends, and the income from royalties and fees, less the net outflow, you should consider, also in this arithmetic, the additional plus that comes from the affiliate-related exports.

Senator JORDAN. From the additional exports?

Mr. HAMILTON. The incremental exports; yes.

Senator JORDAN. By the affiliate operation in the foreign country.

Mr. HAMILTON. Correct.

Mr. NORRIS. I would certainly subscribe to that. I think that the figures do demonstrate it is about 25 percent. There is also the very fundamental position that it is the only way very often that American companies can get their market positions abroad. Experience demonstrates that often the only way to get these positions is to start some assembly or manufacture abroad, and once you establish a market position for your so-called run-of-the-mill products, this in turn, leads to the ability of the U.S. company to export its more sophisticated products as they are developed and they certainly are developed.

Senator JORDAN. Mr. Norris, you have a very fine paragraph on page 8 of your statement starting, "Historically, international trade and private overseas investment have been favorable factors in our balance of payments."

I think in that paragraph you speak about the exports to affiliated companies representing approximately 25 percent of all U.S. exports. It looks to me like these regulations are killing the goose that laid the golden egg. Mr. Hamilton, do you think that the regulations will be effective in stemming the balance-of-payments deficit?

Mr. HAMILTON. Well, there is no question that as they are constructed that they would have some effect. I must say that——

Senator JORDAN. Short run or long run?

Mr. HAMILTON. They may have a shortrun effect of curtailing the outflow. The question is whether they will have the longrun effect of actually damaging something that is much larger, and, therefore, more important, and that is the inflow.

I must say that I don't envy the position of our friends who have to administer the program. As I understand it, they were handed the $1 billion target, and the regulations, with two hands at the same time. I think good administrative practice might have dictated that they be handed the target and then asked to develop the regulations that are designed to meet it.

At the moment, I don't think anybody, either in the corporate world, or in the agencies, knows exactly what the shortrun effect of the present regulations would be, whether they would generate savings less than the $1 billion target or whether they would generate $2 billion. This frankly, makes the administrators uneasy, because they can't afford to be too understanding of any one company's problems, because they are afraid that they thereby may miss the target.

I must admit if I had been handed the assignment of saving $1 billion in 1968 over 1967, from this private sector, I would have done it somewhat differently, although I am encouraged by Professor Behrman's view that new investment abroad is really returned on a net basis in the balance-of-payments statistics very quickly. I think he said in about $2\frac{1}{2}$ years.

Senator JORDAN. Yes; I remember that figure.

Mr. HAMILTON. It should have been easier to take up slack there, and maybe reduce the $3 billion outflow to $2 billion, without, at the same time, requiring a greater return of income, the $5 billion figure I mentioned.

They had their choice of attacking either the $5 billion coming in and the $3 billion going out, or both. I think it might have been sounder to draft the regulations to reduce the $3 billion down to $2 billion to reach the target.

Senator JORDAN. Thank you, gentlemen. My time has expired.

Chairman PROXMIRE. Gentlemen, all of you seem to disagree, more or less, with the President's balance-of-payments program. Mr.Cook concentrated on one specific limited element of it, but, certainly, Mr. Norris and Mr. Hamilton, you most emphatically disagree with much of what he has proposed.

I would like to ask you to tell me whether or not on each of the elements in the President's program you think, No. 1, his estimate of savings is about right or exaggerated, or even in the wrong direction for the first year; and, then if you care to do it, how long before you think this kind of a program, if persisted in, would become perverse.

In the first place, the mandatory investment program. As I understand it, mandatory investment restraints, the President said, would save $1 billion, or he wants to save $1 billion; that is the goal. The Federal Reserve restraint would have $500 million additional restraint; the travel restraint a half billion dollars; the repatriated earnings, which I guess is about a half billion dollars; and the Government expenditures overseas, a half billion dollars.

I presume there is no argument on the last part. That is pretty simple. So, let's take the $2.5 billion of the program other than the Government expenditures overseas. Mr. Hamilton.

Mr. HAMILTON. With your permission, Mr. Chairman, I will stick to the aspect I know best, the mandatory program.

Chairman PROXMIRE. There is no reason you should stick to the parts you know best. We don't do that in the Congress. Give me your impression on all of them. It would be helpful.

Mr. HAMILTON. On the mandatory program, the savings of $1 billion could be made by either controlling the outflow or asking companies to increase the inflow, not necessarily through the repatriation of dividends, with all of the consequences I have mentioned, but, if necessary, bringing it back through other sources, including the proceeds of borrowing.

Chairman PROXMIRE. So you think that the estimate may be in the right amount? I am just asking whether you do?

Mr. HAMILTON. I think the $1 billion would be achievable. Obviously, if only 50 companies bring back $20 million more in 1968 than in 1967, the target is achieved.

Chairman PROXMIRE. How long before it has a perverse effect for reasons that you have so well spoken of?

Mr. HAMILTON. If you are doing this through new investment, then, of course, I think we have to rely on Mr. Behrman's estimate that it is probably 2 or 3 years before this begins to——

Chairman PROXMIRE. Within 2 or 3 years. In other words, this will contribute a negative element to our balance of payments.

Mr. HAMILTON. Right.

Chairman PROXMIRE. Not a positive element.

Mr. HAMILTON. But, if this is attempted through the repatriation route, and you get the kind of retaliatory and competitive problems which I have referred to, then, of course, the consequences would be much quicker.

Chairman PROXMIRE. Well then, the repatriated earnings you would agree could be a half billion dollars. It would be deteriorating more rapidly than the investment.

Mr. HAMILTON. The question is, rather, whether you bring it back solely from native companies by having to have them declare and pay out extremely high dividends, or whether the Department gives us some flexibility as to whether we bring it back from the various sources available to us.

We think we can generate the same plus for the balance of payments, and by that I mean an improvement in 1968 over 1967, but without the damaging consequences of having to do it through divided declarations.

Chairman PROXMIRE. How?

Mr. HAMILTON. Purely by bringing back more. Please don't misunderstand me. As I said earlier in the testimony, we want to do everything we can, not only to continue——

Chairman PROXMIRE. I am sorry; maybe I missed something earlier. You said just by bringing back more. If you don't bring it back by dividends, and you don't bring back repatriated earnings, how does the Federal Government administer a program to bring back more, without either of those?

Mr. HAMILTON. Well, under the voluntary program, on occasion we brought back the proceeds of long-term borrowings, we brought back additional amounts in fees, and so on.

Chairman PROXMIRE. This is my question.

Mr. HAMILTON. There is an alternative.

Chairman PROXMIRE. On the assumption that the voluntary program continues?

Mr. HAMILTON. Right.

Chairman PROXMIRE. Now my question is: Will the mandatory program increase, or rather diminish the outflow by the $1 billion the President estimates? I am a little confused by the last part of your answer. You are implying now that you don't need the mandatory program, that the voluntary program would work to diminish the outflow by $1 billion.

Mr. HAMILTON. I think the $1 billion could have been obtained without a mandatory program; that is correct.

Chairman PROXMIRE. With the 1965 program.

Mr. HAMILTON. I think the $1 billion also could be obtained under the mandatory program, solely by reducing the outflow side.

Chairman PROXMIRE. So that what you are saying is that 1968 will be a better year than 1967, in part because you don't have the peculiar conditions which you had in 1967—with the British devaluation and other elements—and that if you continue the voluntary program, that you could make a billion-dollar-better showing on net capital outflow, absent having the compulsion; is that correct?

Mr. HAMILTON. When we talk about reducing the net dollar outflow, that applies to many companies.

When we apply it to ITT, it is a question of increasing our inflow. We would be able to do that, and make a positive contribution in 1968 over 1967.

Chairman PROXMIRE. Now, how about travel?

Mr. HAMILTON. From my point of view, the only thing I can say here is——

Chairman PROXMIRE. I am not asking you if it is good or bad. We have our own impressions of that. Some of us are very critical of it; but will it work?

Mr. HAMILTON. In the first place, I don't think it will work. Second, ITT people are, all over the world, making sure that we generate the earnings which we are counting on here. I think the people had better stay abroad and continue their travel.

Chairman PROXMIRE. You have no particular objections to the Federal Reserve program, I take it; that is, the restraint on banks and financial institutions abroad?

Mr. HAMILTON. No, sir; in fact, we have some credit organizations that are subject to that program.

Chairman PROXMIRE. Very good.

Mr. Norris?

Mr. NORRIS. Oh, I think that under any mandatory program, you can do anything you want; I mean if you insist that you bring back a half billion dollars.

Chairman PROXMIRE. So, you say it will work, but for how long?

Mr. NORRIS. Only because it is mandatory, and I think the actual results will depend upon the degree of flexibility that is exercised in the management of the program, and there must be flexibility because a lot of companies hurt not only short run but they certainly hurt long run.

Chairman PROXMIRE. You have answered the first part of the question that you think you will get the billion dollar saving. But, the next part of the question is, How long before that will deteriorate?

The burden of the testimony, including Professor Behrman's testimony this morning, was that there is such a quick payback that if you cut investment abroad by $1 billion, presumably within 2½ years, you lose your benefit and you begin to worsen rather than benefit your balance-of-payments situation.

Mr. NORRIS. I agree with what has been said this morning.

Chairman PROXMIRE. Would you agree that is right?

Mr. NORRIS. Yes; and I think there are also short-term losses, too.

Chairman PROXMIRE. How about on repatriation of earnings?

Mr. NORRIS. Here again, I think, if it is mandatory, you can force anybody to do something under threat of penalty, and imprisonment and fines. But I think the real problem here is whether U.S. industry isn't going to run into really difficult problems with respect to their partners abroad, where you have nationals who have majority interests, and where you have laws, as in the case of France, under which you are actually precluded from doing various things; for example, depending upon whether your interest is in a society of limited responsibility or a société anonyme.

There are these other restrictions that I have attempted to point out, such as in Brazil. In many cases you can't do these things by law. Or you do them against the rights of minority shareholders, and you can't force your position as a majority holder.

Chairman PROXMIRE. You make a very, very strong case. I simply wanted to get your notion. Now, how about on travel? Will that work?

Mr. NORRIS. The main thrust of our position on travel, Mr. Chairman, is that under no circumstances should this program apply to business, because I think there is an immediate loss and I think that there is a very long-term penalty that is paid.

Chairman PROXMIRE. Is there? Secretary Fowler testified that in his judgment this wouldn't diminish the amount of travel at all—just the amount spent. He argued that there would be the same number of students going abroad and teachers going abroad, businessmen going abroad, but he contended that with a graduated tax and with a 30-percent tax on everything spent over $15 a day, that Americans would be much more careful about where they stay, and how much they pay. They would be much more careful with what they are spending. Is there any validity in that to you?

Mr. NORRIS. Of course, if you want to pay the cost of travel, you can always travel under the proposed program.

Chairman PROXMIRE. Businessmen would certainly tend to travel in spite of the 30 percent tax. It wouldn't stop them from traveling; would it?

Mr. NORRIS. But at great penalty and at great cost. They can't anticipate as an example what their expenditures are going to be, which you are obliged to do under the explanation of the program that was put out by the Secretary. That is a very cumbersome proposal.

Chairman PROXMIRE. I think they would be the least likely to curtail their travel, because they are going abroad for a specific business purpose. The cost of that travel as compared—not in all cases, of course, but as compared to the great majority of the cases with the necessity for having the businessmen travel—the cost would be relatively minor.

On the other hand, a tourist, a student, a teacher, because, of course, they have to pay the whole thing themselves out of their own pockets, in many cases I think that they would not travel.

Mr. NORRIS. I think the cost to business would be substantial.

Chairman PROXMIRE. It undoubtedly would be substantial. I am just wondering if it would deter, actually deter, prevent travel.

Mr. NORRIS. It certainly would not deter necessary travel.

Chairman PROXMIRE. Yes.

Mr. NORRIS. I think, however, that there may be some curbing of travel which you would normally take for long-term objectives in the management of your programs abroad to develop your market position, and I think this in turn would have an effect upon our inflow, short term and long range.

Chairman PROXMIRE. Do you want to comment, Mr. Cook? I wish you would.

Mr. COOK. I would only say this: We have had some experience with foreign exchange controls, particularly with English sterling. These regulations we have are called direct investment controls.

By definition of the word "investments" they are actually exchange controls, I mean that is so if you cut away all of the fat. These are exchange controls.

I have never had any experience with exchange controls except with sterling exchange, and the rules applied to nationals of all countries, whether they were English or Americans. We were doing the switch business after the war in sterling.

This was fine as long as they didn't catch our money going through the system. If they did in violation of the regulations, they confiscated it.

Well, I wonder if any exchange controls such as these are having any real length of life, because I can't imagine a sophisticated investor in Europe subjecting himself to having his money locked up.

He can make 3 percent a month in Brazil tonight, but if you get it down there you can't get it out. There are lots of other places to go with money. So, I am suspicious that these exchange controls will be self-defeating because of the fear that they create in the minds of foreigners.

Chairman PROXMIRE. You think they will be self-defeating and quite rapidly.

Mr. COOK. In my judgment, like the battlelines during the Civil War, the value of the bonds in France went up and down based on the value of the collateral in the South.

I think the same is true. As our balance-of-payments deficit or surplus fluctuates, so will the efficacy of the exchange controls, particularly when we have $30 billion in short-term assets abroad on call.

Chairman PROXMIRE. My time is up.

Senator Percy?

Senator PERCY. I am sorry I was not here for the testimony, but I read your statements. Mr. Hamilton, I can only say I wholeheartedly concur with virtually everything you have said. The positions are sound, and we deeply appreciate your giving us the benefit of these views.

I would like to ask this. I have read several newspaper articles indicating there was some reluctance on the part of companies to testify, because of the procedure being used for specific exemptions. There is a good deal of discretion in the Department of Commerce as to who gets exempted. The implication in the articles was that if someone came down and testified, they might not be exempted. Do you think that this is a legitimate concern as expressed in this newspaper article?

Mr. HAMILTON. I guess I had better answer that, Senator Percy. No. Obviously, if we thought this was a problem, that we weren't going to be treated fairly by the administrators, we would have had to consider—rather, we would probably have been up here earlier, let me put it that way. No, we fully expect the people in the agencies to render effective and fair treatment.

As I mentioned, before you came in, I think the problem is that they have been given both a set of regulations and a target, and they are very reluctant to ease up in places where it otherwise obviously makes sense, because they don't know what the quantitative results will be on that target.

I said earlier that I am glad I do not have to manifest the wisdom that they are going to have to have to review, let's say, our whole corporate program as it affects the international flow in 1968, and do it in such a way that it provides equity among companies, that it duly recognizes the rights of shareholders, and that it takes the proper long-range view of the U.S. balance-of-payments interest.

It would have been better if we could have had a more well-considered and well-thought-out regulation. The regulation frankly was drafted quite harshly, with the thought that administratively it could be made more lenient, more responsive to need. But the resulting load on the people in the Office of Direct Foreign Investment is tremendous and may prove to be nearly impossible.

Senator PERCY. Mr. Norris, I wonder if you could comment on the small percentage of export business done by small business in this country and the vast proportion of it done by major business.

Now, the point I made with Government witnesses on the travel tax is that it will not impede the travel of those 3 percent of our companies in this country who are in the category doing 95 percent of our foreign trade.

But what we have been trying to do for many years is interest the rest of American business in business abroad. I don't see how they can understand how to do business abroad, develop those markets, and adapt their product for those markets, unless they travel.

It seems to me that the travel tax will impose an undue hardship on the very small business that we want to encourage to go abroad to develop these markets that will improve our balance of trade over a period of time. Would this concur with your judgment, being in the practical world of business?

Mr. NORRIS. I thoroughly concur with that viewpoint, and I go further and say that it will impose a considerable hardship on the large companies also who are doing a substantial part of the export business today.

There is not only the matter with respect to the large companies in developing their export business, but it is the management of their investment programs which is extremely important also. If one tries to look at our total position in world trade, I did an exercise on this a few years ago. I think it must have been 1964 or 1965. If you took the total trade that was generated by reason of our own exports, and exports out of affiliates of American companies abroad, I think at that time it amounted to around $64 billion or $67 billion. This is in my view the true measure of the stake of our companies, and of our country's stake in world trade.

There is a very definite interrelationship between trade and investment. Each supports the other. Overseas investment generates exports, so that I don't think you can separate the functions. They are very definitely dependent one upon the other.

With respect to the smaller company, that is afraid to get its feet wet in the export business, this is essentially a matter of orientation. I think it is an educational process which we must continually go through. I sit on the executive board of the National Export Expansion Council and much is being done to try to generate this interest with the small businessman. But I think it needs some help. It needs some help in the form of some incentives for the smaller company which has never been in the export business to start, to get its feet wet. I do feel very strongly that small business would be particularly harmed by any travel tax program as far as it relates to business.

Senator PERCY. I wonder if the travel proposal is not terribly discriminatory in favor of big companies as against medium-sized companies. My concern is generated by my experience representing a medium-sized company abroad. We would have to send people from this country to develop sales abroad. But we are competing against huge companies that have resident people abroad who don't have to come back to this country except for infrequent trips. Those fellows don't have the tax. Those smaller companies and medium-sized companies that have to send people back and forth have to pay an unusually discriminatory high cost in the form of the travel tax.

Mr. NORRIS. I think your reasoning follows very clearly.

Senator PERCY. One last question, Mr. Chairman, if I have a minute left.

Mr. Hamilton mentioned a figure of $82\frac{1}{2}$ percent as against the Commerce Department regulation 65 percent figure. Could you explain this difference?

Mr. HAMILTON. Well, Senator Percy, 65 percent has been a much misunderstood figure.

There has been some discussion that American corporations operating abroad have been paying out approximately 65 percent of their disposable income in the form of dividends, and have been remitting this back to the United States. When we dug into these figures, we found some interest payments in the figures and we found some branch profits which probably reduced the actual payout to around 50 percent payout.

But, nevertheless, the thought would follow, even if the number were 65, that since the regulations provide you only have to pay out as much in1968 as you paid out in the base years 1964, 1965, and 1966, that you could retain 35 percent.

However, as you will recall, Mr. Chairman, in my testimony I mentioned that the regulations limit investment in 1968 to 35 percent of the direct investment in the base years, and direct investment includes reinvested earnings, so in effect what can be retained in 1968, under the more harsh of the two provisions as they affect a company which has been paying out at a 65-percent rate, is not 35 percent, but, unfortunately, is 35 percent of 35 percent, or 12 percent. I assure you this is a very little understood situation. In fact, I must admit that there are many treasurers of large corporations that don't yet understand that this is what the regulations say.

Senator PERCY. Thank you.

Chairman PROXMIRE. Have you checked that with the Department of Commerce? Do they agree that it is 35 percent of 35 percent?

Mr. HAMILTON. Yes, sir; for a company that has been paying out 65 percent.

Chairman PROXMIRE. Ambassador Roth has arrived. I understand Mr. Widnall has one question and then we will hear from Ambassador Roth.

Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Hamilton, do you believe that the informal ad hoc approach currently being used by the Department of Commerce is the best procedure for covering specific exemptions?

Mr. HAMILTON. No, Mr. Widnall. I think it would be much preferable if time could still be given to developing a set of regulations which, on the one hand, recognized the target of a billion dollar improvement in 1968 over 1967 in the private sector, but, on the other hand, sought improvement in those areas where there would be less longrun damage or where it would at least be postponed the longest.

My own feeling is that with \$3.5 billion flowing out annually, it is about \$3 billion net of what is being borrowed abroad, that there probably is room in there for reduction of as much as \$1 billion in any 1 year, if indeed that is necessary. The corporations, at least, can control what goes abroad.

They also are, to some extent, free to determine what they borrow abroad. But, when you deal with the income side, the \$5 billion worth of income, this becomes much more difficult for any corporate head-quarters on this side of the water to control, partly because the income itself is subject to competitive conditions over which they have no control, and partly because repatriation at excessive levels is dangerous, for reasons I have mentioned, such as having nationals on the board, having a rather delicate situation of trying to fit into the local national scene as much as possible to further our relationships with our customers, the governments, and our competitors. Therefore, I would conclude that we should stay away from the income side, and from any targets with respect to that area, except for the one requiring the same percentages of payout as in prior years.

I would accept the latter as being perfectly reasonable, and I would even have gone a little further and said you could have had a modest increase in that payout rate which might, in our case, mean something slightly above the present 50 to 55 percent, but not, sir, in the area of 80, 85, or 90 percent.

Representative WIDNALL. Do the other witnesses have the same opinion with respect to that?

Mr. NORRIS. I think so. Basically; yes, sir.

Representative WIDNALL. Is that true with you, Mr. Walker?

Mr. WALKER. Yes.

Representative WIDNALL. Mr. Cook?

Mr. COOK. I am not suffering from the pangs of maturity that my friend on the right is, so we have never repatriated any money, so anything you do to us in my type of business, which is a high borrowing, low equity position in agricultural commodities, quite frankly, I don't know what it is going to do with our overseas trading. I don't really think that is an issue right here as far as my balance of payments. We have some serious problems, and frankly, we don't know what we are going to do. In the first place, we can't understand the regulations.

Chairman PROXMIRE. Thank you very much, gentlemen, for excellent testimony on a very complicated problem. We will now hear from Ambassador William M. Roth, the President's Special Administrator on Trade Negotiations, and if he cares to bring some of the gentlemen on the staff with him, he may do so.

We are delighted to have you. We know of your reputation in this situation. We are proud and happy to have you here. We have some serious questions about the trade problems. You have a prepared statement. If you will introduce your colleagues for the record.

STATEMENT OF HON. WILLIAM M. ROTH, PRESIDENT'S SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS, ACCOMPANIED BY THEODORE R. GATES, CHIEF ECONOMIST; JOHN REHM, GENERAL COUNSEL; AND WILLIAM KELLY, COORDINATOR FOR NEW TRADE POLICY STUDY

Mr. ROTH. This is Mr. Ted Gates, who is our Chief Economist; Mr. John Rehm, who is our General Counsel; and Mr. William Kelly, who is the Coordinator for our New Trade Policy Study. If I could, I would like to read my statement.

Chairman PROXMIRE. Very good. You may proceed.

Mr. ROTH. I have made some changes in it since the one you have before you.

First, let me say that I welcome this opportunity to appear here and to talk not about the past, but the future, and what we are doing to prepare ourselves for it.

Last July I appeared before your subcommittee and outlined the results of the Kennedy Round, which had just been successfully concluded. Today I shall discuss the next step, the future of American trade policy, which our Office is engaged in studying at the direction of the President.

I shall begin today, with fundamentals—what our trade policy has been for these past 34 years, why we have consistently pursued it, and why we should continue to do so.

Taking into account the hard lessons of experience—the Smoot-Hawley Tariff Act of 1930 and the downward spiral of world trade which followed it—the United States embarked in 1934 upon a policy of trade liberalization and expansion. That policy has gone forward under administrations of both parties, and has had the support of congressional majorities of both parties. There has been steady progress toward the removal of trade barriers over these three decades, culminating in the Kennedy Round last year. World trade during this period has steadily expanded, and its benefits have been ever more widely diffused among nations and people.

Why have we and other nations been steadfast in our trade policies and goals? Fundamentally, because we have all recognized the great economic advantages of the division of labor among nations as well as within nations—with each doing what it does best. Keener competition is an ever-effective stimulus to efficiency, productivity, and innovation. All of us benefit, as consumers, from access to a greater range of variety and quality in the goods we buy, and their more competitive pricing. Trade among nations is, after all, only the extension beyond our borders of the basic elements of the free enterprise system—competition, specialization, the price mechanism, the free market, freedom of choice, and mutually advantageous exchange.

The gains, in the real economic world, do not come entirely without some pain. Therefore, we have sought—through an evolving set of programs and statutory provisions—to maximize the benefits to the great majority of our citizens while minimizing injury to the few.

We must be prepared to adjust to changing circumstances—indeed, our free enterprise system is in itself a potent force for change. Therefore, while steadfast in our goals, we must reexamine from time to time the means of achieving them. This is the purpose of our study.

We are beginning with a thorough examination of our competitive position in world markets—now and in the future. Much has changed since 1962, when we last took stock. The pace of economic development has greatly accelerated. Industrial technology and agricultural productivity have grown by leaps and bounds. New industries have sprung up, both here and abroad. New competitors are appearing in virtually every market.

Some of the critics of a liberal trade policy see ominous portents for the future in this rapid pace of recent change. America, they say, is rapidly losing its competitive edge. Ignoring our high technology, our sophisticated management techniques, our advanced and flexible capital market, and other factors relevant to our competitive position, they predict that lower wages abroad will drive our industries to the wall. But a sound assessment, we feel, should take into account all the elements which contribute to success in the world's markets.

There are more positive reasons, too, for a careful look at the nature of future competition. Sound policies can come only from sound forecasts of our needs. We need to know what will be the nature, the terms, and the problems of competition in future world markets—what difficulties our exporters will face and in what areas the imports of 1970 may cause domestic hardship.

What will be the implications for our trade of the rapid and continuing development of regional economic blocs? Or of the continued evolution of the restrictive agricultural policies adopted in some of our major export markets? What contributions could expanding East-West trade make to world prosperity and peace?

What is the interplay between our future trade and our now enormous stakes in oversea direct investment? Each of these involve many factors which must be carefully sifted out and appraised—in terms of jobs, productivity, income, growth and, above all, the national interest.

We are considering the specifics of trade policy as well—such as the various ways of conducting trade negotiations, the impact upon trade of the remaining tariff and nontariff barriers, the trade interests of the developing countries, the problems of adjustment within our own economy to foreign competition, and the ways in which trade policy is formulated and administered, both within our own Government and in multinational forums.

One of the most important questions with which our study is concerned is that of future negotiating goals and techniques. We are looking at several possibilities. It has been suggested that the linear approach of the Kennedy Round, having been successful once, should be tried again. But for a number of reasons, such as differing tariff levels among countries, the linear approach encountered many problems in the Kennedy Round, which might prove insurmountable in any similar future negotiation. The item-by-item method followed in previous negotiations could be again tried—although, of course, it was earlier experience with the tedious difficulties inherent in the item-by-item method which led to the adoption of the linear approach.

Eric Wyndham White, the retiring director-general of the GATT, has proposed that future negotiations be conducted on the basis of industrial sectors or groups of products and include both tariff and nontariff barriers. One problem with this approach is trying to find sectors in which the participants could achieve reciprocity. Logically, such negotiations might also include such matters as international investment and research and technology, as well as tariff and nontariff barriers.

Tariff harmonization has also been suggested and, in fact, was tried on a limited basis with the steel negotiations in the Kennedy Round. The advantage attributed to tariff harmonization is that it would put producers in all countries on a more equal and competitive basis. Harmonized tariffs, however, may have more the appearance than the substance of equality, because the same tariff applied in different countries provides different degrees of protection to the domestic industries concerned. Furthermore, other factors, such as nontariff barriers, may play a very important role in determining the actual level of protection.

During the past few years, as Senator Javits and Congressman Reuss have brought out, considerable interest has been expressed in possible U.S. participation in free-trade areas. Conceptually, these could cover either all products or particular sectors, such as in the United States-Canadian automotive agreement. Much attention has been given to a North Atlantic free trade area—either as an alternative to United Kingdom entry into the ECC or, possibly, as a first step toward an enlarged free trade area that would embrace most, if not all, of the developed countries. We are trying to measure the economic impact of such arrangements, as well as their advantages and disadvantages to U.S. trade.

All proposed methods of negotiation must, of course, take full account of the fact that nontariff barriers as well as tariffs would have to be covered.

Prior to the Kennedy Round, and during it, the United States successfully negotiated for the reduction and elimination of nontariff barriers.

Through the GATT, which the United States took the initiative in forming, we have succeeded in obtaining the removal of most import quotas maintained by other industrialized countries. The relatively few remaining ones are mostly agricultural. We are continuing to press for liberalization in this field, but it is a slow and difficult process, since all countries resort to some restrictive devices to maintain the income of their farmers. We ourselves, as you know, use quotas for this purpose. Under section 22 of the Agricultural Adjustment Act, we limit imports of cotton and cotton products, wheat and wheat products, most dairy products, and peanuts.

We made substantial progress in the Kennedy Round toward liberalizing nontariff barriers. We negotiated an antidumping agreement that should limit the imposition of antidumping duties to cases of actual injury, as in our own law, and insure that regular and open procedures are followed to avoid their arbitrary and protectionist application. No change in our own statutes will be required.

We also negotiated a separate agreement involving a nontariff barrier of our own—the American selling price system of customs valuation. In exchange for its termination, we would, under the terms of this balanced agreement, receive deep cuts in the chemical tariffs of the ECC and the U.K. In addition, the ECC countries would eliminate discriminatory taxes against American-type automobiles, the United Kingdom would reduce its Commonwealth preference on tobacco, and Switzerland would eliminate its import limitations on canned fruit preserved with corn syrup.

This agreement was negotiated on an ad referendum basis for later submission to Congress, and we received some criticism to the effect that it amounted to an invasion of the prerogatives of the Congress, although we do not believe this to be true. The agreement, of course, will not become effective unless and until Congress acts to abolish the American selling price system. Let me say that this will be a very real test of our determination to come to grips with nontariff barriers and will have considerable bearing on the course of our future trade policy in this area. We welcome the full examination of the agreement by all Members of this Congress.

Nontariff barriers are the trade negotiation frontier of the future. We have a long way to go. One reason is that too often in business, in government, and in legislative bodies, the term "nontariff barrier" is used without precise definition, facts, or analysis. In preparing for the Kennedy Round, we often found it impossible to get the close and detailed information we needed to formulate a negotiating position. Often business had not done its own homework in this area, filled with analytical traps for the unwary.

For instance, what trade impairment will chemicals X, Y, and Z suffer in the German market because of an upward shift in their border taxes last January 1? We do not know, and the chemical industry does not know. It involves a study of the price consequences of the tax increase as well as a host of other factors. Oversimplified answers will not help.

For this reason, my office will hold public hearings shortly to enlist the advice, information, and expertise of business and agriculture in nontariff barriers, and in other areas of trade. Shortly thereafter, in Geneva, all the major trading nations will submit their own analyses of each other's nontariff barriers. This will lay a foundation for a later negotiation looking to the dismantling of as many as possible of these nontariff barriers—the most difficult, most complicated, and most tenacious of trade barriers.

However, events in the world are moving with such rapidity that certain kinds of nontariff barriers cannot await the conclusion of our trade study. An example of this is one I just mentioned, the effect of border tax adjustments on trade, which figured in the President's balance-of-payments message of January 1. We hope and expect to have this complex and often exaggerated problem examined in the GATT in the near future.

With respect to the developing countries, I need not tell this committee that the needs are great and the problems involved in meeting those needs equally great. There is certainly no easy way of bringing the economy of a developing country to the point of takeoff. Nevertheless, the developed countries must do all in their power through their own commercial policy to assist these countries.

Last year at Punta del Este, the President declared the willingness of the United States to explore with other developed countries the possibility of a joint program to grant generalized tariff preferences to the developing countries. A number of questions, however, require careful examination, such as the following:

What kinds of safeguards and what exceptions should be provided to protect sensitive domestic industries? What countries ought to benefit from these preferences? What kinds of products might be most appropriate in terms of the export prospects of developing countries? What should happen to existing preferential arrangements such as the Commonwealth and ECC preferences? How long a period of preference would be desirable? What margin of preference would be helpful, while at the same time not disrupting the U.S. market?

These questions, and others, were debated at a ministerial meeting of the OECD last November. The United States took the position that tariff preferences must be generalized and not of benefit only to a particular region. In addition, it emphasized the reverse preferences, or giving a developed country a special position in a developing country market, should be phased out. There was no agreement, certainly, on all aspects of a developed country preference position. But the desirability of a general preference scheme was sufficiently recognized so that the developed countries could take a more or less concerted position to the UNCTAD II meeting in New Delhi, which is now in progress. However, it is still too early, in my judgment, to know whether the many varied and complex questions which preferences involve can be answered to our satisfaction and that of the other countries concerned.

Aside from tariffs, the developing countries place considerable emphasis on commodity arrangements. Experience has shown that any consideration of a commodity arrangement raises questions relating both to the stabilization of primary product prices at remunerative levels for efficient producers and to the commercial impact of commodity arrangements on users of the products covered by such arrangements. More work is required, in my judgment, to determine the true commercial benefits to be derived from such arrangements.

My office does not have the primary responsibility for the negotiation of commodity agreements on tropical products. Nevertheless, we have a great and continuing interest in areas of such great significance to developing country trade. Therefore, our current study will place emphasis on the long-range implications and the possible benefits of such arrangements, including their implications for a sound U.S. commercial policy.

As you know, the United States has supported the joining together of developing countries in regional trading arrangements—for example, the Latin American Free Trade Association. However, in part, because we do not have a large body of experience to guide us, their impact upon member and nonmember countries needs further examination. For example, how do these regional trading arrangements affect U.S. export interests? Moreover, it is not clear what kinds of conditions the United States should seek in relation to the establishment of such arrangements in order to render them as consistent as possible with an open international trading system. I think this is a point that most certainly should be underlined.

Another topic to which we attach great importance is the problem of adjustment to import competition.

In 1962, as you will recall, the executive branch proposed, and the Congress enacted, a program of adjustment assistance to help firms and workers hurt by increased imports caused by tariff concessions.

Conceptually, this was a significant forward step in the evolution of our trade agreements program. It amounted to an acknowledgment that increased quotas or duties need not necessarily be the most appropriate or effective form of relief for injury due to import competition. Unfortunately, the program did not, in fact, become operative, and, therefore, has not yielded us any experience upon which to base future policy, although we will be proposing liberalized criteria for adjustment assistance in this field shortly.

But, even without such a body of experience, we must continue to explore alternatives to quotas or higher tariffs. We should also examine other existing programs, such as the manpower training and development program, and insure that they also make a maximum contribution to our ability to adjust to import competition.

As you know, there are some who say that there should be an overall economic mobility program which is not tied to any specific cause of economic distress. While this is obviously beyond the bounds of a study of trade policy, I would personally think it worthy of greater consideration.

Recently, I have heard it said that the conditions for escape-clause relief are just as unrealistic as those for adjustment assistance, especially since they turn on the same causal factors. This conclusion seems to me premature. I think an examination of the escape-clause petitions made since 1962 would reveal that they involved weak cases in which the tariff concession was a very old one or in which it was not clear that there had been an increase in imports. In short, I am not persuaded that the criteria for escape-clause relief are unduly rigorous. However, I do believe that import restrictions should be an available remedy in certain cases and that we should not reject out of hand any objective attempt to reevaluate the sufficiency of the conditions for escape-clause relief.

The final topic of our study concerns the administration of trade policy. Domestically, this has to do with the organization and administration of trade policy within the executive branch and between the executive branch and the Congress. It was the Congress, of course, which was, in effect, responsible for the creation, in 1962, of the Office of the Special Representative for Trade Negotiations. The role of this Office has been evolving, particularly since the conclusion of the Kennedy Round. Others can best judge how effective our role has been. At the very least, however, we have raised the issue of how trade policy could be coordinated within the executive branch—and, hopefully, even shed some light on it.

I am aware of some feeling that the relationship between the Congress as delegator and the executive branch as delegate is not what it should be. It is obvious that there cannot be an effective trade policy without full congressional participation and, indeed, periodic grants of authority to the President to work in this field with other countries. I think that the institution in the Trade Expansion Act of the congressional delegates proved to be a most effective one. I would certainly hope that other mechanisms, both formal and informal, could be established to maintain even greater rapport and understanding between the two branches.

Likewise, consideration should be given to the continuing development of effective forms of cooperation between Government and business, labor, agriculture, and consumer organizations in the formulation and implementation of our trade policies.

Internationally, it is clear that there is one organization which is first and foremost in all trade matters, although there are others that play a very important role. For this reason, American support of the GATT is absolutely vital, since it is the only agreed code—however imperfect—by which countries trade with each other. For certain specific issues, the OECD and UNCTAD have proven effective. Considerably more attention, however, needs to be given to the orderly interrelationship of these and other international organizations.

This, then, is a quick survey of the matters we are dealing with in our trade policy.

I welcome your questions, now and at any time, and thank you again for this opportunity.

Chairman PROXMIRE. Thank you, Ambassador Roth, for a very comprehensive and yet concise statement.

Ambassador Roth, I would like to ask some questions that are not directly related to trade policy perhaps as much as they are to the economic impact of trade and what we can do about it.

Why, in your view, did our trade balance deteriorate as badly as it did in the fourth quarter? I noticed that exports declined and imports increased very rapidly.

Imports increased from an annual rate in the third quarter of $26.2 billion to an annual rate of $28.4 billion, about a $2 billion increase; and exports—which have been disappointing all year after the first quarter, which was a good quarter—remained around $30.7 billion in the first quarter, $30.8 billion in the second, $30.5 billion in the third, and down to $29.9 billion in the fourth.

What is the reason for this deterioration?

Mr. ROTH. I am sure there are a great many. In part on the export side, among other things, our agricultural exports declined, partly due to better crops in Europe.

On the import side, it is difficult at this point to be entirely sure, but I think, in part, some overheating in the economy, certainly the copper strike, and the possibility of a steel strike had something to do with it.

Chairman PROXMIRE. You see, it seems to me, it is very important in making economic policy, to try and separate out those temporary elements. I think you are very wise in going into the copper strike and the steel strike; both of those were significant elements, but obviously temporary we hope. We hope we are not going to have a copper strike that will go on for years, and we hope that the steel situation will be settled one way or the other by July 1.

But, what I am concerned about is whether this could be anything like a fairly permanent or at least a long-term thing, in which case it seems to me that our policy action is more urgent than if it is simply a temporary problem.

Mr. ROTH. I think it is wise to separate them out. One of the temporary elements in the last quarter was the heavy increase in imports of whisky. But, in relationship to our trade account as it affects the balance of payments, the most important thing is that we maintain the stability of our economy, in terms of prices and costs, and, on the other hand, that the economies of the surplus countries, the European countries, be expanded by one measure or another.

Chairman PROXMIRE. One way is to invest more abroad to help them expand.

Mr. ROTH. Apart from the balance-of-payments implication of the outflow of direct investment, when you look at the long term this is certainly an element.

This is why I say that one part of our study will be to analyze, in a way that hasn't been done as thoroughly as we need, the relationship between direct investment abroad and trade, because there is such a relationship.

An American plant abroad tends to buy American components from here, and the fact that plants go abroad does not necessarily mean a reduction in profits and employment in this country.

Chairman PROXMIRE. Is there any kind of a study that you know anything about—in view of the importance of this, I hope maybe there is—that would show how significant a difference it would make in both imports and exports if we have an inflation in the coming year of 3 percent instead of an inflation of 4 percent?

You see, as I look at the elements involved in our trade—food, automobiles, and so forth—so many of them are fairly insensitive to a change in the Consumer Price Index. I am just wondering if that much of a difference in inflation, which is all the Council of Economic Advisers claims for a surtax, could make any big difference in our trade situation?

Mr. ROTH. I know of no detailed studies of this. I think, on the other hand, it is quite clear that a heavy expansion in our own economy would certainly, as it did in 1966, draw in a large increase in imports. This is one of the problems that I don't think is sometimes appreciated. When it is pointed out in a certain industry that there has been a tremendous increase in imports, the underlying factor—there are a number of them, but certainly one basic underlying factor—is always that there is an inflated economy into which the imports are coming.

Chairman PROXMIRE. Let me ask this: You refer to the export rebate and import tax, and as I understand it, this is a possibility that the administration has been considering.

When I was briefed on the balance-of-payments situation by an administration official 8 weeks ago or so, he mentioned this as a real possibility and said the President was sending officials around the world to discuss this possibility with our trading partners.

I am just wondering if we are likely to vitiate any prospect of eliminating some restriction we haven't used, but which other countries have used by this kind of discussion and negotiation now?

If the Congress is already getting in the mood to act in this way, it is an appealing kind of action for those who have import problems in their State, and I just wonder if this doesn't seem to be working at cross purposes with your overall presentation?

Mr. ROTH. This is a very good question, Senator. Actually there are two possibilities under consideration. One, a modest border tax adjustment to offset certain indirect taxes of our own. Second, a modest import surcharge because we are in a deficit position.

There are other possibilities, but rather than—and this goes back to the reason for the consultations in Europe and with our other trading partners—rather than use any restrictive measure in the trade area, the most desirable course would be for our trading partners to take expansionary measures of their own.

We feel, as I mentioned, that the surplus countries have a responsibility in a grave situation such as we face just as much as the deficit countries. This is why it makes no sense at all in adjustment terms for the Germans to increase their border taxes, even though it is fully justified in terms of the system. For in effect this means a devaluation of 1 to 2 percent when they are in a surplus position. And this is why we are saying to them now, as our team, under Ambassador Tresize, goes throughout Europe, that there are many things you can do to quicken your economy, to untie aid, and the like. If they could take some action, then it would be less necessary for us to do so.

If ultimately it is decided by the administration that something must be done, I think the most important thing is not to do anything that in any way would undermine the basic trade rules of the trading world, the rules of GATT. Therefore, consultation and working through GATT procedures becomes of great importance. As I say, no final decision on this has been made, and consultations in Europe and other countries are currently being conducted.

Chairman PROXMIRE. Thank you very much.

Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I am particularly pleased to see Ambassador Roth and his team here to testify. Along with the President's Economic Report, he will help keep this committee updated on what has transpired in the international trade area. Certainly the impact of trade today on our economy and the problem that we are now experiencing in the international balance of payments makes it most timely.

I am pleased to see that your Office is moving forward in this comprehensive study. May I ask a little bit about how you are formalizing these studies? Is it correct that these studies are going to be done in conjunction with public hearings?

Mr. ROTH. That is correct, Congressman.

Representative CURTIS. Who will be actually conducting the hearings? Will the format be similar to that of the Committee on Reciprocity Information?

Mr. ROTH. Yes. They will be run very much like we ran the hearings we held at the beginning of the Kennedy Round. Our Office chairs them, but there will be representatives on the panel from other agencies.

The thing this time that we tried to do last time—and we were not satisfied we were entirely successful—is to encourage industries to really do their homework, and to come to this not with platitudes, not with problems of general restrictions abroad, but with very specific ideas of what those restrictions might be.

In many cases we found, during the Kennedy Round, that certain companies couldn't give us the detail we needed because the data was confidential, such as cost data. So we hope in these cases we could meet privately with these industries, because this is the kind of gutty material we need, in order to put our case together in this complicated area.

Representative CURTIS. This, I think, is most essential. I know Members of the Congress and I have received due complaints from time to time of alleged unfair trade practices by countries abroad. Yet, frequently we don't get the details.

Mr. ROTH. Congressman, could I just interrupt to say that there are two parts of the setup of our study which have not been completed?

One is that there will be appointed, as there was for the Kennedy Round, a blue-ribbon advisory committee of leaders from industry, labor, and agriculture.

We also need to develop a method of congressional participation, and this mechanism has not been developed yet. We are even considering the possibility of putting something to this effect in our proposed trade bill, but whether it is done formally or informally, this is the critical ingredient.

Representative CURTIS. Yes. I am most anxious to see the Congress take an active part. Just how to do it is the question.

Of course, the Joint Economic Committee, to some degree can follow this, and I know it will. Then the legislative committees, such as Ways and Means and Senate Finance, will follow this, also. But this wouldn't adequately bring about the coordination that I think is necessary in conjunction with these studies.

I guess you will be getting into techniques of handling unfair trade practice and unfair tariff barriers when you find them. Why haven't we developed and utilized the countervailing duty approach a great deal more. Will you be getting into that kind of a study?

Mr. ROTH. We already are, in several ways. We have asked, during the ministerial meeting of the GATT last November that a group be set up specifically to talk about countervailing duties, subsidies, and related factors. We will be talking about that.

Representative CURTIS. I have felt that counterveiling duty as a method of eliminating the use of an unfair trade practice or a subsidy, does relate to alleged subsidies. But it seems to me that it would be possible to have them serve a further purpose and relate to any kind of an unfair trade practice, just as we did with the international antidumping agreement. It looks to me that maybe we could come up with an international agreement on counterveiling duties, because everyone should be concerned about how to handle an unfair trade practice, one that has been found to exist.

Mr. ROTH. As you know, our countervailing duty law does not have an injury requirement as required under the GATT. However, in talking about countervailing duty law, we also want to talk about subsidies, bother the overt ones and the hidden ones, if you will, that are inherent in the common agricultural policy of the EEC.

Representative CURTIS. One other area, the treaties of friendship, commerce and navigation that we have with many of these countries seem to have in them the provisions of machinery to do something about nontariff trade barriers or subsidies or any of these things.

Would this be an area that you would be investigating to find out what could be done through these treaties that we already have to bring about a cessation of unfair trade practices, if they are found to exist?

Mr. ROTH. This is, certainly, an area we can look at.

Representative CURTIS. And I notice in the steel report this was one of the things they pointed out; that here was the machinery if it was, and had not been utilized, at least it was not available to them in a practical way.

Mr. ROTH. May I say, Mr. Congressman, that in our study we are taking a few industries and looking at them, as it were, under a microscope.

Representative CURTIS. You are doing that with steel, aren't you?

Mr. ROTH. We are doing that with steel.

Representative CURTIS. I was most pleased with that, because I thought the Senate Finance Committee did an excellent job. They are doing some more work on steel which will enable you to use that study in carrying it on beyond that.

Mr. ROTH. It is an important sort of prototype industry, and I think in terms of a review of basic trade policy that a study of this industry can give us a great deal of useful material.

Representative CURTIS. One other area.

Senator Proxmire asked whether you would be getting into direct investment and how it relates to trade. I was most pleased to have your affirmative response. I have been very much concerned.

We have not really related our foreign aid programs—AID, Public Law 480, or various development banks, loans, and so forth—to trade.

There is a slogan, "trade not aid," which I happen to agree with. I think there is a place for aid.

I think it is very important to help get nations on their economic feet. But I have been fearful that there hasn't been the kind of coordination between trade and aid.

Would this be an area that you would be exploring at all?

Mr. ROTH. As of now we had not thought that this would be a part of the study.

Representative CURTIS. Yes; and yet you have to do it in respect to the agricultural agreements where one of the hopes is that these other countries will provide more aid.

Mr. ROTH. That is true. We will certainly be dealing with the problems of developing countries.

Representative CURTIS. But it illustrates how closely these things are coordinated. I appreciate you have a problem here. You do have your jurisdiction.

But I am at least in the position where I can make these comments that somewhere in the administration or in the Congress we have to bring together, just as you did mention, the commodity agreements which are not under your jurisdiction. Yet, in so many areas, how can we readily deal with the problems of trade without having to do those commodity agreements?

Mr. ROTH. I would like to comment on this problem of the interrelationship between the various areas that affect trade. I think, certainly, one of the things that has become clear to me in the last several years, and perhaps particularly in the last 6 months, is the relationship, for instance, between trade policy and fiscal and monetary policy. And we do have a balance-of-payments committee in which all the agencies concerned are involved, so we are all aware of what is going on.

But, looking to the future, and, certainly, in terms of a study such as ours, this is an interrelated world. You cannot separate trade out from the more general economic and fiscal problems. You just can't.

Representative CURTIS. I see my time has expired. Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Nice to see you again, Mr. Roth.

Mr. ROTH. Thank you, Senator.

Senator MILLER. At the beginning of your speech you referred to the Smoot-Hawley Tariff Act of 1930. I wonder if you could refresh my memory of that. Was that a high tariff act?

Mr. ROTH. That is correct.

Senator MILLER. It was not a quota act, was it?

Mr. ROTH. No; it was a high tariff act.

Senator MILLER. The reason I asked, I notice that some accounts in the press and some witnesses have referred to some of these quota bills that are pending in the Senate Finance Committee as Smoot-Hawley Act measures. Since the Smoot-Hawley Act did not have anything to do with quotas, I just thought perhaps we ought to bring out that difference.

Mr. ROTH. I think that is a good point. It could be argued that a tariff at a sufficiently high level in effect has the effect of an absolute quota.

Senator MILLER. Of an absolute quota.

Mr. ROTH. But you are correct.

Senator MILLER. Which would mean nothing. I assume when you say absolute quota, you mean that there would be no imports at all because the tariff would be so high that nobody would be able to buy.

Mr. ROTH. I mean a more limited amount.

Senator MILLER. Sir?

Mr. ROTH. A more limited amount of imports. A quota is not an absolute prohibition.

Senator MILLER. I understand that. A quota is certainly not an absolute prohibition. You might have, for example, a quota on behalf of our domestic consumption. That would certainly not be an absolute prohibition, but it would mean that goods would come in at a low price, probably, whereas if we had a Smoot-Hawley Act approach it might put a very, very high import levy on it, and it might narrow the import quantities down to 50 percent, but they would be at a very high price; would they not?

Mr. ROTH. That is right.

Senator MILLER. You referred to the President's balance-of-payments message of January 1, relating to border tax adjustments on trade. Do I understand that there is some intimation that the Congress might be asked to enact some kind of a border tax as sort of a countervailing offset to border tax arrangements in other countries?

Mr. ROTH. As I mentioned, this is one possibility we have looked at, but not in retaliation against the border taxes of other countries. The whole area, as you know, of border taxes is a very complicated one. It is based on the theory that an indirect tax, like a sales tax, is passed on into price fully, whereas a direct tax such as we have, the corporate income tax, is not. Therefore, based on economic theory of 20 years ago, a border tax for one is legal, and for the other is not under the GATT.

In the last 20 years, economic theory has become more sophisticated. It is now, I think, clearer that not necessarily all of an indirect tax is passed on into price and perhaps some part of a direct tax is, depending upon elasticities. Therefore, we feel that there is a basic inequity in the GATT rules.

On the other hand, because we do not have the analysis we should, it is not entirely clear that in the past our trade has been impaired by the offsetting border tax. But this is one we have to get into in great depth.

Senator MILLER. Do you have any idea how soon we will have hard statistics that would enable us to make an intelligent decision on this?

Mr. ROTH. There are two problems. One, what we might consider the basic inequity and the basic difficulty of two systems of taxation operating together. The other is a more specific and immediate problem; namely, that Germany, on January 1, moved from the so-called cascade tax to an added value tax. Accompanying that was an adjustment at the border from undercompensation, because they could not calculate what the tax was, under the old system, to full compensation, which meant an increase in tax from 4 to 10 percent.

Before we can know what effect this will have on our export trade, we will have to know what the price effect in the German economy is. I think it will be a number of months before we get this in a definitive way. Then we have to begin looking at individual American exports and see whether there has been an effect.

Senator MILLER. Do you think that we are going to have adequate statistics to enable us to legislate on this at this session of Congress?

Mr. ROTH. No. In terms of the problem of border taxes, as such, we have asked for negotiations on the GATT rules, but it will be a long and complex process. Now this problem, the basic problem of border taxes as such, is perhaps separate from the balance-of-payments question of whether we should do something moderate and temporary in the trade sector to help our export position. They are really two different problems.

Senator MILLER. Well, I can see where they might be two different problems, but I can see where they could be related, too.

Mr. ROTH. They are related, also.

Senator MILLER. And, I can see where if we are not careful on the relationship, we might get ourselves into some problems that we do not want to get into. That is why I am wondering what we are going to have by way of hard statistics that will enable us to legislate prudently on this, if we are asked to legislate on it. You apparently do not hold out much hope of having those statistics for quite a long time.

Mr. ROTH. Not on the basic problem of border taxes. This will take considerably greater analysis both within our own Government and internationally. If we did come to the Congress with something in the trade area affecting the balance of payments we would, I hope, have a supporting case. But, I think the most important thing, as I mentioned before, is that should we do anything, we do it within the trading rules of the world, and that in no sense will we undermine those rules and set up a spiral of reaction on the part of other countries so that we net out nothing in terms of our trade balance.

Senator MILLER. You state: "I do believe that import restrictions should be an available remedy in certain cases."

Does this mean that in certain cases that you believe that import quotas should be available?

Mr. ROTH. That is right, as they are where the national security is brought into play pursuant to an OEEC finding, or where it can be shown that an entire industry is severely damaged by imports—then there is the escape clause, and I think that this is an important out that any economy needs.

What I was trying to say here is that I feel that the present escape clause is adequate. On the other hand, I do not want this study to be, in any sense, doctrinaire. There should not be anything we cannot look at and should not look at in depth.

Senator MILLER. I have just one more question. You are continuing to operate and do some negotiating in your office; are you not?

Mr. ROTH. Yes, sir. We do not have any authority, but we are continuing to negotiate.

Senator MILLER. I appreciate that. I understood from Secretary Freeman when he testified last Wednesday that there were negotiations being carried on on this particular problem. As I understand it from a speech by the Foreign Agricultural Service, one of the officials of the Foreign Agricultural Service, the Common Market has been charging import duties on our grain shipments to the Common Market, and they have been taking some of that money to subsidize—to pay a subsidy for exports of canned ham.

Last fall, 46 of us joined together in a telegram requesting countervailing duties. We have not seen any action on that yet. Secretary Freeman believed that this was in the process of negotiations. Are you familiar with this or any member of your staff here?

Mr. ROTH. No; I am very familiar with it.

Senator MILLER. Can you tell us where we are on this?

Mr. ROTH. Yes. It is still under investigation, but this comes after a period of very intensive negotiation in which I took part. I went to Geneva to talk to the Community about it. As a result the Dutch decreased the amount of the subsidy; they would say they have, in effect, eliminated it. It was a very considerable figure. I think it was around 23 percent. The Treasury, along with Agriculture and ourselves, is looking at the figures to see whether or not we are satisfied. But may I explore this just a little bit more with you?

This comes back to the question of countervailing duties.

Chairman PROXMIRE. Could I interrupt just for 1 minute?

I, unfortunately, have to leave, Ambassador Roth, and I apologize. I have asked Congressman Curtis to take over the chair as he will do. He is, as you know, the ranking minority member, but I want to thank you for a very, very fine presentation and for your particularly excellent responsiveness to our questions.

Mr. ROTH. Senator, thank you very much. And should the committee at any point, as our study goes on during the year, think it would be useful to you—as I think it would be to us—to have an interim report and to go into these problems in more detail, we would be delighted.

Chairman PROXMIRE. Fine, that is an excellent suggestion. Very good.

Representative CURTIS (presiding). Proceed.

Mr. ROTH. Senator, our countervailing duty law does not have an injury requirement as it is supposed to have under the GATT. Therefore, any time that a party claims that a subsidy is in existence—this goes to industry as well as to agriculture—the Treasury must make an investigation.

We try sometimes first to see if the problem can be worked out, because it is to the benefit of our domestic economic interest as well as to international relationships to do away with the subsidy, if at all possible.

In certain cases countries are not entirely cooperative, and therefore, there is nothing to do but to begin official investigations. Even when they are cooperative, it still may be necessary. You may have noticed just last week in the Federal Register that we are beginning investigations on tomatoes and tomato paste.

Last year we took countervailing duties against Italy in the area of electrical transmission towers. This is an instrument that is difficult for us to use in international relations, because it is not entirely consistent with the GATT. Nevertheless, we feel it is an important one for us to use, because in agriculture, in particular, when you look at third markets, we are disadvantaged by subsidies.

Senator MILLER. May I interrupt you at that point?

Under the GATT rules, would that subsidy have been legal, too?

Mr. ROTH. Under the GATT rules, and Mr. Rehm, you can correct me, if it was shown that the subsidy caused injury to a competing industry, in that case the country would be responsible. If there were no injury, then it would not be illegal.

Senator MILLER. Then here is the problem. What happens during the period of time that all of this is going on? You see, we received requests, urgent requests, that countervailing duties be put on immediately, and then let the investigation proceed, and if it was determined that there was indeed no harm, then, of course, the countervailing duties would go off. But, if it was determined that there was indeed harm, the countervailing duties would stay on, and the idea behind this request was that we ought to take the protective measures before it was too late and the damage was done.

Do I understand from what you say that that is impossible?

Mr. ROTH. Under the law the investigation must take place first, because the case must be proven. On the other hand, once you announce an investigation, often that in itself has an impact. I think this is an important point you raise. This is the reason why we have requested in the GATT a discussion not only of the countervailing duty laws, but also of subsidies, because they are closely related.

Basically we would be willing to do away with subsidies, because we think we are competitive. Poultry is a good example.

Senator MILLER. As I understand it though, the answer to my question is that what you have worked out is now being analyzed by your people—by Agriculture.

Mr. ROTH. Treasury.

Senator MILLER. And Treasury, to determine whether or not it will be necessary to have a countervailing duty.

Mr. ROTH. That is correct. Meanwhile, there has been this decrease of a substantial sort.

Senator MILLER. Thank you, Mr. Roth.

Thank you, Mr. Chairman.

Representative CURTIS. Senator Percy?

Senator PERCY. Ambassador Roth, Republicans have not only seized control of this committee this afternoon but by our presence have indicated our deep interest in your work.

Mr. ROTH. Thank you, sir. We have no fear from Republicans.

Senator PERCY. I personally would like to express great admiration for the work that you have done with the Kennedy Round. I know how tough this job has been, but I think the reaction of the business community has been unusually understanding and moderate and appreciative of the tough jobs you have had. I think, also, your educational efforts to prevent us from going into a disastrous round of quotas and restrictions that would set back our policy 35 years, has been very, very good.

Having said that, I wonder if you enthusiastically and wholeheartedly support the President's travel ban and travel tax which, in effect, seems to me to be a highly restrictive, protectionist program. A tax on tourists abroad is the same as a very steep tariff on the import of tourist services. Do you feel that this is a good example to be set by the world's leading nation in liberalizing trade?

Mr. ROTH. I do not think that I can comment on that problem. I must say that when Secretary Katzenbach and Deming and I made this rush trip, on January 1, throughout Europe, to discuss the total program, I was impressed with the fact that the Europeans recognized that a very drastic program of this sort was terribly necessary. And I think I would have to agree that to have a balanced program means something on the current account as well as the capital account.

I do feel, as I relate all this to problems of trade, that the important thing is that any program, whether it be on the tourist side or any other, not bring about retaliation, not bring about any downward spiral, and in effect not undermine what we have been trying to do.

Senator PERCY. Do you think we can carry this out without retaliation?

Mr. ROTH. I think we can without severe retaliation, as I think it is a moderate program. This is one thing that I think is important in talking about any such measures and any measures that might be proposed in trade areas, if they are. I do not know whether they will be or not. The Europeans' deep concern is that they should be temporary. This is why they are so terribly concerned more than anything else.

Jean Rey, when he was here last week, made very clear their terrible fear of this type of quota legislation that is now before the Congress, because this is——

Senator PERCY. What leads you to believe though, Ambassador Roth, that this could be a temporary thing? We have had "temporary" excise taxes for 23 or 25 years. Once you get adjusted to this, what is going to cause a rectification? Do we see a substantial reduction in our oversea expenditures and commitments? Can we perceive in the immediate future a drastic reduction of our expenditures in Vietnam and foreign aid? Do we see a dramatic reduction in inflation in this country, to dramatize the ability of our country to increase our exports substantially, rather than suffer a decrease because really of a lesser competitive position?

What is going to happen that will make this temporary 2-year situation?

Mr. ROTH. Let me relate this to the area of trade—rather than tourism—where I am somewhat more at home. If, for instance, we decided to ask for a small import-export adjustment, as it were, to do this under the GATT we would need an IMF finding. We would do it through the GATT and we would be policed by the GATT. I think this is the important part of going through international channels, that it would be under review in relationship to the balance of payments.

Now, as to your second problem, which really is how long will the balance-of-payments problem last, I certainly will not try to forecast that. But, certainly, again in Europe, when we talked about the problems, they were understanding of them, and we talked about some of the measures that would have to be taken. They said, "The first thing you have got to take, particularly if you want our cooperation, is the

10-percent surtax." They said, "We, in no sense, want you to deflate your economy. This would have strong repercussions in Europe. But, you have got to do something to tighten." I think their feeling is that if some of them could expand—France has taken some measures already—this in itself would have an important influence.

Senator PERCY. On the travel tax, I wonder whether or not the experience of the British, who have tried to restrict and have restricted the amount that British citizens can spend overseas, would not really warn us that such curbs are pretty hard to enforce. It causes the best citizens to find a way to get around it. They get pounds abroad and have been spending them for years.

Europe is full of Britons, none of whom were permitted by law to take more than 50 pounds or its equivalent out of the country, all of whom exceeded that, and yet they are there.

I wonder how many dollars we have lost since the President's announcement. Is everyone not finding some way to protect themselves, if they feel this is going to really hurt, in the long run, their goal to do business abroad, their ability to get an education? Have we not been trying to regulate and control the farmers' output for 30 years and have not yet found out how to do that? They always are able to produce more on less acreage. You cannot find enough regulations to outwit 200 million people.

I wonder whether we have not already lost far more than we would gain, just by people taking preventive measures to get around an oppressive government that tries to strike a blow at a free people. All of us who have fought to free the movement of goods, it is repugnant to have us, as the richest nation on earth, to have a restriction on the movements of people. Imagine making it unpatriotic for a clergyman to go abroad to Africa or Asia, a student or a teacher or someone to visit the homeland or the fatherland.

I really feel this has been a disastrous decision by this administration. It is a terrific blow to our prestige. We have to weigh how much these things save us, and then how much at the end they really cost us in lack of confidence in America's ability and in the dollar, I think.

I wonder whether or not you could not be a voice that within the administration could get them to withdraw what I think is an impossible requiry they are making, a mandate that I find the American people are revolting against, I think the Congress will revolt and it will do us far more damage than it is ever going to do us good.

Mr. ROTH. One part of the President's program in this area, I think, perhaps should be emphasized, because I think it has more long-range implications, and that is the encouragement of tourists to this country. Hopefully some of the money that could be collected from, say, the 5-percent tax on international tickets, which, after all, merely equates the domestic one, could be used for this. Actually, when the Katzenbach-Deming party got to Switzerland, the first thing they said was that we should increase our tourism. Obviously we were not very good at this. They were, and they would put together a technical assistance program for us.

I think this is something we can use, and I think Ambassador McKinney's study group is going to come up with some useful answers in this area, in order to bring a lot of people here who want to come.

Looking to the future, because I think this goes to the heart of your question, Americans should travel more and more, after we get over this immediate problem, but this should be balanced by more and more other people coming to this country. It is the gap that is the problem, not the absolute numbers on either side.

So, I think there is a positive element, and I think this is the important long-range problem.

Senator PERCY. I certainly concur with you, and I think you know that a group of us put in a bill to increase substantially the amount of money we spend to encourage tourism. That is the positive approach. That is our way of doing things, to avoid restrictions and fear and intimidation and avoid making a person an unpatriotic citizen if he goes abroad. We must lead with the positive.

That leads me to the second point. I wonder whether you would not concur that, really, to solve this problem our biggest hope is to expand the trade surplus that we have—which is declining now—and to see that we can get this back up to the $7 billion, $8 billion, $10 billion category, to finance all of our operations overseas, and expand them rather than finding ways to keep restricting.

To me this means we must encourage more businessmen to go abroad, to study markets, to look at what we can do to get products over there, to set up merchandising organizations abroad, and see that the world market of 3 billion people is a big market for them as against the little 200-million-person market in this country. If my figures are correct, only 5 percent of our companies do 95 percent of our overseas trade.

This is why I think the travel ban strikes a blow at what we have been trying to do for years: to open up the eyes of American businessmen to the opportunities abroad and encourage them to go abroad.

Mr. ROTH. I certainly feel that the long-range answer is to improve our trade surplus, and, as you know, there are a number of tools that the President is asking Congress to bring into play. I think these will be important. But I certainly agree with you that American industries have a fat market behind them, have not gone abroad to the extent that they should or could with profit, and they should be encouraged to do so.

I was thinking about the remark on the patriotism of people traveling abroad, and I was thinking how difficult it was to make wives feel unpatriotic—at least, some wives.

Senator PERCY. I would just like to try to modify one aspect of this in my own personal judgment. You may disagree with me. I do not think the expansion of trade is too much a long-range program. To me that is about the quickest thing we could do. The factories are in production. Goods and services are available. If we can just find ways to open up more markets abroad, I think we can rectify this balance more quickly than any other way. Now, the restrictions that we voluntarily made just a few years ago already are starting to cost us very desirable dividend income from abroad. Some of those investments abroad yield three to four times as much as the investment opportunities we have in this country.

I am all for trying to get more dividends back into this country, and doing things to encourage them to come back, such as stamping out all the tax havens. But, to restrict investment abroad, for a very long period of time, and keep us out of markets is a very dangerous thing over the long run.

Everything you have done and everything I read in your testimony is positive, forthright, forward-looking, and yet, these several things that have been done vis-a-vis the balance of payments have been completely contrary to that whole philosophy.

I hope we will put the emphasis on the positive side rather than restrictive measures which are just contrary to everything we believe in. There is not anyone in this Government smart enough to outwit the American businessman and the American public if they do not believe in what you are trying to do, and they are going to try to get around your restrictions.

Sorry to have talked so long, but I am deeply concerned about this situation.

Mr. ROTH. Certainly no one, including the administration, would want to see more than a temporary control of direct investment. It is interesting, I think, that even before the voluntary program was in effect, it has encouraged the creation of a Euro-dollar market, a European capital market. I think this has been a good thing. I think this should be encouraged.

You know, you hear about the problems of imports in this country, but when you are in Europe you hear the opposite thing; namely, the problem of competing with American industry, which has the availability of capital resources and much better management skills and higher technology. You see the reverse and that American industry can compete.

Senator PERCY. That is right. There is not any question about it. But the one thing I am really concerned about is how long we can continue to sustain this tremendous inflationary pressure at home. Efficiency can overcome a lot. But whether it can overcome $20 billion to $30 billion in inflationary pressure, with the kind of deficit the administration now proposes and the resultant wage increases that are going to keep coming well above productivity increases, remains to be seen. Inflation is already putting pressures on American prices abroad.

I do not know whether American technology can work fast enough to overcome that.

Mr. ROTH. This is why the Europeans were so concerned about the tax increase. And, really, this is the basic thing, keeping prices and costs, as you said, stable here, and then having some expansion in the surplus countries. This would have a most immediate effect on trade. I think you are absolutely right.

Senator PERCY. I thank you very much, Mr. Chairman, for your generous time, and, Ambassador Roth, once again, my great commendation to you for your great service to this country.

Mr. ROTH. Thank you.

Representative CURTIS. Thank you, Senator.

I have a couple of questions. In your reference to the Europeans' concern over our having a tax increase, you mean they are concerned with the size of the deficit. The Europeans I have talked to are more concerned about seeing us cut our expenditures. I know it is the proper thing for an administration official to put the emphasis on the tax increase, but it is really the deficit that is creating these inflationary forces.

When Senator Proxmire asked you about what was the cause of the cutback of our exports, vis-a-vis the increase in imports, you mentioned several things. But you did not mention inflation.

Mr. ROTH. I think I did.

Representative CURTIS. Did you?

Mr. ROTH. Yes.

Representative CURTIS. Then I misunderstood. I think this, of course, is the basic concern, and it is going to be increasing.

Restricting private investment abroad does get at the very base of our increased exports. This is another factor which has concerned me greatly. Another point I wanted to make is the reason why I was not here this morning for the committee interrogation. I was over in the Ways and Means Committee, where we were hearing public witnesses from the private sector on the problem of the proposals of the administration on the travel tax. The point that was made and that needs to be emphasized in respect to encouraging tourists here, is that we are today the largest host nation——

Mr. ROTH. The largest what?

Representative CURTIS. We are today the largest host nation. You might not believe it listening to the kinds of testimony and statements that have been made, but this is true. We produced some data showing that this has been increasing at a very rapid pace. I think there are figures there for a period of 6 years.

Mr. ROTH. That is correct; it has been.

Representative CURTIS. Much more than elsewhere. We now have 9 million people coming over, so what we are really talking about is a rapidly growing economic development; and can we make that growth faster? But, when you are dealing with growth, you can damage it. I fear that this administration's package is going to damage what is already going on. I am sorry Senator Percy left, because his reference to having Government increase the amount of money that they are spending to encourage tourism over here leaves me quite cold. That is what a lot of the witnesses wanted.

I asked these questions: How much private capital is invested abroad right now, and spent abroad, in promoting tourism into the United States, and what has been that increase?—because it has been increased.

I am not so concerned whether the Government spends it. But, I am concerned by the inconsistency in the administration's position. It would restrict private investment abroad in this very area of travel, too, and yet ask for an increase in Government spending abroad to promote tourism in this country. Well, it just so happens that Government people, dedicated as they are, will not spend the dollar as effectively as the airlines and the travel people and the combines that have developed in our society with our Hertz organization and our motels and people that derive money from having people come over here. They are spending money. But I do not have the data for which I asked.

What is this restriction on private investment going to do to their plans for expanding their efforts to bring tourists to the United States?

Mr. ROTH. Another factor which goes back to something you said earlier affects tourism just as much as it affects trade; namely, the need to keep prices and costs stable in this country.

Representative CURTIS. Oh, yes.

Mr. Roth. Because it is the same thing. The more we can maintain stability, the more travelers we can get.

Representative Curtis. This has not been done well. I am being sarcastic. By having the highest interest rates since the Civil War, we, at least, have been encouraging investors to come to this country.

Thank you very much, Ambassador Roth.

This adjourns our hearings for today. The committee will meet tomorrow at 10 o'clock in this same room where we will hear the Secretary of Labor, the Honorable Willard Wirtz.

(Whereupon, at 5:15 o'clock p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, Feb. 20, 1968.)

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 20, 1968

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

The committee met at 10 a.m., pursuant to recess, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Javits, and Percy; and Representatives Curtis, Widnall, Reuss, Moorhead, and Rumsfeld.

Also present: William H. Moore, senior economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

Our witness this morning is the distinguished Secretary of Labor, the Honorable W. Willard Wirtz. As we all know, Mr. Wirtz is in a position of great economic importance, as the principal official of our Government, not only on economic statistics, as we are all aware, but also on manpower policies, on wage-price policies, and on other policies that deeply concern this committee and the Nation.

Mr. Wirtz, we are delighted to have you. You may proceed with your statement.

STATEMENT OF HON. W. WILLARD WIRTZ, SECRETARY OF LABOR; ACCOMPANIED BY ARTHUR ROSS, COMMISSIONER OF THE BUREAU OF LABOR STATISTICS

Secretary WIRTZ. Thank you, Mr. Chairman.

First, may I identify—although I am sure it is unnecessary to this committee—Mr. Arthur Ross, Commissioner of the Bureau of Labor Statistics, who is here with me this morning. Mr. Ross is also my adviser on economic affairs. When we get into the area of economics and statistics, whatever you may have included in your reference to me could only apply to him, and not to me.

I have filed with the committee, Mr. Chairman—unfortunately somewhat belatedly—a statement which I think, if it best fits the committee's convenience, I could summarize fairly quickly, as a basis for whatever questions you may have. I would be glad to do that, if it meets your convenience.

Chairman PROXMIRE. Yes. It is an excellent statement.

Secretary WIRTZ. The statement recognizes that there is ample basis for these hearings and for your questioning, in the Economic Report of the President and in his message to the Congress on January 23—and then in the Council of Economic Advisers report. And I hardly need say I identify myself completely with the matter in those reports, and have, in this statement, simply tried to emphasize one or perhaps two points which are covered in those reports. There is nothing here, so far as I know, inconsistent with them, but this does represent an emphasis on two points—the first of which is this very stubborn fact that now, after 7 years of uninterrupted, unprecedented economic expansion, there is an extraordinary amount of remaining unemployment, which is hanging on. At this point, almost by definition, that unemployment is what is left after we have pressed the economy to what most of us consider its maximum effective point, so that it could not be pressed further without danger of what is recognized generally—although I realize there is disagreement on this—of overheating. So, what we are talking about here has been called hard-core unemployment; it has been called structural unemployment more traditionally. It could also be identified as subemployment, or long-term unemployment. For purposes, I believe, of the committee's current analysis, it is that unemployment which remains when the economy has done all that it can, and when fiscal and monetary policy have been pressed as far as they can be pressed, and what it leaves is a picture of 3 million unemployed as of a particular time; 10 to 11 million unemployed at one point or another during the year, with a concentration of that unemployment in particular areas——

Mr. Ross. Ten to eleven million unemployed——

Secretary Wirtz. At one time or another during the year, and with a concentration of that unemployment in particular areas, and among particular groups, particularly the minority groups and, in age terms, the group between 18 and 19. And so, Mr. Chairman, members of the committee, my statement is an attempt to focus as sharply as possible on that particular fact, and on what we are trying to do about it.

I have summarized in the statement the approach that is being taken to this problem on two fronts. First, we are increasingly a country which does whatever we can measure, whether for better or for worse. And there has been a little-noticed development of very real significance—I think particularly in the kind of thinking for which this committee is responsible—a real development in the last 12 or 24 months in the identification and measurement of the hard-core kind of unemployment we are talking about, which, from here on, I will use as a shorthand phrase, referring to that unemployment which fiscal and monetary policy and the expansion of the economy alone will not meet.

In this last 2-year period we have tried, under Mr. Ross' leadership in the Bureau of Labor Statistics, and throughout the Department, to try to bring our forms of measurement of the problem, of personal economic disability, into line with the recognition of this hard-core kind of unemployment. And, in this statement, there is a summary of what has been done there.

There are really three steps in it. First, we have taken those monthly reports which the country is familiar with in terms of only a single percentage—you pick up the paper and read that unemployment is 4 percent, or 4.1 percent, or 3.8 percent, and the matter is left in the headlines there. Very frequently, we have tried to get behind that, and bring out what has been in those figures but has not been emphasized promptly—the facts of the unemployment rate for minority groups, the facts of the unemployment rate for women, the facts of the unemployment rate for youth. And I simply want to point out here what is old learning to this committee: Whenever we see a monthly report of a 3.5-percent unemployment rate, as we did in January, unfortunately it is an average which conceals both the success which we have reached—a rate for adult males and heads of families, which is now about 2 percent—and the failure, which is reflected in rates for minority groups which are twice the majority group rate, and in the rates for youngsters, which are again about twice whatever they are for older people.

So, to carry it to the extreme, it is too bad, but true, that when the country is advised, in the short television program or in the newspaper headline, that we have a 3.5-percent unemployment rate, it does not get through that as far as adult males are concerned it is down to 2 percent, which is about as far as it can go, but very probably, although our sample is quite small, it is also about 30 percent for Negro girls between the ages of 16 and 19. All of that is lumped together.

Now, the first thing we have done is to try to get behind that, and I think quite successfully.

The second thing that is being done now, which will represent the most sophisticated measurement which is going on, is reflected in the statement and it is in the description of a completely new approach to, or at least a new emphasis on, these monthly figures. This approach is going to let us give you, within the year now, a very clear picture, on the basis of regular monthly checks, of how much of what kind of unemployment there is where—not only in terms of the demography of the group, but also in terms of its location physically. And then beyond that, we are also moving in this measurement into an area in which we have so far been able only to guess—namely, the amount of what the public thinks of as unemployment, but what we do not call unemployment at all, because traditionally when we describe unemployment to the country, we are describing the number of people who are actively looking for work and unable to find it, and we are not including those who are not even looking for work, but who should be. And, so, I report to you as the second development in this area, that within the year we will be getting information which breaks down the unemployment figure in terms of the type of people who are involved, the area in which they are located, and which on the second hand adds this nonparticipation in the work force.

Now, the third thing which we are doing—and it is to some extent on an interim basis—is to take the information which we already have, and to use it as the basis for what are necessarily estimates, but quite reliable estimates, of the picture in the 20 largest cities. Before, it has been on a nationwide basis. As of today—and timing it deliberately to coincide with this hearing—we are releasing reports now on the 20 major cities, with a breakdown of unemployment in the standard metropolitan statistical areas. We are releasing today this report which also shows the unemployment rate for the center city of 14 of these standard metropolitan statistical areas, rate for the center city, as well as the unemployment rate for the part of the area which is around the city, and these are broken down also on the basis of race; broken down also on the basis of sex; broken down also on the basis of age.

Now, there are copies of that report which will be released later today. They have been given to you and the committee. And I have summarized them in my statement.

I think it is a pretty significant advance.

We had 15 of them ready about 6 weeks ago, and did release those. We are now working on the 20, and this is the first release of those.

I have, in my statement, summarized some of the results on a 20-city basis, but I point out that in doing that we really defeat the purpose of that approach, which is to get away from the averaging of a lot of matters, and to present the picture which will probably be most useful locally—to present the picture in terms of the situation in a particular city.

In my prepared statement, I have suggested some of what we are finding here.

Again, one of the biggest lessons is how much difference there is in the situation—so that you have unemployment rates today in Minneapolis-St. Paul of 2.2 percent, 2.3 percent here in Washington, but 5.6 percent in Los Angeles, and 5.4 percent in San Francisco and Oakland.

Just to take another illustration, when you get into the Negro unemployment rates, which we have referred to quite generally in their relationship to white unemployment rates, you find that Negro unemployment averages 2.3 times as high as white rates, and yet, here again, there are differences which are perhaps more important than anything else.

So that here in Washington, the ratio between Negro and white race is 1.6 percent—1.6 to 1, rather. In New York, it is 1.5 to 1. You turn to Cleveland, it is 3.1 to 1, which means three times as much. You go to St. Louis, and it is 4.2 to 1.

So we have really totally different situations.

Chairman PROXMIRE. 4.2 to 1, meaning there are four times as many Negroes out of work as whites?

Secretary WIRTZ. Taking account of the difference in the size of the group.

Chairman PROXMIRE. Sixty percent more in this city?

Secretary WIRTZ. That is correct. Or on a pro rata basis—taking account of the fact there are fewer Negroes, it is still true.

And then when you turn to the tables, too, you will get what I think is a very important lesson.

We have sort of escalated our figures about some of these matters by talking in percentages, which often seem to imply a good deal more than the facts show. And we forget that although this problem, for example, of minority group unemployment is exceedingly serious, it is still well within reach.

So, in my statement, I have suggested a little of that. If you take these 20 areas as a whole, the nonwhite unemployment in 1967 totaled 269,000. That is in the 20 cities. In these tables, incidentally, we have taken all 12 months of 1967, averaged those figures together. The 1967 average of those 20 cities' nonwhite unemployment is 269,000. It is surely within our reach, if we really go after it.

Incidentally, that is about half of the nonwhite unemployment in the whole country. We can scare ourselves sometimes with the percentages, and the figures, and forget that in a work force of 70 million to 75 million, this is something we ought to be able to get if we simply get down to business on it.

I have used Chicago as a single illustration. There the nonwhite unemployment includes 9,000 adult men, 11,000 adult women, 16,000 teenagers. A total of 36,000; 33,000 of them are in the central city, in Chicago. That should not be too much of a job for a city that size, or a country this size, to get at, if we get down to it.

Now, that is enough perhaps to summarize the changes that we have taken in the approach to analyzing this problem. But, I cannot emphasize too much the significance of our getting the indexes now into line with the social priorities in this country. And, of course, what is involved is a very basic difference.

We have been approaching unemployment, to a very considerable extent on the theory that we have it on a nationwide basis, involving aggregate policy. It is very important these figures do now substantially tell us what it is in terms of the individual approach to the problem that has to be taken.

Mr. Chairman, members of the committee, a good deal of the unemployment that remains is more personal than it is economic, although no one of the three terms is very good any more. They all have old, blunt, rusty meanings—unemployment, economic, personal. They are just the best words lying around.

In the second part of the statement, I have summarized the approach that is being taken as far as the operating programs are concerned, but have not gone into it in detail here, because I am assuming that it falls, if not outside, then on the edge of the committee's interest. But I want to just summarize it very quickly.

The emphasis right now on the manpower program, which is what I am talking about, are these:

First, to concentrate that program where the problem is concentrated. And by concentration, I am talking now about specific census tracts, in specific areas in the city—the concentrated employment program is aimed at, or will be in the course of this year or next, 146 specific census tract areas, where unemployment still hangs on.

Then in the President's job program, we are looking at the 50 cities; we are taking the 50 largest cities, because we know that over half the remaining unemployment is in those 50 largest cities.

Now, this does not mean that the other areas are being left out. But, what it comes down to is, we are taking about 25 percent of our program funds, and aiming those right at the areas in which this situation exists.

The second major development, as far as this programing is concerned, is that we are relying much more strongly than we were before on the enlistment of private business in these programs. These programs represent a sophisticated development of the original on-the-job training concept. I will be glad to go into further detail about those programs, but in a very meaningful way we are turning now to the enlistment of and close cooperation with employers in these programs. There has been set up a committee, the National Alliance of Businessmen, headed by Henry Ford, a 65-man committee, around whose advice and counsel the jobs program will be quite thoroughly developed.

Along with the model cities program, what you have here is the reflection of an aiming of the manpower program, a shooting with a rifle—or, I would like to think, with even heavier artillery—but not with a shotgun, as we were before.

There are other parts of those programs I would be delighted to talk about, but I do not want to intrude my particular interest on those of the committee.

There has been a good deal of talk, I should say, about the extent to which there has been a lack of consideration of priorities. I do not believe that is true as far as this area is concerned. I sense, in my official capacity—not sense, but know, in my official capacity—a complete acceptance of the priority of the manpower program. It is reflected in this fact—but only illustratively of the one fact—that in the budget which the President has transmitted to the Congress for fiscal year 1969, the total for the manpower programs—and I am taking a comparatively narrow definition of manpower programs—is to be $2.1 billion. That compares with $1.6 billion in 1968. It is a 20-percent increase. It will mean, in another way of suggesting its magnitude to you, that in fiscal 1969 there will be, in work and work training programs in this country, which include both allowances and partial wage payments to cover the training part—1,300,000 people involved in these programs, receiving not only training, but allowances or stipends of one kind or another. It becomes a much more sophisticated form of a public work and training program than the one most of us grew up with in the 1930's.

So there is a strong emphasis on it, a strong priority attached to it.

In conclusion, Mr. Chairman and members of the committee, I have tried to suggest this. I think it is terribly important to recognize the unmet part of this problem. It is terribly important, too, to recognize, because it is so little noticed, it is so much overlooked, the fact of the gains that are already being made. I know it is not popular today to suggest the gains that are being made in any particular area. It is more sophisticated, it is more liberal, it is more newsworthy to talk about bad news. I do not mean to depart too much from that pattern of discussion and publicity. But, I would like to point this out: I believe it is true that every single group in this country, not just the country as a whole, but every single group in it, Negroes, youth, any group, is infinitely better off from the standpoint of employment opportunity than it was 5 years ago.

Now, you can take the other side of that case, or anyone can take the other side of the case. And if you do, it is to suggest, in my judgment, that a selected use of statistics can be used to support almost any proposition you want to. I hope it is not heresy to suggest that today the computers, like the Scriptures, can be quoted to support almost any proposition, if you take something out of context.

I believe the statement remains solid and true—that regardless of what is left to be done, every single group in the country is today better off from the standpoint of employment opportunity than it was 5 years ago.

That leads you to another development which I suppose is the most important development in the last 5 years.

Five years ago, I believe, we were still accepting in this country what was virtually a deterministic philosophy, and it was not very far removed from predestination and foreordination, although we did not quite realize it in those terms. I think the most important thing that has happened is today we have rejected any comparison with the past as being almost irrelevant, almost immaterial, and we have accepted the proposition that we can do almost anything that we set out to do—at least as far as this area is concerned.

I think that is the most important change there has been.

Now we meet this situation. Every gain we make today means instead of approaching our goal, we are a little further from it than we were before, because we are setting a new goal in terms of human capacity. And this is a very realistic thing. It is as real as the fact reported in the newspapers last week, that when Detroit recently opened its employment gates almost without limit of any kind, the result was to increase unemployment in Detroit, because it brought more people into the work force, indeed it brought more people into town.

We face the fact that as we make our programs to meet unemployment in the slums more effective, unemployment in the slums is likely to increase because of the people coming into the city from outside the city. It is a significant fact that several million people will move from the countryside to the cities in this decade, a great many of them, the underprivileged, the disadvantaged—because of the superior opportunities that they feel are presented in the cities as far as employment is concerned.

Now, I do not say this in complaint. It is simply a reflection of the fact that the country now senses that it can meet a much higher standard than it did before. And it is a grand thing to throw away the measures of the past, and to have a new standard set for you every time you approach the old one. I have suggested here that it does sometimes, at the end of the day, make you feel like a greyhound chasing a mechanical rabbit, that you can never catch up with it—and yet, it permits you, the next morning, to wake up realizing that in a kind of economic way man has rejected the old idea of determinism, and has accepted the proposition that we can perfect the human ideal.

That leads me to my final point. It is a point of emphasizing the unfinished part of this business. There have been three stages in evolution of the manpower program. They ought to be clearly marked. The third one we are just moving into, and it is the one I want to mention here in conclusion.

We started our first official recognition of the unemployment problem in the middle thirties—we started out by talking about unemployment insurance, and employment exchanges—the Social Security Act of 1935, and the Wagner-Pizer Act of 1933.

The closest we came to a recognition of the individual's significance in the unemployment situation was to say if you are out of a job, drop by such and such an address. And furthermore, if you have worked for the system, we will now pay you unemployment insurance benefits for a while. That is the only road of recognition of the individual there. It was a system-oriented kind of thinking about the whole business—the only jobs we were thinking about were those which the system wanted to have filled. And we furthermore thought about unemployment in this country, until this decade, in terms of its being simply a product of the equation of fiscal and economic policy and of the expansion of the economy.

We just assumed there would be employment or unemployment depending on whether times were good or bad. That was the first stage.

We have been for about 6 or 7 years now in the second stage, which represents a very considerable advance. Now, in the manpower program we are recognizing that a lot of people are unemployed even when there are job possibilities, and we have to develop their capacity to fill the jobs, as well as develop the job opportunities.

That is a very important second step, and one which I do not mean to minimize in its significance at all.

But I think we are well reminded that we are in danger of taking a new form of deterministic approach in which we set up the economy as an end instead of a means, which is all it can be—we set up manpower programs as programs. And we are leaving out, or not yet paying enough attention to the fact that in a very real sense, man does not live just by a job alone—at least in the income sense.

What I am trying to suggest is that I think we are moving now into a third stage in which the quality of work is going to receive a good deal more attention than it did before—when we talked only about the quantity.

We are still measuring unemployment, even in our most advanced current stages, in terms which mean that if an individual has half of his or her capacities used, he or she is fully employed.

Now, that is an old barnacle definition of employment, which is cast entirely in terms of what the system wants instead of what the individual can do.

Now, this is very relevant all the way up and down the employment line. But, it comes into its sharpest focus in connection with our approach to the problem of the currently disadvantaged workers. And I am suggesting in this statement, Mr. Chairman and members of the committee, that we will make a great mistake if we conceive of this civil rights revolution as being an economic revolution, when in fact it is a social revolution. It would be entirely possible to offer every Negro in this country a job as a hired hand, or as a permanent Government employee, give him a permanent Government shovel, or give him guilt-edged Government guarantees—and I spell that g-u-i-l-t. You can give him all of those things and not get to the heart of the civil rights revolution—because it is not going to answer the problem that this country brought on itself, simply to offer any kind of job, on any kind of terms, to the people that we are talking about here. It involves a great deal more than that. It involves making them full participants in the whole work relationship. It involves a great deal more than just a paycheck for whatever job may be involved.

I would be glad to go into this further.

I would recognize it has not a great deal of immediate relevance, except for this point. We have not got time to make another round of mistakes as far as the civil rights revolution is concerned. And to whatever extent we approach it at this time on too narrow a basis, we are going to run out of time. And to whatever extent we feel we can meet its demands today, simply by offering any kind of job at any kind of rate under any circumstance to these people, we are going to be wrong.

I want to make it perfectly clear what I am talking about lies very close to the area which we have considered, some people have discussed in terms of the Government's being an employer of last resort, and others in terms of a guaranteed income. And I do not mean to reject that kind of thinking. I mean to make it perfectly clear that there is involved in some of the developments of that kind of thinking a short-cut across quicksand that still leaves the desirability of looking at those proposals for the great value which is in them, if we do not make the mistakes to which I have referred.

I say, Mr. Chairman, I will be glad to go into this further if there is interest on the part of the committee.

That concludes my statement, Mr. Chairman.

I know from previous experience you may well want to inquire about the collective bargaining picture, about the wage developments which are in prospect, in our recent past, about wage-price policy. I do not, by omitting them from the statement, mean to minimize their importance. They are very well covered in the various reports.

I will, of course, welcome whatever questions you may have in the broader area.

(The prepared statement of Secretary Wirtz follows:)

PREPARED STATEMENT OF SECRETARY OF LABOR, W. WILLARD WIRTZ

This testimony proceeds from the Economic Report of the President, from his Message of January 23rd to the Congress, and from the Annual Report of the Council of Economic Advisers; and there is little to add as further basis for the fuller development the Committee's questions will permit.

My particular interest and responsibility center on one stubborn fact—a stubborn fact which these Reports have noted: the substantial unemployment which remains after seven years of unprecedented economic expansion—at such a rate that 7½ million jobs have been added in the past four years.

The President referred to this after noting that unemployment in 1967 was at its lowest level for many years: "Yet there is no room for complacency in these achievements. The unemployment rate for Negroes, Mexican-Americans and other minorities remains distressingly high, and far too many of our teenagers look for work and fail to find it. . . . Increasingly our efforts are concentrated on the disadvantaged who have been unable to share in our prosperity."

We now know, quite clearly, that *whatever* is done to strengthen the over-all economy, consistently with the accepted views about the dangers of "overheating" it, will leave—*unless other and entirely different measures are taken*—these consequences:

An average of about 3 million people unemployed *as of any one time*—resulting in an unemployment rate (as traditionally defined—meaning those who "are looking for work and unable to find it") of between 3.5% and 4.0%.

About 10 million people unemployed *at one time or another during the year.*

A so-far-uncounted number of additional people who ought to be working but who for one reason or another are not "looking for work" and therefore are not included in the traditional "unemployment" statistics.

A heavy concentration of the remaining unemployment among particular groups (especially "minority groups" and youth) and in sharply defined areas (the urban and rural slums, especially the "ghettos").

I report to the Committee, therefore, on the development of the policy and the "manpower" programs which are the essential complement of fiscal and monetary policy—for their purpose is to meet the problems of the unemployment (call it hard-core unemployment, or sub-employment, or structural unemployment) which expansion and growth of the economy will not meet.

These are essentially problems of "unemployment" which are more "personal" than "economic"—although each of these terms is less than precise, and reflects poorly quite a lot of new understanding.

I report significant progress in this area: (a) in the development of new methods of identifying and measuring this type of "unemployment"; and (b) in the development of new operating programs to meet it.

First, about its identification and measurement:

For many years the national unemployment rate was regarded as an adequate measure of sufficiency or insufficiency of job opportunity. By this measure we have done very well indeed. The overall rate stood at 6.7 percent in 1961 and was still at 5.7 percent in 1963. It was down to 4.5 percent by 1965, to 3.8 percent in 1967. For January 1968, the rate was 3.5 percent, lowest since the Korean conflict.

For some time now we have been high lighting in our reports on employment and unemployment the situation among the groups which have shared least in the general improvement: Negro and other "minority group" workers, with unemployment still twice as great as white workers; teenagers, with unemployment averaging 12.9 percent in 1967, not much improved since 1961; nonfarm laborers, with an average rate of 7.6 percent in 1967; and so on. Moreover, it has been increasingly emphasized that while almost 3 million persons are unemployed at any one time, approximately 11 million experience joblessness at some time during the year, and that of these over a million are unemployed for a total of at least half a year.

But we have also come to realize that this traditional concept of unemployment—which includes only those who are actively searching for works and reports nothing of the frequent inadequacy of what they find—is misleading as a measure of hard-core personal economic disability. It takes little or no account of the fact that hundreds of thousands of men and women are not working because of remediable physical and emotional handicaps. Others are not looking for work because they lack the basic minimum of literacy or skill, or have been repeatedly rebuffed, or cannot find transportation to where the jobs are located, or cannot find child-care facilities. Still others have only part-time work although they need and are looking for full-time employment. Millions with full-time jobs cannot earn enough to support their families decently.

In November of 1966, we conducted a set of experimental surveys in 15 slum areas in some of the Nation's largest cities, designed to illustrate these problems of incapacity, underutilization, nonparticipation and substandard employment which lies beyond "unemployment' in the traditional sense of the term. In addition to an average "unemployment" rate of 10 percent, we found another 7 percent of involuntary part-time workers; and of those with full-time jobs, more than one-fifth were earning less than $60 per week. Outside the labor force we found a large number of men so estranged from the world of work, and of women convinced that they will be barred from work, that they were not even seeking jobs. At least one out of three residents in these slums was found to have a serious problem related to employment.

From these pilot surveys the Department has been moving into a regular and systematic program of information and analysis concerning the economic pathology of the slums. The Bureau of Labor Statistics conducted methodological work in 1967 in order to tackle special problems of communication, reduce the "undercount" of slum residents (especially young Negro males), and achieve a better understanding of job-seeking methods utilized by casual workers without good training, experience or connections. We are now activating the regular survey program by training interviewers, preparing forms and instructions, selecting neighborhood samples, and so on. In the course of this year we will be getting regular and reliable information not only describing and measuring employment problems (going beyond the traditional concept of "unemployment") in the slums but also analyzing causes and pointing to the necessary remedies. This information will be indispensable in appraising results of efforts such as the Concentrated Employment Program, the Model Cities Program, and the JOBS program.

In the meantime, we have developed a method for using reliable working estimates of the unemployment situation (largely in terms of the traditional definition of "unemployment") *on a city-by-city* basis. This is being done for the 20 largest metropolitan areas. The first complete report on these 20 areas is being released today. (A preliminary report on 15 of them was released several weeks ago.)

These reports are based on annual averages of 12 monthly surveys during 1967. They include breakdowns as between the metropolitan area as a whole and the center city (in the case of 14 of the 20 areas); on the basis of race (for all 20 areas and cities): and age and sex (for most of the individual 20 areas and 20 central cities, and for all the cities together and the areas together).

I mention here only a little of what these new compilations show, for their largest usefulness will be to the citizens and public officials in each of these areas—who have so long had to work in the dark without reliable, detailed data about their own particular unemployment situation.

The figures in fact highlight the great weakness in the law of averages—that it conceals failure with success—for these estimated unemployment rates range from 2.2 percent in Minneapolis-St. Paul and 2.3 percent in Washington to 5.6 percent in Los Angeles-Long Beach and 5.4 percent in San Francisco-Oakland.

Negro unemployment rates "average" 2.3 times as high as white rates, but here again there are important differences. The ratio between the Negro and white rates is 1.5 in New York and 1.6 in Washington, compared with 3.1 in Cleveland and 4.2 in St. Louis.

For the 20 areas as a whole, unemployment averages 4.7 percent in the central cities, 3.1 percent in the suburbs. The principal reason is that the majority of whites live in the suburbs, while over 80 percent of nonwhites are in the central cities.

These tables also make clearer the actual magnitude of unemployment, as distinguished from ratios and percentages. For example, nonwhite employment in the 20 largest areas averaged 269,000 in 1967—divided almost equally among adult men, adult women and teenagers. (This was 42 percent of total nonwhite unemployment in the Nation.) Nonwhite unemployment in a single area can be illustrated by the situation in Chicago: 9,000 adult men, 11,000 adult women and 16,000 teenagers, for a total of 36,000, of whom about 33,000 are in the city of Chicago itself.

I report, therefore, that we are now well along in a major redesigning of manpower statistics in the pattern of today's social priorities.

The President describes, in his January 23rd Message, the development and the new emphases in the operating manpower program. He prescribes there an intensification of present efforts through: (1) the further concentration of resources and facilities on those particular areas where the needs are greatest; (2) unified planning and action by the government agencies and private organizations concerned with manpower; and (3) the greatly increased involvement of private industry in overcoming hard-core disabilities.

I only summarize briefly here the three special program developments which are designed to implement the President's instruction: the Concentrated Employment Program, the manpower aspects of the Model Cities Program, and the JOBS Program presented to Congress in the January 23 Message.

The Concentrated Employment Program responds to the President's directive in his 1967 State of the Union Message that governmental measures be redeployed so as to provide concentrated assistance to those with the greatest need. The guiding principles are (1) to enlist the active cooperation of business, labor and other community interests; (2) to provide a wide range of counselling, health, education and training services as needed by the individuals being served; (3) to provide the follow-up assistance necessary to assure that a job, once obtained, will not quickly be lost; and (4) to combine in a single project contract the training and work-training components available under the various statutory authorizations and appropriations.

By the end of fiscal 1968 we expect that Concentrated Employment Programs will have been established in 76 urban slum and rural poverty areas. In 1969, we plan to have 99 urban and 47 rural areas.

The *Model Cities Program,* established under the Demonstration Cities and Metropolitan Development Act of 1966, will mount a compresensive attack on the social, economic and physical problems of blighted urban areas. The coordination of federal, State and local efforts required by this Act includes the commitment of the Department of Labor to carry out the manpower aspects within the framework established by the Department of Housing and Urban Development.

All of the 65 Model City planning grants approved by the end of 1967 have included manpower components. Substantial reduction of unemployment and underemployment through work and training opportunities for neighborhood residents will be an integral part of every Model Cities plan.

Wherever possible, CEP and Model Cities neighborhoods will be aligned. The Neighborhood Service Centers will bring together, in one installation, the services administered by the Department of Housing and Urban Development, the Department of Labor, the Office of Economic Opportunity and the Department of Health, Education, and Welfare.

The *JOBS* (Job Opportunities in the Business Sector) program for involvement of private industry in training and employing the disadvantaged is a logical growth of previous undertakings.

Of the 113,000 new OJT trainees enrolled during 1967, about two-thirds were disadvantaged. This experience taught us that in order to attract hard-core recruits and move them through training into steady employment, a broader type of program would be needed. More counselling, health assistance and other supportive services would be needed; and the additional costs incurred by employers through loss of productivity, unusual supervision needs and other extra burdens would have to be taken into account. In 1968, the OJT program is emphasizing jobs with career potential, and is providing positions in private industry for many young persons initially enrolled in the Job Corps and Neighborhood Youth Corps.

Under the JOBS program, the Government will locate and identify the hard-core unemployed. Cooperating companies will furnish jobs and bear the normal costs of training, while the Government will underwrite additional costs such as literary training, transportation, health services and counselling.

The President also announced the establishment of a National Alliance of Businessmen to help launch the program. Leading business executives are spear-heading the effort in the 50 largest cities. An expenditure of $106 million from available manpower funds has been programmed for Fiscal Year 1968, with an increase to $244 million planned for Fiscal Year 1969.

The CEP and JOBS programs permit combining the resources available to meet hard-core unemployment under both the Manpower Development and Training Act and the Economic Opportunity Act—so far as the administration of the EOA programs has been delegated to the Department of Labor. These include the New Careers program, the Special Impact program, Operation Mainstream and the Neighborhood Youth Corps.

These programs funded under the Economic Opportunity Act are budgeted for $745 million in fiscal 1969. Training programs under the Manpower Training and Development Act are budgeted for $513,044,000. In addition the Department will be administering the work incentive program for AFDC recipients, with an expected enrollment of 110,000 recipients in fiscal 1969.

The grants budget for administration of state employment security agencies requests $616,573,000 for 1969. I will not take time to tell the whole story of how the employment services are redirecting their efforts to serve those in greatest need, but it is an exciting story indeed.

All in all, programs administered by the Department of Labor will provide 1,300,000 training and employment opportunities in 1969.

In summary, regarding this matter of hard-core unemployment, I suggest the importance of recognizing fully all that remains to be done—and equally what is currently being accomplished.

As well as I can advise you, not only the population of the Nation as a whole *but every group within it* has—*by any past measure*—made unparalleled gains during the past five years so far as employment opportunity is concerned. When particular statistics are picked out to buttress a contrary conclusion, it only confirms that computers can now, like the scriptures, be drawn upon selectively to support almost any proposition.

One of the significant things that is happening is that each gain which is made in increasing employment opportunity draws additional people into the work force. The development of effective training, work-training, and employment opportunities for the hard-core unemployed encourages those who had given up to try again. There is still only partial realization of the extent to which the intensification of efforts—and the increased effectiveness of the efforts—to meet the problem of hard-core unemployment in the city slums is drawing the nation's disadvantaged more rapidly into the cities.

This is not remarked in complaint. The most important thing that has happened in these past five years is probably that we have rejected, as the measure of our achievement, any standard of previous performance—substituting instead the measure of the human potential. What we were able to do before is irrelevant, any gain by that standard immaterial. If this means feeling at the end of each day like a greyhound chasing a mechanical rabbit that can never be caught, it also means starting the next morning with the ennobling realization that man has finally shaken the false ideologies of predestination and determinism and has accepted responsibility for perfecting the human ideal.

This leads to a final point.

The first stage in the development of a national policy regarding employment and unemployment accepted the non-use of people—i.e. unemployment—almost entirely as part of the product of a national economic equation. The purpose was to increase the number of work opportunities. It was system-centered. The only measurement was in terms of a totally undifferentiated national average. The principal feature of that policy, so far as recognition of the individual was concerned, was paying him insurance benefits for a time when he lost his job—if he had contributed to the system.

The second stage has been to recognize the necessity to assist the disadvantaged individual in qualifying himself for the work opportunities which are available. This has meant significant advances—reflected in the "manpower" program which has been described here. The needs of "the system" continue to be recognized at this stage as dictating what employment is to be.

The significant character of the third stage has already emerged. It involves the quality of "employment," the circumstances of the employment relationship, the meaning of work to the individual—beyond the fact of its providing a minimal living wage. This new factor takes a variety of forms, affecting much more than the employment of the disadvantaged. It is reflected in the fact of current measurement: that we count as fully employed a person whose capacities are only half-used. It is most sharply apparent today in the increasing realization that equal employment opportunity for the previously and presently disadvantaged groups demands a good deal more than providing their members just *any* kind of work on any kind of terms. The basic human elements in the civil rights revolution would remain untouched by hollow assurances to Negroes of the chance to be "hired hands" or life time holders of public works shovels or guilt-edged Government income guarantees. What is sensible in current proposals for "last resort employment" and "guaranteed income" plans must be carefully separated out from elements which would make these disastrous short-cuts across quicksand. This is a social, not an economic, revolution.

The implications of these broader considerations go beyond the scope of this hearing. But there is reason to remind that any consideration of "economic policy" tends to assume that man lives by bread alone, and that any report on "manpower policy" tends to overlook the implications of the fact that even the phrase itself derives from "horsepower."

I realize that the Committee's inquiry of me will proceed into other entirely different areas—collective bargaining prospects, wage and price policy, and so forth. It has seemed advisable to confine this statement to a single area. I shall of course welcome your broader questions.

Chairman PROXMIRE. Thank you, Mr. Secretary. I have been listening to statements before Senate committees now for 10 years. This is—I think this ranks as one of the most powerful, eloquent, moving, and competent statements that I have heard.

Secretary WIRTZ. Thank you.

Chairman PROXMIRE. It is most impressive and most encouraging. I am delighted you put it into a perspective of progress. You are right that we tend to be pessimistic, and we tend to look at the weak spots, and overlook the progress. Your statement did a lot to give us the kind of perspective we need.

Also, it is good to get this instrument of social policy that you are giving us; the breakdown of unemployment figures by city, and by the areas surrounding cities.

I want to get to that.

Before I do, however, I would like to ask you for your own justification of the administration's proposal for a 10 percent surtax which the Council of Economic Advisers, which I should say the Chairman of the Council, Chairman Ackley, wrote me would diminish the number of jobs during this calendar year by 150,000—fiscal year 1969 by 300,000—and would hit at a time when many economists feel that the economy is likely to be softer.

Under these circumstances, it seems to me that this very well might create a situation where it is much harder to get at the hard-core unemployment—recognizing that excellent as the new programs are, and improved as they may be, what we need above all, I think, is an economy which provides a maximum opportunity for those seeking work to find it in private employment, and good as the Government's manpower training programs are, far more important, and far more effective, by and large, are the training programs that take place in private industry.

Under these circumstances, what is the justification for a surtax that can very seriously interfere with employment opportunities for the hard-core unemployed?

Secretary WIRTZ. My response, Mr. Chairman, takes account of two inhibiting factors. One is that—the statement I am about to make has been made by so many people under so many different circumstances it will be discounted as being only the voice of a parrot. And second, my response to the question must necessarily be intuitive to a certain extent, because I recognize the significance of broad principles which I only partially understand. But my answer adds up to a complete and unqualified endorsement of the surtax proposal.

I mention it only briefly—because they have no novelty. It is with a very serious and concerned consideration of the fact to which you refer. I know that when we talk about the necessity of cooling off the economy, what that translates into as far as my most immediate concerns go is the prospect that some fewer people will be working than were before—unless we do something else about it.

Now, I am not completely clear about the additional things that we can do about it.

We are talking about some of them when we raise the training, the work training program for next year from a million to 1.3 million people. We have that problem in mind. And then the greatest consideration, Mr. Chairman, and one which I do not profess personal competence to evaluate, is in terms of the alternatives. If the figures are correct—and I assume the correctness of the figures which you have since I have not talked to Mr. Ackley in terms of the specific figure of 150,000—and if that is the job price tag of a 10-percent surcharge, my approach to it would be, first, to try to compensate for it in other ways—significantly, in the work and the work training program. And second, to say that I would not think that a very high price to avoid the alternatives which could be involved in an inflationary spiral. And that if that were the price, I would like not to have to look it in the face, because it is a tough price. But if we are talking about, as I am convinced we are, a situation in which we must avoid the dangers of inflation, I think the benefit and advantage to the working wage earner of this country—who is by statute my constituent—is very much on that side—just very much.

I said my answer would be intuitive, and it is to this extent. When I get through all my homework about the surtax, and so forth, and do not understand all of it, I still come out with a complete conviction that in this stage in the development of the prosperity of the economy we ought to pay our bills. And I know that is an oversimplification. And I know that it is not an absolute that I am talking about. But, if the prospect is for a $14, $15, $20 billion deficit, whatever it may be—when I look at our gross national product—I say it is intuition, I suppose it is upbringing—in fairness to the folks, I do not think that is total ignorance—my reaction is that we ought to pay.

Chairman PROXMIRE. Well, you see, the problem that this presents—in the first place, 300,000 jobs, I think, would be eliminated in fiscal 1969. And I think this is a conservative estimate—it could be much higher than that.

At any rate, these are not the only alternatives. Another alternative is very possible—I know that you do not approve of this at the present time, for various reasons, but it would still seem to me it is a perfectly feasible alternative—to work for a wage-price guideline figure. It is my understanding that there is a trade-off in the view of many economists between a low level of unemployment and some degree of inflation. One way of keeping that level of unemployment as low as possible, consistent with keeping prices down, is to have a wage-price guideline that is specific and definitely understood.

This worked, I think, extraordinarily well from 1962 to 1965. An excellent study by John Sheahan who is a distinguished professor at Williams, and who appeared before this committee a couple of weeks ago, together with three other top economists in this area, confirmed that we would do better if we had a precise and definite guideline figure, which we did not have last year, and we do not have again this year. It is very hard to get. It is nothing like 3.2 percent—it would have to be 4½ percent, 5 percent—but something that would help to hold down the negotiated wage increases that we are likely to get in the 6 to 7 and 8 percent range. A guideline figure of 5 percent would make it possible to keep the cost-push element of inflation under better control, make it possible, therefore, to stabilize, or come closer to stabilizing prices, while at the same time providing more jobs.

Secretary WIRTZ. I appreciate that point. I do not have much observation that is new on it. You are right—within this same forum a year ago I expressed the view which I very strongly hold, that under present circumstances the establishment of a specific adjustment point and guideline would not result in any curtailment of wage or price increases.

You will note I subscribed completely to two other propositions which are implicit or on the edges of what you have said. One, at no point am I going to support stopping inflation by what I can identify at least as a deliberate stimulation of unemployment. I know we did that for a long time. And I am against that—100 percent.

On the affirmative side, at the same time that I say I do not believe a decimal point figure guideline will help on this whole matter, you know that I think very strongly that the principle of productivity is right—not as a matter of morals, but as a matter of everybody's self-interest. Every time I see a wage increase which is higher than productivity, and every time I see a price increase which is not justified by the same principle of productivity, I know that we have lost ground. The country, as a whole, has lost ground.

Now, the particular people that got it did not. But it is going to be infectious. And I am concerned today in a very real way—we are at that point where wage increases which are above productivity, and price increases which are not required, or warranted by productivity, are having, or will have, an epidemic effect. I am very much concerned.

Chairman PROXMIRE. Aren't we much more likely to get them absent some kind of a figure that the Government will announce and fight for and make clear throughout the country?

Secretary WIRTZ. You put it in the form of a question. I know your view on it. Mine is to the contrary. I think we are not more likely to get them absent a specific figure. And I think that in a very real way.

Chairman PROXMIRE. What kind of restraint is there on a union not to try to match the Ford settlement, or not to try to exceed the Ford settlement? After all, the President says we hope you will restrain your wage demands. But, unless there is a figure, what does it mean?

Secretary WIRTZ. Well, I do not know, Mr. Chairman, whether we are talking economics or the language, because my answer would be when you say what restraint is there—if against our mutual legal background by restraint we mean something that stops a person, and says you just cannot do it, it is against the law—the answer to your question is "No."

Now, if we go to a broader area of restraint, I do not believe I am under any illusions about the inclinations of both price setters and wage setters, or price bargainers in this country, to try to get all that they can in a particular situation.

I think the answer to whatever extent there is restraint in the broader sense, as a pragmatic answer, has got to come from the pressures on the other side. In both of those cases, it is the consumers pushing the pressures on the price side, and it is the employer pressing against the wage pressures on the union side. And I believe we kid ourselves if we think that there is any accepted or recognized articulated, clearly identified concept of a public interest that any union or any seller brings to bear when he decides what the wage demands will be, or how high his prices will be set. I believe it is only the influences of the marketplace.

Now, I believe that the consumers' pressures on price—against price increases—are greatly increased by the Government saying, "Now, look, this thing is in such a situation where right now you better fight as hard as you can against price increases."

Chairman PROXMIRE. Wouldn't you agree there are circumstances under which wage-price guidelines can be effective; that they were effective from 1962 to 1965?

Secretary WIRTZ. I think they were, too, in that period.

Chairman PROXMIRE. What you are arguing for now, Mr. Secretary, is fiscal restraint and monetary restraint. But you do not provide what the wage-price guideline experts said—you should also have it if you have this—which is a restraint in the area of wage settlements and price determinations——

Secretary WIRTZ. I have never been very timid about expressing questions as to whether the experience with the decimal point guidelines was in itself much of a restraint.

Of course, the increases in violation of the productivity principle were a good deal higher on the price side during that period than they were on the wage side. The wages stayed roughly in line for the first 3 or 4 years of this decade—5 years—they stayed roughly in line with the productivity principle while prices went higher. But, as far as I can give you, what is again necessarily a subjective judgment, I do not believe that except for perhaps the steel case in 1963, 1964, and possibly the General Electric case the following year, I do not believe that the fact of the decimal point figure could be translated into the dynamics of that bargaining as I saw it.