

And, so, I do believe that it is the pressure, or the information, the learning, the education which is given the country as a whole, which is translated into these forces and which has its effect.

I am very hopeful, of course, that in the working of the Cabinet Committee, which the President has established, we will find ways, working together and with representatives of unions and companies, for implementing this. But, if your next question is how that is going to be done specifically, I will realize quite quickly, and you will, too, that I am falling back on an article of faith, that that good sense can be sufficiently communicated, that it will do well, and that that good sense is not made more effective when it is put into a decimal point.

I realize it is an area of argument and disagreement, and a strongly held view.

Chairman PROXMIRE. My time is up.

Congressman CURTIS?

Representative CURTIS. Thank you, Mr. Chairman.

There are a number of points I would like to develop, but I am not going to have the time to do it.

Missing from this report, which I think is important, is the impact of war on unemployment. If we took the same 600,000 boys that are in uniform now, because of Vietnam, as well as probably a million and a half in the munitions plants, and added them to the unemployment rolls, we would have some real problems. And I think we have to think in those terms.

Also missing from the report is the impact of inflation on unemployment. Inflation is continuing. It is going to increase imports and bring about a further decline in exports. This has a serious impact on unemployment.

The impact of high interest rates on employment was brought to our attention forcibly in the homebuilding industry.

A fourth area—and there is nothing in the report on this—is the situation regarding labor-management settlements and strikes. The chairman has been examining another area which is not mentioned here—wage-price guidelines, or wages and prices with respect to our productivity increases.

So, it is very difficult to conduct an examination on a paper that does not even discuss what I think are the underlying economic conditions that this committee has to grapple with.

Now, let me go to some things that are discussed here——

Secretary WIRTZ. Mr. Chairman——

Representative CURTIS. Sure, you may respond.

Secretary WIRTZ. I have assumed, Mr. Curtis, you are familiar with the reports, the Economic Report, and with the Council of Economic Advisers' Report.

Representative CURTIS. Oh, yes.

Secretary WIRTZ. On everything you have mentioned we have tried to cover in our very detailed report from the Bureau of Labor Statistics to the Joint Economic Committee last week. And I have assumed that there is familiarity with that, and that we would be glad to answer questions on that.

Representative CURTIS. Well, let me say this:

When you appear, Mr. Secretary, as the Secretary of Labor, I

assume that you are going to stress those things that are the most significant and important—even though they are in the documents, and indeed some of this is discussed here—so that we can then direct our colloquy toward these important things.

Now, I can prepare a series of questions, and you can answer. But, I am familiar with these personal appearances of the administration. This is the occasion, I think, to point up those things that are the most significant. I think I can draw the proper conclusion that those areas, not included in your paper, are those that the administration feels are not particularly critical.

Secretary WIRTZ. I think that is right. In your terms, Mr. Curtis, my statement does represent those things which I think are most important. I am really more interested today, and I think the country ought to be, in the scenery than in the garbage. I think it is more important. And that is the reason it is emphasized here.

Representative CURTIS. Well, we can take our rhetoric out in another forum than this. I have listed things that are not garbage by any means. The impact of the war on the unemployment situation is not garbage. The impact of inflation on employment as I have described it, with respect to exports and imports, is hardly garbage. The impact of high interest rates on unemployment and employment, and certainly productivity increases, are hardly garbage.

But we will develop our rhetoric in other forums. And believe me, I shall.

Secretary WIRTZ. I should prefer that.

Representative CURTIS. Now, having said that, I would like to devote a little time to some of the things that are discussed in this report.

Referring to—in your prepared statement—the first stage in development of national policy with regard to employment and unemployment—and I am skipping: “* * * to increase the number of work opportunities.” The second stage, “* * * to assist the disadvantaged individual in qualifying himself for the work opportunities which are available.”

What I find missing in here is a discussion of the machinery that—to identify what work opportunities are available, because without this kind of material and data, it is very difficult for me to conceive how any of the training programs that you mentioned in your report can be fully effective. They can be partially effective.

Two of the tools are, one, updating the Dictionary of Occupational Titles. The recent updating goes back really to 1965. Where is this sitting? Is there a new revision that is about to come out?

Secretary WIRTZ. I will check on the specific schedule, and we will supply it for the record. The answer to your question is that we are continually working on it. But the answer to your question is also that that work has been somewhat slowed up. That has a lower priority now under the economic pressures than it would otherwise have.

(Information below subsequently filed):

The “lower priority rate” is assigned because the current edition of the Dictionary of Occupational Titles is a comparatively recent (December 1965) publication. We are planning on a full revision every 4 to 5 years, and are contemplating the next revision (fourth edition) for 1970.

This is possible through arrangements that are underway to computerize the revision, maintenance, and printing of the DOT to make the information

more timely, accurate, and varied (depending on the need) in format. We anticipate being able to use this automated programing technique in fiscal year 1969 and we will project a new edition of the DOT for the following fiscal year (1970).

Work is continually being done to keep the information up-to-date. Parenthetically, we have, in the past, prepared and issued "supplements" to earlier editions, rather than a full revision. However, we found these to be less than satisfactory to the many users of this document, since each supplement means another volume to procure, handle and keep track of—and this frequently isn't done.

It may be of interest to note that the current edition of the DOT added some 6,000 occupations to the preceding edition; and that we anticipate adding an estimated 4,500 occupations new in the economy to the next edition of the dictionary. In addition we intend reflecting the many thousands of changes that will have taken place in the jobs currently existing in the economy.

Representative CURTIS. How can that have a low priority if the essential features of any job-training program where you are spending hundreds of millions of dollars depend on identifying the opportunities which are available. And, believe me, the opportunities that are available require new skills for new jobs which were not even in existence before.

How, can you elucidate that?

Secretary WIRTZ. I am not clear about the question. Is the question whether I think that it is important to try to keep those descriptions up to date?

Representative CURTIS. Yes.

Secretary WIRTZ. I do.

Representative CURTIS. You are saying that because of the economy pressures, that this has been slowed down. I am arguing relative priorities, saying it seems quite clear to me this is of the highest priority.

Secretary WIRTZ. Any limiting factor, as far as we are concerned on that, has come from the attempt to do just every single thing we can to pull in our belt. When the Congress says cut out 2 percent of your jobs, and cut off 10 percent of your programs, we have got to do just exactly that. And I do not object to it. But—

Representative CURTIS. In other words, what you are saying is that you do not agree that this is the highest priority. If it were the highest priority, you would not cut it—you would cut things of lower priority?

Secretary WIRTZ. You are perfectly correct.

Representative CURTIS. Then there is apparently a difference of opinion. You do not think that continuing to update the Dictionary of Occupational Titles is of this high priority that I attach to it?

Secretary WIRTZ. I do not think the further expansion of the program of keeping up the dictionary is of the priority which you apparently attach to it.

If your suggestion is that the first thing we should do in the Department of Labor is to put more people on the dictionary, we would have a point of disagreement.

Representative CURTIS. I am sure we would because I would say that it is almost inconceivable to identify the opportunities which are available if you have not constantly kept up to date the nomenclature that describes these jobs. How any of these programs can function without this essential data is incomprehensible.

So, I move to the next tool, the jobs available statistics, which, as I read the Manpower Development Training Act, was a requirement that

the Department of Labor developed. Two years ago, this committee held hearings to be sure that we were not in error about the feasibility of the jobs available statistics and the necessity of it as far as making any manpower training program work.

But, where are we on that?

Secretary WIRTZ. You know our story on that, Mr. Curtis, and how complete our agreement is on it. And, you know, too, that we have, in the 5 years that I have been Secretary of Labor, taken each year, to the Congress of the United States——

Representative CURTIS. You did not last year, and you have not this year.

Secretary WIRTZ. We have twice——

Representative CURTIS. You have not ever since then.

Secretary WIRTZ. We have twice taken to the Congress of the United States, both the full recommendations of the Secretary of Labor, the full recommendations of the Bureau of the Budget, and the strong recommendations of the President, a proposal, a line proposal, for that study, and the Appropriations Committee, or Congress has decided we should not do it.

Now, I still agree with you in your position. So, we have tried to meet that problem as much as we can.

Two years ago it seemed to us of critical essentiality that we do it, because at that point there were manpower shortages, and we thought we had to identify those as carefully as possible—not only in the interests of the individual, but in the interests of the economy. And so we did—on a draft basis—put together on a bimonthly or quarterly basis the fullest information we could on that.

We have abandoned that in the last year, because the shortages are probably not as acute as they were before.

We are also trying, in a variety of manpower development and training programs, to get that information in one form or another. And I believe we have it substantially. We have given up on the attempt to get from the Congress the approval, the special authorization for it. But we have tried to put it together in our own programs—I agree with you on this point, and in reality, on a great many more than the previous comments might have suggested.

I would add this:

To the extent that we can shift the program to an on-the-job training basis, as we are doing, that problem is met to a very considerable extent by seeing to it that at the training point the individuals become part of the employment relationships in which they will continue after they have completed training.

Representative CURTIS. My time is up.

I can only say—and I will come back and discuss it—these efforts are very, very feeble.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

I want to pursue, Mr. Secretary, the questions that Chairman Proxmire was directing at you—in which you have said in effect, when Chairman Proxmire communicated to you Gardner Ackley's view that the tax increase will take enough demand out of the economy to make unemployed around 300,000 people who otherwise would be employed—your answer was that that is a stiff price to pay, but that

you think it has to be met because we, in your phrase, have to pay our bills.

Secretary WIRTZ. No, Congressman. I think you left out the point that my response to that would be first to try to find, and I think we would find, ways of making up that figure. There is a coincidence between that 300,000 figure, which frankly I have not heard until today, and the expansion of the work training program, which is also being expanded this year, 300,000. So my first reaction is not that I just would pay that price. I would try to meet whatever the effect was first.

Representative REUSS. But if you cannot meet it, because—what shall it profit a Secretary of Labor to train people for jobs if there are 300,000 fewer jobs than there otherwise would have been? You just have to keep training them, but they won't get a job, as you think—passing that point, you then come to the nitty-gritty, which is that you would be willing to pay that price in order to pay the Government's bills.

Secretary WIRTZ. No. If that is a proper paraphrase of what I said, I should say it again. I am never going to settle to pay a price in unemployment to prevent overheating in the economy.

I would take into account the importance to the wage earners of this country of prices not getting way out of line. And I will take into account the desirability of paying whatever our bills are.

But I cannot support a proposition that you do any of these things at a recognized price of employing fewer people than there were before. Therefore, I try to bring these things together by making some provision—training them for better jobs—which the economy will continue to need.

I try to meet that price by some alternative method.

Representative REUSS. I tarry on this point so long because it is vitally important. And I am afraid it is one we are going to be confronted with every year for a while, until we solve the secret of the philosophers.

I am concerned, though, as you are, that here we are, unemployment still not down to the 3-percent goal which we used, at least, to say should be our goal, and here we are running a \$14- or \$16- or \$18-billion deficit. Something is wrong with the scenario, obviously, as I have kept observing for the last couple of years. What I think is wrong with the scenario, or in part wrong with it, is that our tax system is so full of loopholes that it is not grabbing the revenues that it should, and I ask you—does it really seem like a good idea to retain those loopholes in the system, to let year after year go by without even asking the Congress to do anything about them, and then take it out on the hide of the average moderate income taxpayer, and reduce his demand-creating potential.

Frankly, it does not seem to me a very good way to run the economy.

I wonder how you account for these huge deficits that we are running, at 3.5 percent unemployment.

Secretary WIRTZ. There are several elements in the question, Mr. Reuss; when we get into the area of tax loopholes, you will realize that it is an area with respect to which my competence would be purely personal, and nothing more. But I am against them.

Representative REUSS. I know that. Everybody is, in principle. But I wonder if it is not a serious matter, that the administration has not

asked the Congress to do anything about them. Because, when you plug a tax loophole, you probably do not throw a man out of work, as you do when you grab a similar amount of revenue by an across-the-board tax increase.

Most of the money that would be brought into the Treasury by plugging tax loopholes is money that is not spent on consumption, or isn't spent on real investment in plant or equipment, but instead bids up the price of commodities, or stamps or jewelry or art works, or chases around in the stock market, or leaps overseas into foreign speculation. It does not make jobs.

Therefore, we have something grievously wrong in letting the loopholes go unplugged, because we lack the will to do anything about them—we have to throw men out of work, some 300,000 of them, in our model here, in order to, in your phrase, pay the bills.

I am for paying the bills, but why not pay the bills by getting revenues that do not tend to put people out of work?

Secretary WIRTZ. If the question were whether to pay our bills by closing tax loopholes, or putting 300,000 people out of work, I would take the closing of the loophole. I believe that is an oversimplification of it.

Representative REUSS. A little, but not entirely.

Secretary WIRTZ. It is surely not irrelevant. But I would like to suggest that I think the unemployment rate will not be larger if the surtax is imposed than if it is not imposed. I want to be very clear about that.

Representative REUSS. You reject Gardner Ackley's 300,000 figure?

Secretary WIRTZ. No. I do not think that is what he says. There are a lot of other things going on. There is a manpower training program that is covering 1,300,000 people this year. There are a lot of other things going on. I repeat, I think that if or when the surtax is imposed, the unemployment rate will be lower than it is now, or at least no higher than it is now.

I think the increase in the number of jobs this year will be as large as it was last year, or approximately that large. I believe that is about a million six hundred thousand. So that I do not think that the surtax will reduce that.

Representative REUSS. You will have me voting for the surtax in a minute here. You really think unemployment will come down?

Secretary WIRTZ. Yes, Mr. Reuss. I think the question is whether it is legitimate to look at the surtax alone. In complete candor, perhaps even letting my guard down, I accept those figures. But I would point out there are a lot of other things going along with them. And I would urge considering two parts of the program which the President has put before the Congress—one, a surtax proposal, which you say the chairman on the Council of Economic Advisers says could in itself have an effect on reducing employment by 300,000, and a second provision of which is a manpower program expanded by half a billion dollars which will have the result of putting another 300,000 people into training.

Representative REUSS. Let me take the second part of that. I will just expand, and forget about the contracting—what is wrong with that? And pay the bills by plugging tax loopholes.

Secretary WIRTZ. I beg your pardon?

Representative REUSS. I was buying part of your package. I will buy the Labor Department part—let us increase those training programs to 1.3 million, and then let us provide jobs for those who are getting the training, by forgetting about the surtax, and instead recouping the revenues by plugging tax loopholes. Your answer, maybe, is that we should have done that a year or two ago and we would be all right. But, would you at least give me that satisfaction?

Secretary WIRTZ. I sure would—on this basis. All my life I have said in public places and as an individual, that I am opposed to a number of tax loopholes. I have not changed my mind on that. If it is a matter of expression of administration policy, obviously a statement by the Secretary of Labor about tax loopholes is not worth the back page of a paperback book. But in terms of a personal position that I have held for a lifetime about tax loopholes, I agree completely.

Representative REUSS. I was not asking you the question of morals or equity or fairness. I was asking you the question of whether we do not have to plug our tax loopholes in this country in order to get the revenues we need in the Treasury, so that at a time of close to full employment, we do not keep running disastrously large deficits.

Secretary WIRTZ. It ties the two together again. And I do not rush from that—the loopholes and the effect on employment.

I have not thought it through to an evaluation of whether the closing of the loopholes to which you are referring would have an effect on employment. I would like to try to do it.

I think your question is rather about whether the surtax could be replaced by the closing of the loopholes.

But if the question is—as I gather now it is—if the question is whether the closing of the loopholes would permit a continuation of employment at a higher level, I believe I am out of my depth. I do not believe I could honestly answer the question of the tie-in between the two.

Representative REUSS. It is a question the Secretary of Labor ought to be concerned with.

Secretary WIRTZ. The question—

Representative REUSS. You are not just concerned with structural—

Secretary WIRTZ. That is right.

Representative REUSS (continuing). With structural unemployment. You are concerned with overall demand unemployment, too.

Secretary WIRTZ. Sure, of course. And if overall demand should go down, the unemployment rate would go up. And along with everything I have said about the importance of the manpower program, I recognize that any rocking of the boat—as far as the fiscal, monetary, general economic situation is concerned—would hurt more than anything that we could possibly make up on a structural basis. I know that.

Representative REUSS. Thank you..

Chairman PROXMIER. Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Secretary, we are always very pleased to have you before the committee. We know you have a great fund of knowledge in connection with this field.

In your statement, you said:

One of the most significant things that is happening is that each gain which is made in increasing employment opportunity draws additional people into the work force.

Now, is it not equally true that as we get inflation, the cost of living increases, additional people are drawn into the work force because they cannot meet their bills?

Secretary WIRTZ. I should think it would have some of that influence. There would be a family which would be pressed tighter by an increase in the cost of living. And if the husband's income did not go up as much as the cost of living, then there would be additional pressure for the wife to attempt to work, too. That would be true.

Representative WIDNALL. It has been my own observation that many people who thought they had acquired enough for retirement, or who were forced into compulsory retirement, with an annual income which seemed to be sufficient at the time, have now found that it is completely inadequate for their needs, and they have to go back and acquire work of some kind, somewhere within the labor force. And I think there is an equal pressure in that direction caused by inflation, and the very definite change in the cost of living for the average family.

Do you have an inventory of the number of people holding two jobs?

Secretary WIRTZ. We have tried to get—let me answer your second question first, and then just an observation on the first part.

I will supply the information that we have available on what we call moonlighting.

Our last survey of persons with two or more jobs was made in May 1966. At that time 3.6 million workers, or just under 5 percent of all employed persons, held more than one job. This proportion was somewhat lower in 1966 than in 1964 or 1965.

I submit for the record a report on moonlighting which appeared in the Monthly Labor Review in October 1967, pages 17 to 22.

(The report follows:)

MOONLIGHTING—AN ECONOMIC PHENOMENON

The Primary Motivation Appears To Be Financial Pressure, Particularly Among Young Fathers With Low Earnings

(By Harvey R. Hamel*)

Moonlighting habits of the American worker have not increased or even changed much in recent years. The most recent survey of dual jobholding shows that 3.6 million workers, just under 5 percent of all employed persons, held two jobs or more in May 1966. This proportion was somewhat smaller than those revealed by the 1964 and 1965 surveys.

The typical multiple jobholder is a comparatively young married man with children who feels a financial squeeze. He has a full-time primary job and moonlights about 13 hours a week at a different line of work. Teachers, policemen, firemen, postal workers, and farmers are most likely to moonlight. Many of them work for themselves on their extra jobs (operating farms or small businesses) while many others are sales or service workers.

One of the major subjects explored in this article is the relationship between moonlighting and weekly earnings, data on which is available for the first time. There is also an analysis of the association between moonlighting and hours of

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work, an indication of some of the possible reasons for moonlighting, and a discussion of the industries and occupations of moonlighters.¹

A QUEST FOR HIGHER EARNINGS

Why do over 3½ million persons hold two jobs or more? The primary reason seems to be economic. Many moonlighters need, or believe they need, additional income. For some, a second job is a necessity. A second job enables others to live at a higher standard.

For still others, a second job may be the means by which they are able to maintain a standard of living that would otherwise be lost because of, for example, sudden large expenses, loss of wife's income, or a decline in earnings on the primary job.

Because financial reasons are a prime factor motivating moonlighters, the Bureau of Labor Statistics collected data on the usual weekly wage and salary earnings of dual jobholders on their primary job and of single jobholders. These data show that generally the level of a worker's earnings determines his propensity to moonlight. Multiple jobholding rates for men 25 to 54 years old are highest at the lowest earnings level—under \$60 a week. As the level of earnings rises, the incidence of dual jobholding declines (see chart 1). The lowest rates were found among workers with the highest weekly earnings—\$200 or more.

The close association between multiple jobholding and earnings is most evident from the data for married men 25 to 54 years old, the group for whom family financial responsibilities are usually the greatest. Among these men, the moonlighting rate for those earning less than \$60 a week was 12.5 percent, more than twice as high as the 5.3 percent for men earning \$200 or more a week.

Data available for the first time show that among men who are heads of households, there is a close relationship between the multiple jobholding rates, the number of young children, and usual weekly earnings. The moonlighting rate tends to increase with the number of children under age 18. The rate for men with at least five children was nearly twice that for men with no young children, as shown in the following tabulation:

*Multiple jobholding rates for men who were heads of households, May 1966—
Children under age 18*

Total	7.9
None	5.4
1 child	8.3
2 children	9.1
3 or 4 children	9.8
5 children or more	10.3

Within each of these groupings, multiple jobholding rates tended to decrease as earnings increased. For example, among men who were household heads with three or four children, the rate was 16 percent for those who earned under \$60 weekly, about double that for those with earnings of \$200 or more.

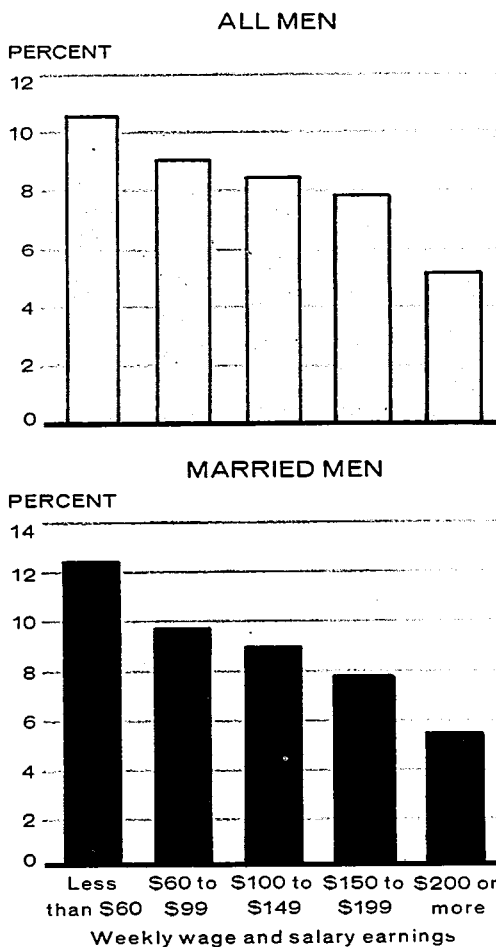
¹ Data in the current report are based primarily on information from supplementary questions to the May 1966 monthly survey of the labor force, conducted for the Bureau of Labor Statistics by the Bureau of the Census through its Current Population Survey. The data relate to the week of May 8 through 14.

This is the seventh in a series of reports on this subject. The most recent was published in the *Monthly Labor Review*, February 1966, pp. 147-154, and reprinted with additional tabular data and explanatory notes as Special Labor Force Report No. 63, which also includes a complete listing of earlier reports and their coverage.

For purposes of this survey, multiple jobholders are defined as those employed persons who, during the survey, (1) had jobs as wage or salary workers with two employers or more; (2) were self-employed and also held a wage or salary job; or (3) worked as an unpaid family worker, but also had a secondary wage or salary job. The primary job is the one at which the greatest number of hours were worked. Also included as multiple jobholders are persons who had two jobs during the survey week only because they were changing from one job to another. This group was measured in the December 1960 survey and was found to be very small—only 2 percent of all multiple jobholders.

Persons employed only in private households (as a maid, laundress, gardener, babysitter, etc.) who worked for two employers or more during the survey week were not counted as multiple jobholders. Working for several employers was considered an inherent characteristic of private household work rather than an indication of multiple jobholding. Also excluded were self-employed persons with additional farms or business, and persons with second jobs as unpaid family workers.

Chart 1. Multiple Jobholding Rates for Men
25 to 54 Years Old, May 1966



Financial pressure, however, is not the only reason why workers moonlight. There are several other considerations. Some workers with a regular wage or salary job want to continue or try their hand at working for themselves on a part-time basis while still maintaining their basic source of income. One-third of the multiple jobholders are self-employed on their second job. They moonlight at their own business or devote a few hours to providing some professional service in their spare time without committing large resources or all their time to the venture. Moreover, the fact that half of this self-employed group operates a farm as their second job suggests that some of these dual jobholders have chosen not to abandon the farm way of life even though economic reasons force

them to work at a full-time wage or salary job. Others may have moved to the country and taken advantage of the opportunity to do a little farming on the side.

Some persons moonlight because they are interested in another line of work. They experiment with a second job, but still maintain their primary job until they determine whether they like the work on their new job and decide whether it is feasible to make a change to this new line of work. Still others moonlight because there is a shortage of their particular skill (for example, teachers and skilled craftsmen) and they find it very easy to make extra money.

The basic characteristics of moonlighters have remained about the same in the course of several BLS surveys. The majority are men. Their multiple jobholding rate is about three times that for women workers. (See table 1.) A smaller proportion of Negro than white workers were multiple jobholders.²

The incidence of holding two jobs or more was highest among men 25 to 44 years old. This age group accounted for 43 percent of all employed men, but over half of all men holding more than one job. Moonlighting was least likely among the very young (14 to 19 years old), most of whom are attending school, and among workers 65 years old and over. Married men were twice as likely to be moonlighters as single men.

In sum, the data suggest that the typical moonlighter is a highly motivated and energetic young married man with a growing family, who works at two jobs or more primarily to provide additional income for his family but also for a variety of other reasons; to try his hand at working for himself; to keep busy; to obtain satisfaction; to experiment with another line of work; or to supply his skills that are in demand in his community. The moonlighter aspires to a better living and is willing to work hard to obtain his goal.

WORK-HOURS ON BOTH JOBS

Although the rate of multiple jobholding has remained substantially the same in recent years, the question still arises as to whether a shortened workweek would lead to higher moonlighting rates among workers who are affected by the cutback in hours. There is no question that when hours are shortened the opportunity to hold an extra job increase. However, an individual's decision on how to use his free time—to moonlight or do something else—involves many factors other than the number of hours worked.

One way of examining the relationship between moonlighting and the length of the workweek is to compare the dual jobholding rates of men working shorter hours with those on a longer workweek. The data show that in nonfarm industries persons who worked 35 to 40 hours on their main job were no more likely to be multiple jobholders than those who had worked 41 to 48 hours.

TABLE 1.—EMPLOYED PERSONS WITH 2 JOBS OR MORE, BY SEX, 1965-66

Month and year	Number (thousands)	Persons with two jobs or more		
		Multiple jobholding rate ¹		
		Both sexes	Men	Women
May 1966	3,636	4.9	6.4	2.2
May 1965	3,756	5.2	6.7	2.3
May 1964	3,726	5.2	6.9	2.1
May 1963	3,921	5.7	7.4	2.4
May 1962	3,342	4.9	6.4	2.0
December 1960 ²	3,012	4.6	5.9	2.0
December 1959	2,966	4.5	5.8	2.0
July 1958	3,099	4.8	6.0	2.2
July 1957	3,570	5.3	6.6	2.5
July 1956	3,653	5.5	6.9	2.5

¹ Multiple jobholders as percent of all employed persons.

² Data for Alaska and Hawaii included beginning 1960.

² Data for nonwhites will be reported as data for Negroes, who constitute about 92 percent of all nonwhites in the United States.

Hours worked on primary job	Multiple jobholding rates for men, May 1966		
	All industries	Agriculture	Nonfarm
Total.....	6.5	8.7	6.3
1 to 21 hours.....	7.3	9.0	7.0
22 to 34 hours.....	10.3	14.1	9.6
35 to 40 hours.....	6.8	9.7	6.7
41 to 48 hours.....	6.7	14.6	6.4
49 hours or more.....	4.5	5.8	4.3

This suggests that reducing the workweek by only a few hours would not in and of itself substantially affect the incidence of multiple jobholding provided there was no cutback in earnings. No significant inverse relationship exists between moonlighting and the length of the workweek. This finding accords with the conclusions of a recent study of rubber workers in Akron, Ohio.³ It seems reasonable, therefore, to assume that among full-time workers, factors other than the length of the workweek determine whether a man looks for a second job.

Men working part time (22 to 34 hours) were more likely to be moonlighters than men with a full-time job (but since most men work full time, the majority of multiple jobholders are full-time workers). The rate was lowest for men working over 48 hours a week on their main job. Dual jobholding rates for men who worked less than 22 hours weekly were relatively low, reflecting the fact that men working so few hours a week are mainly students or older men unlikely to be interested in a second job.

Typically, multiple jobholders worked full time on their principal job and part time on their extra job; about one-fourth worked part time on both jobs; and 8 percent worked full time on both. On the average, they worked a total of 52 hours, only 13 of which were on their second job. The 39 hours on the primary job paralleled the 39 hours that single jobholders worked on their only job. Of all multiple jobholders, those who were farmers or factory workers on their primary jobs worked the longest total workweeks—59 and 57 hours, respectively. Men worked much longer hours than women on their extra jobs, 14 compared with 9 hours. Men who had additional wage or salary jobs worked longer at these jobs than those who were self-employed on their extra jobs, 15 hours and 12 hours, respectively.

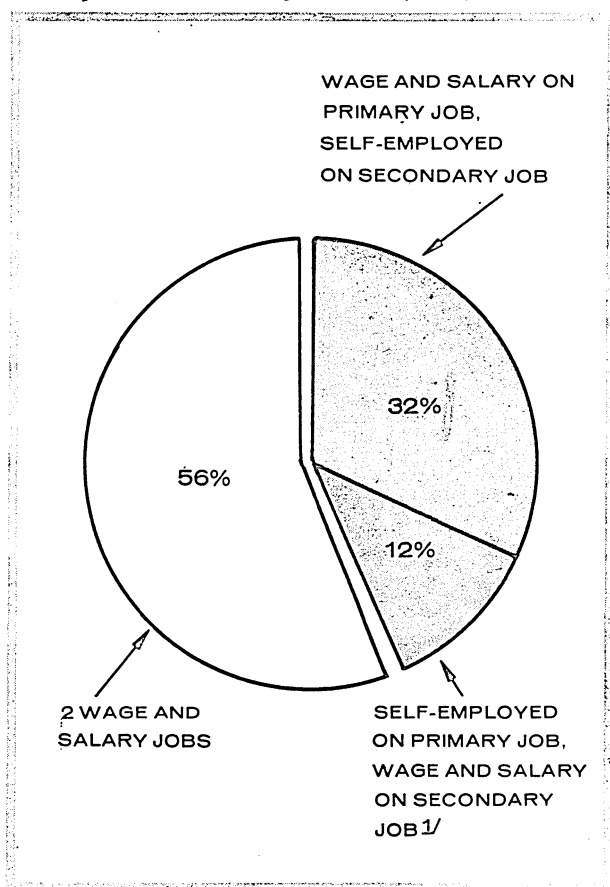
MOONLIGHT INDUSTRIES

One of the most significant aspects of moonlighting is the high incidence of self-employment. About 1.5 million or more than 2 out of 5 multiple jobholders operated their own farms or businesses or were self-employed professionals on the first or second job (chart 2). About half of them were farmers, typically holding down a regular blue-collar job and running their farms in their spare time (table 2). Workers who operated farms as their normal line of work were nearly twice as likely to have a second job as the average worker. About 25 percent of the 200,000 moonlighting farmers had second jobs as a hired hand on someone else's farm; 40 percent worked on construction or transportation jobs or in factories.

On the other hand, the multiple jobholding rate for nonfarm self-employed workers was low. This reflected both their relatively high earnings and the fact that businessmen and self-employed professional people often do not have the time for a second job. The majority of the dual jobholders had two wage or salary jobs. Of salaried employees, public administration workers were more likely to moonlight than workers in any other major nonfarm industry. The dual jobholding rate is particularly high for postal workers (1 out of 10), a proportion which has remained consistently high over the years (table 3). Other nonfarm wage or salary workers with higher than average multiple jobholding rates included those working in educational services, entertainment and recreation, transportation, construction and forestry, fisheries, and mining.

³ John Dieter found no statistically significant difference in multiple jobholding rates for Akron workers on a 36-hour workweek and those on a 40-hour workweek. He concluded that the high incidence of moonlighting in Akron for many years may reflect an established custom of these workers, and that other factors (primary job income, number of children in the family and employment of the spouse) offered better explanations of moonlighting. See "Moonlighting and the Short Workweek," *The Southwestern Social Science Quarterly*, December 1966, pp. 309-315.

Chart 2. Class of Worker of Primary and Secondary Jobs for Multiple Jobholders, May 1966



¹ Includes a small proportion of multiple jobholders who were unpaid family workers on their primary jobs.

One-third of all the secondary jobs were in either farm or nonfarm self-employment. Another 43 percent of the moonlighters had paid jobs in the trade or service industries, which can use many part-time workers. Usually, moonlighters did not work in the same industry on their second job as they did on their primary job. Except for service and trade workers, only a small proportion had two jobs in the same industry.

There was a sharp difference in the kinds of second jobs held by white and Negro dual jobholders. About one-third of the white moonlighters were self-employed on the second job, and one-fourth worked in service industries. Among Negroes, however, fewer than 20 percent were self-employed and nearly half worked in service industries.

OCCUPATIONS OF MOONLIGHTERS

Multiple jobholding rates vary with the worker's main occupation. As in prior surveys, moonlighting rates in May 1966 were highest among men who were teachers—1 out of 5 had a second job (table 4). Some elementary and high school teachers may moonlight because they have an opportunity to take evening

TABLE 2.—TYPE OF INDUSTRY AND CLASS OF WORKER OF PRIMARY AND SECONDARY JOBS, FOR PERSONS WITH 2 JOBS OR MORE, MAY 1966

[Numbers in thousands]

Type of industry and class of worker of primary job	Total employed	Persons with 2 jobs or more		Type of industry and class of worker of secondary job					
		Number	Percent of total employed	Agriculture			Nonagricultural industries		
				Total	Wage and salary workers	Self-employed workers	Total	Wage and salary workers	Self-employed workers
Total.....	73,764	3,636	4.9	721	139	582	2,915	2,335	580
Agriculture.....	4,292	335	7.8	120	83	37	215	212	3
Wage and salary workers.....	1,326	88	6.6	56	19	37	32	29	3
Self-employed workers.....	2,253	200	8.9	49	49	(1)	151	151	(1)
Unpaid family workers.....	713	47	6.6	15	15	(2)	32	32	(2)
Nonagricultural industries.....	69,472	3,301	4.8	601	56	545	2,700	2,123	577
Wage and salary workers.....	62,529	3,110	5.0	599	54	545	2,511	1,934	577
Self-employed workers.....	6,371	177	2.8	2	2	(1)	175	175	(1)
Unpaid family workers.....	571	14	2.5			(2)	14	14	(2)

¹ Self-employed persons with a secondary business or farm, but no wage or salary job, were not counted as multiple jobholders.

² Persons whose primary job was as an unpaid family worker were counted as multiple jobholders only if they also held a wage or salary job.

Note: Because of rounding, sums of individual items may not equal totals.

TABLE 3.—INDUSTRY GROUP AND CLASS OF WORKER OF PERSONS WITH 1 JOB AND WITH 2 JOBS OR MORE, MAY 1966

Industry group and class of worker	Percent distribution			Multiple jobholding rate ¹
	Persons with 1 job	Persons with 2 jobs or more		
		Primary job	Secondary job	
All industries.....	100.0	100.0	100.0	4.6
Agriculture.....	5.6	9.2	19.8	7.8
Wage and salary workers.....	1.8	2.4	3.8	6.6
Self-employed workers.....	2.9	5.5	16.0	8.9
Unpaid family workers.....	.9	1.3	(2)	6.6
Nonagricultural industries.....	94.4	90.8	80.2	4.8
Wage and salary workers.....	84.7	85.5	64.2	5.0
Forestry, fisheries, and mining.....	.8	1.0	.4	6.0
Construction.....	5.2	6.5	4.2	6.1
Manufacturing.....	27.0	23.8	6.2	4.4
Durable goods.....	15.7	15.4	3.0	4.9
Nondurable goods.....	11.3	8.4	3.2	3.7
Transportation and public utilities.....	6.0	7.3	5.3	5.9
Wholesale and retail trade.....	15.5	11.9	16.8	3.8
Wholesale.....	3.1	2.8	1.2	4.5
Retail.....	12.4	9.1	15.6	3.7
Eating and drinking places.....	2.6	1.4	3.9	2.8
Other retail trade.....	9.8	7.7	11.8	3.9
Service and finance.....	25.3	25.4	26.6	4.9
Finance, insurance, and real estate.....	4.0	3.9	4.2	4.8
Business and repair services.....	2.1	2.4	2.8	5.6
Private households.....	3.6	.7	3.2	1.0
Personal services, except private households.....	2.2	1.7	2.2	3.9
Entertainment and recreation.....	.9	1.1	3.3	6.2
Educational services.....	6.3	9.6	4.8	7.3
Professional services, except education.....	6.1	5.9	6.2	4.7
Public administration.....	4.9	9.5	4.7	9.2
Postal services.....	.8	1.7	.9	10.1
Other public administration.....	4.1	7.9	3.8	9.0
Self-employed workers.....	8.8	4.9	16.0	2.8
Unpaid family workers.....	.8	.4	(2)	2.5

¹ Persons with 2 jobs or more as percent of all employed persons in industry of primary job.

² Persons whose only extra job was as an unpaid family worker were not counted as dual jobholders.

jobs at school in some professional activity, but other evidence suggests that the most likely explanation is their comparatively low earnings of teachers.⁴ The dual jobholding rate for other male professional and technical workers is high, but less than half that of teachers.

A very high proportion of men employed in protective services (policemen, firemen, and guards) had an extra job in May 1966—1 out of every 6. Their flexible work schedules make moonlighting possible and their relatively low earnings often make it necessary. Other service workers (including barbers, cosmetologists, janitors, attendants, and other workers) also had higher than average moonlighting rates. Men who were managers, officials and proprietors—an occupation group which typically works long hours and whose earnings are generally above average—were least likely to be multiple jobholders. Nonfarm laborers and retail sales workers were also unlikely to be multiple jobholders. Moonlighting rates were generally higher for white than Negro men, particularly among blue-collar and service workers.

TABLE 4.—OCCUPATIONAL DISTRIBUTION OF PERSONS WITH 2 JOBS OR MORE, AND RATE OF MULTIPLE JOB-HOLDING, BY OCCUPATION AND SEX, MAY 1966

Occupation group	Persons with 2 jobs or more—			
	Percent distribution		Multiple jobholding rate ¹	
	Primary job	Secondary job	Men	Women
All occupations.....	100.0	100.0	6.4	2.2
Professional, technical, and kindred workers.....	17.8	15.1	8.9	3.5
Medical and other health workers.....	1.8	1.6	8.3	2.1
Teachers, except college.....	5.2	1.8	19.7	3.8
Other professional, technical, and kindred workers.....	10.8	11.6	7.4	4.1
Farmers and farm managers.....	5.5	16.1	9.5	2.2
Managers, officials, and proprietors, except farm.....	7.8	10.6	4.2	2.1
Clerical and kindred workers.....	10.4	7.4	6.5	2.1
Salesworkers.....	5.2	8.2	5.4	1.7
Retail trade.....	2.1	4.9	4.4	1.3
Other salesworkers.....	3.1	3.3	6.1	3.8
Craftsmen, foremen, and kindred workers.....	15.8	9.8	6.0	4.7
Operatives and kindred workers.....	17.0	11.4	6.0	.9
Private household workers.....	7	2.2	(?)	1.1
Service workers, except private household.....	11.7	11.4	9.6	2.7
Protective service workers.....	3.8	1.3	16.8	(?)
Waiters, cooks, and bartenders.....	2.3	3.7	6.4	3.3
Other service workers.....	5.7	6.3	7.5	2.4
Farm laborers and foremen.....	3.2	3.0	6.7	6.2
Laborers, except farm and mine.....	4.9	4.7	4.8	3.1

¹ Persons with 2 jobs or more as percent of all employed persons in occupation of primary job.

² Percent not shown where base is less than 100,000.

A large proportion of the moonlighters (42 percent) earned their supplementary income as professional and technical workers or managers, or by operating their own farm or nonfarm businesses. Much smaller proportions of the moonlighters were craftsmen or operatives on their second than on their first job. One of the principal differences in the types of jobs held by white compared with Negro moonlighters is that a much larger proportion of Negroes work in lower paying service occupations, including private household service, while a much smaller proportion of Negro moonlighters hold white-collar jobs on either their main or their extra jobs.

The majority of second jobs were in occupations different from the moonlighter's main line of work, but usually within the same major occupation group as their first job. Half the professional and technical workers had a second job in the same occupation group, and half the farm laborers were farm workers on their second job. About one-third of the clerical and the service workers, and one-fourth of the managers and the craftsmen, had second jobs in the same broad occupation groups. On the other hand, the manual skills of farmers and blue-collar workers made a common moonlighting combination. Half the self-employed

⁴ Harold W. Guthrie suggests that the teaching profession is an economically deprived one and men teachers, particularly those who are married with a nonworking wife, must moonlight to maintain a standard of living commensurate with their professional status. See "Who Moonlights and Why?" *Illinois Business Review*, March 1965, p. 8.

farmers had a second job in a blue-collar occupation and about one-fourth of the craftsmen, operatives, and laborers ran their own farm as a sideline.

Secretary WIRTZ. I think that the larger factor in older people working today is the increasing feeling that they want to continue in a meaningful function in life. As far as their financial positions are concerned, the increase in the social security benefits and in medicare a good deal more than makes up for whatever inflation there has been. Inflation unquestionably hurts the retired person. But, if your question is why more people, older people, are trying to work today, we are proceeding on the assumption which I think is completely sound—that they want to have a meaning and a function, rather than for economic reasons.

Representative WIDNALL. Compulsory retirement at a certain age comes as a real hardship to many people I am sure today. With some, they have to retire at a very early age.

Now, I have seen so many people just foundering after their compulsory retirement, and then looking around and trying to find something that their skills and ability would be adequate for, where they could fill that type of job.

Now, hasn't the number of retired people seeking jobs substantially increased in the last few years?

Secretary WIRTZ. May I ask Mr. Ross on that. I do not have the figures immediately available.

Mr. Ross. Well, Congressman, just answering rather indirectly, there are two points. One is the number of unemployed persons over 65 is quite low compared to what it was a few years ago. Secondly, the percentage of older people in the labor force has been declining steadily. So that whereas there are certainly a great many people of the type to whom you refer, the overall statistics indicate that the trend has been generally downward.

Secretary WIRTZ. I would like to subscribe to the general point, Mr. Widnall, which your question implies.

There is no question in my mind but that we, meaning we the people, we the administration, we the economists, have done the poorest job of providing work and service opportunity for older people, of any job that we have turned to in this area. Putting it differently, I count it the least developed area of policy for the country, the economy and the administration.

Representative WIDNALL. I think it is a pretty sad state of affairs when people who are physically qualified, mentally qualified, are forced into retirement today as they are in many instances.

Secretary WIRTZ. Mr. Widnall, I suggest—

Representative WIDNALL. Let me speak about one in Government. There is compulsory retirement of a postmaster at age 70. But if that postmaster is retired at age 70, a new one can be hired at age 70, who can continue on for a number of years.

Secretary WIRTZ. I did not know that.

Representative WIDNALL. It is absolutely ridiculous.

And you have the same situation obtaining in many other areas. I noticed so much that people who are in retirement then go and get jobs as guards in the bank, guards around factory plants, something like that. Also many union men who work a short week, 30, 35, 38 hours, to 40 hours, they get a second job. And they will get a nonunion job for the second job. They want the combination income.

We should have statistics on to what extent this is present today.

Secretary WIRTZ. A shortened workweek does not necessarily lead to higher moonlighting rates among workers who are affected by the cutback. When hours of work are shortened a worker may have the spare time to take a second job, but he has many factors to consider before he decides to look for a second job.

We have compared the relationship between length of the workweek and moonlighting by examining dual jobholding rates of men working long hours with those working short hours. In May 1966 about the same proportion of men working 35 to 40 hours (6.8 percent) as those working 41 to 48 hours (6.7 percent) were moonlighters.

Representative WIDNALL. I would like to make an observation too, about the restaurant field, for instance. I notice this in Washington—where it is quite obvious we have a rapidly shifting group of people acting as waiters in the restaurants, and most all of them have a foreign background. We are still supposed to have so much unemployment in the city. It would certainly seem to me many, many people could be trained in this particular area, to enter the work force in that area. And I just do not understand how all these people keep coming in to fill this type of job, constantly shifting—in the major restaurants here in the city.

Do you know anything about this?

Secretary WIRTZ. Yes, sir. The principal reason is that the rates are so low, that a great many people pass up that kind of work opportunity.

Representative WIDNALL. I would certainly say as far as a waiter is concerned, most of them are getting darned good salaries—total wage.

Secretary WIRTZ. The Wall Street Journal this morning carries a report that we are running out of waiters with a foreign manner, which cuts a little across what you are talking about here. But I think that there is no question about the phenomenon to which you refer. I think the largest element in it is that a great many of those jobs are paid at rates which people are passing up, whether rightly or wrongly.

Representative WIDNALL. May I pinpoint it a little bit more.

At a time when you are concerned with what is going on in the cities, very deeply involved in that, practically every new waiter I see is white in the Washington restaurants, and not Negro. Now, why is that?

Secretary WIRTZ. I do not know. I will try to get some figures on that. The problem that has concerned me more is if you go into a particular hotel or particular restaurant, they are almost always all white or all black. That has bothered me.

But I will try to get some figures, which I do not have, on the racial characteristics of people, waiters in Washington—if there is an increase in the number of white waiters, that would surprise me some.

Let me simply find out about it, because I do not know.

Our training programs in the culinary trades in Washington are highly Negro. But I will try to find out more about that.

Representative WIDNALL. I am not complaining about the service in these places. What I am trying to understand is why when we have such an emphasis on Negro unemployment today—there is supposed

to be very much higher Negro than white unemployment—why does this situation seem to prevail? I will appreciate any figures you give us.

Secretary WIRTZ. Very well, sir.

The most recent data available are from the 1960 decennial census. According to the census, there were 824,000 waiters and waitresses employed in the United States, of whom 8 percent (66,000) were Negro. In the District of Columbia in 1960, there were 7,570 waiters and waitresses, of whom 59.6 percent (4,510) were nonwhite. There are no more current or more detailed area data available.

Representative WIDNALL. Thank you.

Chairman PROXMIRE. Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Secretary, in your statement you refer to the uncounted number of additional people who ought to be working but who are not looking for work.

Granted that you have not counted them, would you be able to estimate the size of that group?

Secretary WIRTZ. It is pretty hard, Mr. Moorhead.

The thing we are talking about is suggested—if you look at table 1 in this information that has come out today—we put in here for the first time, so far as I have seen it, the current labor force participation rate in large metropolitan areas.

The participation rate subtracted from 100 gives the proportion of the population not in the labor force (that is, neither working nor seeking work). It is hard to estimate how many of these persons not in the labor force want to and should be working. I am going to give you, though, the rule that I have been working on in my own mind, and then ask Mr. Ross if he can give us a better one.

I am assuming that there is in the society today a group which ought to be working and which is not working, which is roughly the same size as the group that we are talking about as unemployed. So I think there is about that much additional potential.

Would you like to have Mr. Ross comment?

Representative MOORHEAD. Yes.

Mr. Ross. Well, as the Secretary says, Mr. Moorhead, it is very difficult to know how many ought to be working. We know how many people are not working, we know how many of them say they would like to work—but who are not even looking.

A lot of them say they would like to work. "Why are you not looking, if you want a job?" We do have statistics which I would like to supply—I do not have them with me—the number who say they need some help with their health, the number who say they just do not have the basic training, the number who say that they have a transportation problem, they are too far from work, the number who say that they used to look but got discouraged and just gave up the search.

In the case of women, a great many say, "Well, I have young children, but I would like to work, even so." This is true, I think, of a great number of women on relief. "I have young children, but I would need child care, and I would need some training."

Now, the problem is—we know how many people are not working. To make a judgment how many of them ought to be working is more

difficult. As you know, in the case of mothers, you can argue that either way.

But we do have a good deal of information. I think it is getting better all the time. I would like to supply it for the record.

Representative MOORHEAD. Mr. Chairman, I think that would be very valuable.

Chairman PROXMIRE. Yes, indeed. Without objection, we will receive that information for the record.

(The information to be furnished for the record follows:)

On the basis of a special survey conducted in September 1966, it was found that about 10 percent of the persons not in the current labor force—some 5.3 million—wanted a regular job at the time of interview. Of these, however, 22 percent gave only a qualified affirmative answer ("maybe—it depends"), another 24 percent were negative or uncertain about their intentions to look for work in the next 12 months, and 6 percent did not reply to this question. Thus, about half of those who said they wanted jobs either qualified their responses or were indecisive about whether they would look for work in the next year. The reasons become clear when we examine why they were not looking for work. (See table 1.)

TABLE 1.—PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY REASON OF NOT LOOKING FOR WORK, SEPTEMBER 1966

[Numbers in thousands]

Reason	Both sexes		Men		Women	
	Number	Percent distribution	Number	Percent distribution	Number	Percent distribution
Total.....	5,292	100.0	1,641	100.0	3,651	100.0
Ill health, physical disability.....	1,078	20.4	480	29.3	598	16.4
In school.....	1,242	23.5	706	43.0	536	14.7
Family responsibilities.....	1,080	20.4			1,080	29.6
Inability to arrange child care.....	435	8.2			435	11.9
Miscellaneous personal reasons ¹	434	8.2	144	8.8	290	7.9
Expects to be working or seeking work shortly.....	270	5.1	44	2.7	226	6.2
Believes it would be impossible to find work ²	754	14.2	266	16.2	488	13.4

¹ Includes old age or retirement, moving, entering or leaving Armed Forces, death in family, planning to go back to school, no need to work at present time.

² Includes employers think too old (or too young); couldn't find or did not believe any job (or any suitable job) was available, lacks skill, experience, education, or training, no transportation, racial discrimination, language difficulties, pay too low.

The full report on the September 1966 data entitled "Reasons for Nonparticipation in the Labor Force" is attached. Detailed information on persons not in the current labor force will be released regularly during 1968.

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From the July 1967 Issue

SPECIAL LABOR FORCE REPORT NO. 86

**REASONS FOR NONPARTICIPATION
IN THE LABOR FORCE**

**UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS**

(555)

Reasons for Nonparticipation in the Labor Force

A Special Labor Force
Report on a Test
of Concepts and Methods

ROBERT L. STEIN*

NONPARTICIPATION in the labor force has become a major concern for manpower research and analysis. Among the important questions that need to be answered are the size and composition of the labor reserve—the groups of persons not seeking work at present, but who do move into and out of the labor force, either in response to seasonal changes or on a more irregular basis; the dimensions of the discouragement problem—its causes and the remedial steps that might help discouraged workers find their place in the job market; the number and characteristics of people who need or want work and would be able to take jobs if something were done to help them (health programs, child care, training, etc.). It is also essential to develop a method for measuring changes in these various groups over time.

The challenge to the researcher in this area is to develop objective methods for measuring what are mainly subjective phenomena. While most of our labor force concepts are based on objective, overt actions (e.g., working, having a job, seeking work in a specific way and within a specified time span) the data on reasons for nonparticipation are subjective, based on—desire for work, attitudes, perceptions, and opinions. These more elusive data require careful probing and cross-checking, to explore the depth of a reported attitude or the reality of a reported reason.

Research on nonparticipation is moving forward on several fronts: Analysis of data already collected has been published,¹ in February 1967, a very intensive questionnaire was directed to men 20 to 64 years of age, and a number of methodological studies have been designed to improve measurement techniques. This article summarizes

the results of one particular attempt to measure the reasons for nonparticipation, a test survey conducted in September 1966 with a representative nationwide sample of 13,000 households. The results should be regarded as first approximations in a continuing program of experimentation and testing; however, it is believed that the test survey also provided some important substantive findings.

Approach of the Survey

The specific purpose of the September 1966 test survey, conducted with 13,000 households in the Monthly Labor Survey sample, was to try out a series of relatively simple questions which could be used on a regular basis in the household survey to measure some aspects of nonparticipation. The definitions of *employed*, *unemployed*, and *not in the labor force* were those adopted for official use in January 1967. The sampling errors were about twice the magnitude of those for the regular Current Population Survey using the 52,500-household sample of 1967.² The very small numbers appearing in the tables depict the results of the September 1966 test survey. Considerably more data must be compiled to assess the significance and reliability of these findings.

The first question—"Does . . . want a regular full-time or part-time job now?"—was designed to sort out those who had some "propensity" to enter or reenter the labor force. The question was not

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¹ "Adult Men Not in the Labor Force," *Monthly Labor Review*, March 1967, pp. 5-15.

² See the Technical Note in *Employment and Earnings and Monthly Report on the Labor Force*, February 1967, for a discussion of the labor force definitions and the sampling errors applicable to the CPS estimates.

designed to be used alone, since affirmative answers could not be interpreted without further clarification. It was supposed to identify a subgroup of potential labor force members for further questioning. Consequently, those who reported wanting to work (either "yes" or "maybe—it depends") were asked a second question; "What are the reasons . . . is not looking for work?" A list of reasons was provided on the questionnaire, as follows: Believes no work available in line of work or area; Couldn't find any job; Lacks necessary schooling, training, skills, or experience; Employers think too young or too old; Other personal handicap in finding a job; Can't arrange for child care; Family responsibilities; In school or other training; Ill health, physical disability; and other.

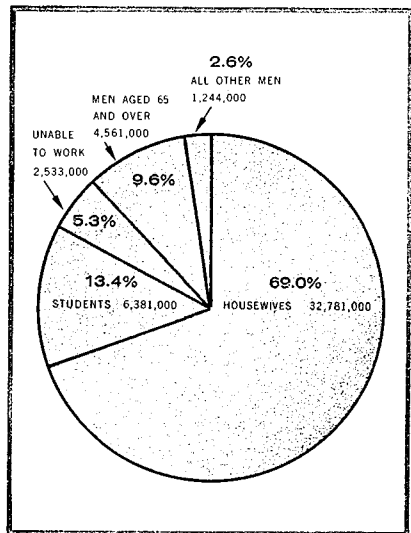
To avoid leading the respondent, the enumerator was instructed *not* to read the list, but to mark each reason mentioned. The question on reasons was an attempt to determine whether those who wanted work were also able to work and available for work. In addition, for about 55 percent of those who wanted or might want a job, the enumerator entered the respondent's verbatim comments to clarify the answers.

It was recognized that this list of possible reasons was not sufficiently detailed to yield information useful for program planning, and that some of the categories were overlapping and not mutually exclusive. However, the approach did represent a systematic effort to obtain an objective and comprehensive measure of unutilized potential manpower resources, within the limitations of a brief and highly structured interview situation. The main reason persons were not seeking work was determined on the basis of the respondent's report of the reasons, the person's major activity during the survey week, and the enumerator's comments.

A third question was asked of all persons not in the labor force, to get an additional indication of their propensity to work or seek work: "Does . . . intend to look for work of any kind in the next 12 months?"

For about half the sample, persons were reporting for themselves; for the other half, the information was based on the statements of someone else in a household. In part, therefore, the resulting statistics reflect another person's perception of the individual's attitudes toward work and work-seeking.

Composition of the Voluntary Nonparticipants,
September 1966



Voluntary Nonparticipants

Altogether, 90 percent of those not in the labor force in September 1966 did not want a regular full-time or part-time job—47.5 million of the 52.8 million persons 16 years of age and over who were not employed or seeking work. They could not be considered as currently available manpower resources, since their nonparticipation was voluntary. At that time, at least, they expressed no desire for regular work. This does not necessarily mean that they had no financial hardships, or that they might not benefit from paid employment if it were made available to them. The term "voluntary" in this context simply means that such a respondent, taking into account his total situation—health, age, and other responsibilities, could not say that he wanted a regular job at the time of the survey. Undoubtedly some of these nonparticipants would be willing and able to work if certain circumstances could be changed.

Information was obtained on the age and sex of the persons who did not want to work, on their

TABLE 1. PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY REASON FOR NOT LOOKING FOR WORK, SEPTEMBER 1966

[Numbers in thousands]

Reason	Both sexes		Men		Women	
	Number	Percent distribution	Number	Percent distribution	Number	Percent distribution
Total.....	5,222	100.0	1,641	100.0	3,651	100.0
Ill health, physical disability.....	1,078	20.4	450	29.3	628	16.4
In school.....	1,242	23.8	706	43.0	536	14.7
Family responsibilities.....	1,060	20.4	.....	.....	1,060	29.6
Inability to arrange child care.....	435	8.2	.....	.....	435	11.9
Miscellaneous personal reasons ¹	434	8.2	144	8.8	290	7.9
Expects to be working or seeking work shortly.....	270	5.1	44	2.7	226	6.2
Believes it would be impossible to find work ²	754	14.2	256	16.2	498	13.4

¹ Includes old age or retirement, moving, entering or leaving Armed Forces, death in family, planning to go back to school, no need to work at present time.

² Includes employers think too old (or too young); couldn't find or did not

believe any job (or any suitable job) was available, lacks skill, experience, education, or training, no transportation, racial discrimination, language difficulties, pay too low.

major activity during the survey week, and on their intentions to look for work of any kind in the next 12 months. The composition of this group of 47.5 million voluntary nonparticipants is shown in the accompanying chart.

Only 2.6 percent were men between the ages of 16 and 64 who were out of school, and presumably able to work, but who did not want work at the time of interview. Half this group were past age 55, and thus undoubtedly include a sizable number of early retirees.

Evidence drawn from the National Health Interview Survey suggests that health limitations may be an important factor among men below age 65 who say they do not want to work and do not intend to look for work, even though they are not reported as totally unable to work.³ More precise information on this point will become available with the results of the special supplementary study conducted in February 1967 of men 20-64 years of age not in the labor force. That supplement will also shed light on the major reasons for nonparticipation among other men of working age who were not in ill health or disabled, but who nevertheless responded that they currently did not want to work.

Involuntary Nonparticipants

Ten percent of those not in the current labor force were reported as wanting a regular full-time or part-time job at the time of interview. Of this 5.3 million, however, 22 percent gave only a qualified affirmative answer ("maybe—it depends"), another 24 percent were negative or uncertain about their intentions to look for work in the next

12 months, and 6 percent did not reply to this question. Thus, about half of those who said they wanted jobs either qualified their responses or were indecisive about whether they would look for work in the next year. The reasons become clear when we examine why they were not looking for work. (See table 1.)

TABLE 2. PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY REASON FOR NOT LOOKING FOR WORK, SEPTEMBER 1966-FEBRUARY 1967

[Numbers in thousands]

Reason	Sept. 1966	Nov. 1966	Dec. 1966	Jan. 1967	Feb. 1967
Men, total.....	1,641	1,582	1,567	1,460	1,524
Percent of total not in labor force.....	13.5	12.9	12.6	10.7	12.1
Reason for not looking:					
Ill health or disability.....	480	469	547	335	444
Going to school.....	706	520	512	669	650
Believes it would be impossible to find work.....	266	274	361	208	199
All other reasons.....	188	319	147	348	231
Women, total.....	3,651	4,609	3,775	3,425	3,780
Percent of total not in labor force.....	9.0	11.3	9.4	8.4	9.3
Reason for not looking:					
Ill health or disability.....	598	458	607	505	458
Going to school.....	536	605	631	616	617
Family responsibilities.....	1,060	1,431	1,097	955	1,090
Inability to arrange child care.....	435	581	453	414	473
Believes it would be impossible to find work.....	458	606	842	399	610
All other reasons.....	516	750	845	596	532

Data from the household survey samples for November and December 1966 and January and February 1967 were developed, using the same general methodology and concepts. The figures appear to be relatively stable (table 2) except for a big jump in the number of housewives who wanted work in November—probably temporary jobs for the Christmas season. There also appeared to be

³ "Work Limitations and Chronic Health Problems," *Monthly Labor Review*, January 1967, p. 41.

a dip in the number wanting work in January, when nearly all economic activity tends to be at a seasonal lull. A considerable amount of experience with these data will have to be accumulated, however, before definite seasonal or cyclical patterns can be detected.

The number who believed it would be impossible to find work ranged between 600,000 and 900,000; on the average, women accounted for two-thirds of this group. The number of men in this category fluctuated between 200,000 and 350,000, with about half the total between the ages of 20 and 64.

A conceptual problem arises when a person reports more than one reason for not seeking work. (In September, about 25 percent of those who wanted work reported more than one reason for not looking; in subsequent months, this proportion fell to 20 percent.) For example, a person in school might also report that he was not looking for work because employers thought he was too young. A housewife with young children might also say she doesn't believe there is any work available that she could do. In the classification system used in this report, top priority is given to "ill health or disability," and those not reporting this reason were assumed to be able to work. Going to school, family obligations, and personal reasons follow in that order, under the assumption that persons who gave these reasons were really not currently available for work, and that their participation in programs to help them find work would be limited.

As table 3 shows, about a third of those reporting they believed it would be impossible to find work were not readily available for work. Of the 1.2 million who believed they would be unsuccessful in the job market, about 450,000 were also either in ill health (100,000), in school (230,000), or tied

down with family responsibilities (125,000). Nearly two-thirds were women.

About 450,000 men age 16 and over who were not in the labor force wanted a job, but were not looking for work because they believed it would be impossible to find any. This included 185,000 who were also either in school or in ill health. About half of the remaining 265,000 reported that their reason for not looking for work was that employers thought they were too old.

One-third of these 450,000 men were teenagers (mainly students), one-third were in the central age groups (20-64), and one-third were age 65 and over. (See table 4.) Most of the latter said employers thought they were too old to work.

The reasons for nonparticipation given by persons who said they wanted a job at the time of the survey in September 1966 are discussed in more detail below. The qualitative analysis of reasons is based on verbatim replies recorded by the enumerators.

III Health or Disability

For over a million nonparticipants (500,000 men and 600,000 women), ill health or disability was given as a reason. For these persons, the desire for work tends to be highly conditional. A person may want to work, but his doctor will not permit it, or he may want only very light, sedentary work a few hours a day. Many of the responses indicated that these persons would accept a job involving a very limited amount of physical activity, but were not interested in actively seeking work. The responses also suggested that additional questions would be necessary to distinguish accurately between varying degrees of inability to work. For some persons, return to the labor

TABLE 3. PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BUT BELIEVED NO WORK WAS AVAILABLE, BY COMBINATION OF REASONS FOR NOT SEEKING WORK AND DETAILED REASON FOR BELIEVING WORK NOT AVAILABLE, SEPTEMBER 1966

Reason	[Numbers in thousands]						
	Total	Employers think too young	Employers think too old	Lacks skill, experience, education or training	Could not find, or believe no job available	No transportation	Other handicaps or barriers ¹
Total.....	1,203	39	257	84	619	147	57
Ill health, disability.....	95	.....	28	.....	45	22	.....
In school.....	229	28	.....	.....	167	34	.....
Family responsibilities.....	74	.....	.....	.....	57	17	.....
Inability to arrange for child care.....	51	.....	.....	.....	28	23	.....
No other reason.....	754	11	229	84	322	51	57

¹ Includes racial discrimination, language difficulties, unsatisfactory pay scale for type of work sought.

TABLE 4. MEN NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY COMBINATION OF REASONS FOR NOT LOOKING FOR WORK AND AGE, SEPTEMBER 1966
[Numbers in thousands]

Reason	Age in years							
	Total, 16 and over	16 to 19	20 to 64					65 and over
			Total	20 to 24	25 to 54	55 to 59	60 to 64	
Total.....	1,641	673	664	122	376	61	105	305
Ill health, disability.....	429	11	308	11	198	33	66	110
In school.....	573	468	105	66	39	11	5	45
Miscellaneous personal reasons.....	22	44	22	28	33	11	5	45
Expected to be working or seeking work shortly.....	44	17	27	27	27	17	34	160
Believed it would be impossible to find work.....	450	155	146	17	76	17	34	122
No other reason.....	266	22	123	17	61	11	34	28
Also in ill health.....	51	23	23	17	17	6		
Also going to school.....	133	133						

force depended on recovery from accidents or from operations, on the outcome of scheduled surgery, on the healing of disfiguring conditions, or general improvement in health. With more precise inquiries, it might be possible to identify those with minor disabilities or illnesses, who expected to be in the labor force within a month or two.

About a tenth of this group indicated that they anticipated that finding work would be impossible, mainly because of their health and disability problems.

Persons in School

In one sense, going to school is not a full explanation for not looking for work. Part-time jobs are available to millions of students who do work weekends or evenings. The responses indicate that many students were uncertain about whether or not they really wanted work. They were available only for those jobs that would fit in with their school programs. In September, also, some of them did not yet have a clear idea whether they could handle their school work and a regular job. Some expected to start looking for work in the next week or two. Replies from about a fifth of the students indicated actual or expected difficulties in finding a job.

Family Responsibilities

Of the persons citing family responsibilities (1.1 million) all were women, and 90 percent were between the ages of 20 and 54. (See table 5.) The vast majority were married and had children at home.

The verbatim replies point up the problems women face in reconciling their desire for work

with their family responsibilities. Some husbands will not permit their wives to accept employment. In other cases, responsibilities to their children prevent women from working. This may be true even when the children are grown: Typical examples are the mother who was too busy getting her daughter ready to go overseas, the mother who has a diabetic daughter requiring special care, and the mother who was waiting until her son returned to his Armed Forces station.

A closely related group are those women who specifically mention inability to arrange for child care as their reason for not seeking work. Presumably this latter group of women would be available for work if they could solve the specific problem of finding someone to care for their children during working hours, whereas those who report "family responsibilities" are unlikely to enter the labor force until their children grow older or their family situation changes so that they have more freedom. Admittedly the distinction is conjectural.

TABLE 5. PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE OF FAMILY RESPONSIBILITIES OR INABILITY TO ARRANGE FOR CHILD CARE, SEPTEMBER 1966
[Numbers in thousands]

Age and reason	Family responsibilities	Inability to arrange for child care
Total.....	1,080	435
16 to 19 years.....	51	51
20 to 24 years.....	102	96
25 to 54 years.....	854	282
55 years and over.....	74	6
Total.....	1,080	435
No other comment.....	740	350
Husband won't permit work.....	62	17
Job, pay, hours, location have to be right.....	175	17
Expected to be working or seeking work shortly.....	17	23
No transportation.....	17	28
Couldn't find or believe no job available.....	37	17
All other (moving; going back to school).....	11	

Miscellaneous Reasons

This relatively small group of about 150,000 men and 300,000 women consisted of women who, at the time of interview, did not need (or really did not want) to work; men and women who were retired or semiretired, but said they might take some light part-time work if it came their way; persons who were getting ready to move, were just getting settled after a move, or were uncertain when or whether to move; persons who were taking care of personal business (e.g., after a death in the family); and young persons who were entering or leaving the Armed Forces or getting ready to go back to school. By and large, it could be said of these persons that at the time of the survey in mid-September 1966 they really did not want to work, or that their desire for work was relatively weak.

Expect to Work or Look Soon

Some 270,000 persons expect to be in the labor force shortly. This group was right on the fringe of the labor force, but did not meet the strict definitions (i.e., working or having a job last week, seeking work in the last 4 weeks, having definite instructions to report to a new job in 30 days, or being on layoff from a job with definite expectation of being called back). For example, there were some who had just quit or been discharged from one job, but had not yet started to look for another. A sizable number of women were waiting to be called to a job (and some of them possibly should have been counted as unemployed), but it was not clear when they last looked, when they expected to report, or even if they had definite instructions to report. Still others said that they planned to start looking for work soon—this week, next week, or within a month or two. A small number of persons actually started working at seasonal farm jobs during the interview week (the week following the survey week), but had not been seeking work in the previous 4 weeks and had not known just when the work would become available.

The Discouraged

An estimated three-fourths of a million persons wanting jobs at the time of the survey, were willing and able to work, were available for

TABLE 6. SELECTED CHARACTERISTICS OF PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE THEY BELIEVED IT IMPOSSIBLE TO FIND, BY SEX, SEPTEMBER 1966

[Numbers in thousands]			
Characteristic	Total	Men	Women
REASON			
Total.....	754	266	488
Employers think too young.....	11	.....	11
Employers think too old.....	229	138	91
Lacks necessary schooling, training, skills, or experience	84	22	62
Could not find or believes no job (or no suitable job) available.....	322	84	238
No transportation.....	51	11	40
Language difficulties.....	23	6	17
Pay too low.....	11	.....	11
Other personal handicaps.....	23	6	17
AGE			
Total.....	754	266	488
16 to 19 years.....	56	22	34
16 to 17 years.....	28	22	6
18 and 19 years.....	28	.....	28
20 to 64 years.....	497	123	374
20 to 24 years.....	34	17	17
25 to 34 years.....	343	61	283
35 to 59 years.....	45	11	34
60 to 64 years.....	74	34	40
65 years and over.....	201	122	79
COLOR			
Total.....	754	266	488
White.....	581	211	370
Nonwhite.....	173	55	118
Educational level			
Total.....	754	266	488
Less than 8 years of schooling.....	195	99	96
Elementary school graduate.....	123	60	73
Some high school.....	182	39	143
High school graduate.....	188	50	138
Some college.....	66	28	38

¹ Includes racial discrimination; excludes mental or physical disabilities.

work (in the sense that health, school, or personal or family obligations did not stand in the way), but had not looked for work in the past 4 weeks. The reasons they gave reflected discouragement or disappointment in the job market, or at least a negative attitude toward their own job prospects. (See table 6.) Two-thirds of this group were 20 to 64 years of age—125,000 men and 375,000 women.

For 430,000 of the three-quarters of a million—110,000 men and 320,000 women—training or placement assistance appeared to be a possible help. These individuals reported that they couldn't find a job or believed jobs weren't available, that they lacked education or training, or that language was a problem.

This group of 750,000 was less educated than the total not in the labor force (only a third were high school graduates, compared with about 45 percent of all nonworkers) and also disproportionately nonwhite (23 percent compared with only 10 percent of all nonparticipants).

Supplementary Tables

TABLE A. PERSONS WANTING WORK WHO WERE NOT
LOOKING FOR WORK BECAUSE OF ILL HEALTH OR
PHYSICAL OR MENTAL DISABILITIES

[Numbers in thousands]

Age and reason	Total	Men	Women
Total.....	1,078	450	598
16 to 24 years.....	90	22	68
25 to 44 years.....	338	138	220
45 to 64 years.....	173	77	96
65 to 69 years.....	101	39	62
70 to 74 years.....	111	66	45
75 years and over.....	245	138	107
Total.....	1,078	480	598
No other comment.....	533	221	312
Would take part-time or light work.....	94	66	28
Will work or seek work when health improves.....	279	138	141
Has family responsibilities.....	79	6	73
No transportation.....	22	11	11
Employers think too old.....	28	22	6
Couldn't find or believed no job available.....	45	17	28

TABLE B. PERSONS WANTING WORK WHO WERE NOT
LOOKING FOR WORK BECAUSE THEY WERE IN SCHOOL

[Numbers in thousands]

Age and reason	Total	Men	Women
Total.....	1,242	705	537
16 and 17 years.....	741	396	345
18 and 19 years.....	317	204	113
20 to 24 years.....	94	66	28
25 years and over.....	90	39	51
Total.....	1,242	705	537
No other comment.....	635	359	266
Job would have to fit in with school program.....	217	110	107
No transportation.....	34	6	28
Employers think too young.....	28	17	11
Couldn't find or believed no job available.....	167	110	57
All other (family responsibilities; expect to enter Armed Forces).....	79	51	28

TABLE C. PERSONS WANTING WORK WHO WERE NOT
LOOKING FOR WORK BECAUSE OF MISCELLANEOUS
PERSONAL REASONS

[Numbers in thousands]

Reason	Total	Men	Women
Total.....	434	144	290
No strong need to work.....	107	11	96
Old age or retirement.....	107	45	62
In process of moving.....	57	6	51
Entering or leaving Armed Forces.....	22	22	-----
Death in family or other personal business.....	45	22	23
Planning to go back to school.....	39	11	28
All other.....	57	27	30

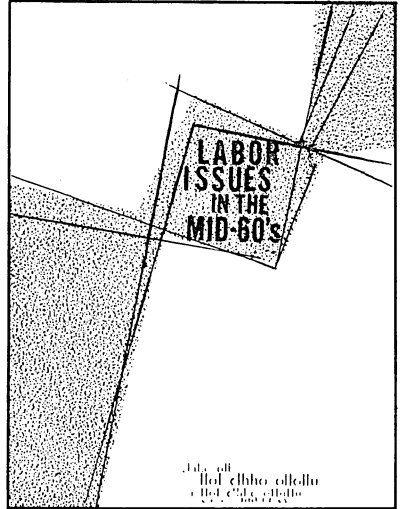
TABLE D. PERSONS WANTING WORK WHO WERE NOT
LOOKING FOR WORK BECAUSE THEY EXPECTED TO BE
WORKING OR SEEKING WORK IN THE NEAR FUTURE

[Numbers in thousands]

Reason	Total	Men	Women
Total.....	270	41	229
Has job lined up or planning to start business in own home.....	107	11	96
Plans to start looking for work shortly.....	85	6	79
Is in between jobs; hasn't started looking for a new one yet.....	28	22	6
Waiting to hear the results of applications or examinations ¹	51	6	45

¹ Includes waiting to enter Job Corps or MDTA.

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Number

- 44 Geographic Mobility and Employment Status, March 1962–March 1963
- 45 Unemployment Among Full-Time and Part-Time Workers
- 46 Out-of-School Youth, February 1963
- 47 Out-of-School Youth, February 1963—Part II
- 48 Work Experience of the Population in 1963
- 49 Labor Force Projections for 1970–80
- 50 Marital and Family Characteristics of Workers in March 1964
- 51 Multiple Jobholders in May 1964
- 52 Labor Force and Employment in 1964
- 53 Educational Attainment of Workers, March 1964
- 54 Employment of High School Graduates and Dropouts in 1964
- 55 Employment of School Age Youth, October 1964
- 56 Labor Force Status of Youth, 1964
- 57 Long Hours and Premium Pay
- 58 Long-Term Unemployment in the 1960's
- 59 Why Women Start and Stop Working: A Study in Mobility
- 60 The Unemployed: Why They Started Looking for Work
- 61 A Portrait of the Unemployed
- 62 Work Experience of the Population in 1964
- 63 Multiple Jobholders in May 1965
- 64 Marital and Family Characteristics of Workers in March 1965
- 65 Educational Attainment of Workers in March 1965
- 66 Employment of High School Graduates and Dropouts in 1965
- 67 An Experimental Study of Repeated Unemployment
- 68 Employment of School Age Youth in October 1965
- 69 Labor Force and Employment in 1965 (Did not appear in the *Review*)
- 70 The Effects of Employment Redistribution on Earnings
- 71 Out-of-School Youth—2 Years Later
- 72 Overtime Hours and Premium Pay
- 73 Labor Force Projections by Color, 1970–80
- 74 Labor Force Projections by State, 1970 and 1980
- 75 Poverty Areas of Our Major Cities
- 76 Work Experience of the Population in 1965
- 77 Job Tenure of Workers in January 1966
- 78 Why the Unemployed Looked for Work
- 79 Adult Men Not in the Labor Force
- 80 Marital and Family Characteristics of Workers, March 1966
- 81 Overtime Hours and Premium Pay
- 82 Low Earners and Their Incomes
- 83 Educational Attainment of Workers, March 1966
- 84 Occupational Mobility of Employed Workers
- 85 Employment of High School Graduates and Dropouts in 1966

Secretary WIRTZ. I think the undercount figure, Mr. Moorhead, in the 1960 census, which bears on this same problem, was almost six million. In percentage terms, the undercount was greatest for Negro males, especially those in the 16-44 age groups.

We will supply those figures specifically. But it is in that range. And that suggests to you how difficult it is, both for us—it suggests both how difficult it is to get at this, and that it is probably a figure of significant size. Because those people just do not show up in any statistics. I think Mr. Ross feels they show up in some of ours better than they do in the census. But there is a large undercount factor there.

I make two points. First, the undercount is hard to compile specifically. Second, it is large.

The Census Bureau estimates an undercount in 1960 census of 5.8 million—2.9 percent of the estimated “true” population figure. The undercount estimate is much larger for the nonwhite population—9.7 percent for males and 7.3 percent for females. The proportion was highest for nonwhite men aged 25 to 34 (18.9 percent). The percentages undercounted were also high for nonwhite men 16-24 and 35-44 years of age—14.9 percent and 13.6 percent, respectively.

The attached table shows the extent of the population and labor force undercount in 1966. The above data are only estimates because it is difficult to get at this problem exactly, but it is clear that the problem of population undercount is large, especially for Negro men.

TABLE 1.—TOTAL POPULATION AND CIVILIAN LABOR FORCE, BY AGE, SEX, AND COLOR, AS PUBLISHED AND AS ADJUSTED FOR ESTIMATED 1960 CENSUS UNDERCOUNT, 1966

[Number in thousands]

Age, sex, and color	Published ¹	Adjusted	Difference ²	
			Number	Percent
WHITE MALE				
Total population, July 1, 1966:				
Total, all ages.....	85,432	87,711	2,279	2.6
Under 16.....	27,642	28,106	464	1.6
16 and over.....	57,790	59,605	1,815	3.0
16 to 24.....	12,578	13,113	535	4.1
25 to 34.....	9,926	10,335	409	4.0
35 to 44.....	10,629	10,942	313	2.9
45 to 64.....	17,305	17,539	234	1.3
65 and over.....	6,908	7,676	324	4.2
Civilian labor force (annual average, 1966):				
16 and over.....	43,572	44,823	1,256	2.8
16 to 24.....	7,454	7,774	320	4.1
25 to 34.....	8,859	9,219	360	3.9
35 to 44.....	9,892	10,187	295	2.9
45 to 64.....	15,439	15,637	198	1.3
65 and over.....	1,928	2,011	83	4.1
WHITE FEMALE				
Total population, July 1, 1966:				
Total, all ages.....	87,820	89,160	1,339	1.5
Under 16.....	26,510	26,782	271	1.0
16 and over.....	61,310	62,378	1,068	1.7
16 to 24.....	12,257	12,564	307	2.4
25 to 34.....	9,941	10,071	130	1.3
35 to 44.....	10,929	10,972	43	.4
45 to 64.....	18,513	18,859	346	1.8
65 and over.....	9,670	9,912	242	2.4
Civilian labor force (annual average, 1966):				
16 and over.....	23,702	24,070	368	1.5
16 to 24.....	5,697	5,842	145	2.5
25 to 34.....	3,732	3,777	45	1.2
35 to 44.....	4,894	4,915	21	.4
45 to 64.....	8,514	8,654	140	1.6
65 and over.....	865	882	17	1.9
NONWHITE MALE				
Total population, July 1, 1966:				
Total, all ages.....	11,468	12,707	1,237	9.7
Under 16.....	4,760	4,947	185	3.7
16 and over.....	6,708	7,760	1,052	13.6
16 to 24.....	1,747	2,054	307	14.9
25 to 34.....	1,273	1,570	297	18.9
35 to 44.....	1,237	1,432	195	13.6
45 to 64.....	1,799	2,040	241	11.8
65 and over.....	652	664	12	1.8
Civilian labor force (annual average 1966):				
16 and over.....	4,901	5,728	827	14.5
16 to 24.....	1,051	1,244	193	15.5
25 to 34.....	1,089	1,342	253	18.9
35 to 44.....	1,090	1,262	172	13.6
45 to 64.....	1,509	1,715	206	12.0
65 and over.....	162	165	3	1.8
NONWHITE FEMALE				
Total population, July 1, 1966:				
Total, all ages.....	12,121	13,071	951	7.3
Under 16.....	4,740	4,888	149	3.0
16 and over.....	7,381	8,183	802	9.8
16 to 24.....	1,766	1,960	194	9.9
25 to 34.....	1,427	1,541	114	7.4
35 to 44.....	1,430	1,526	96	6.3
45 to 64.....	1,975	2,263	288	12.7
65 and over.....	783	893	110	12.3
Civilian labor force (annual average 1966):				
16 and over.....	3,599	3,976	377	9.5
16 to 24.....	764	848	84	9.9
25 to 34.....	777	838	61	7.3
35 to 44.....	863	920	57	6.2
45 to 64.....	1,096	1,257	161	12.8
65 and over.....	99	113	14	12.4

¹ Published totals are the sum of the rounded components shown here and may, therefore, differ somewhat from totals published elsewhere.² Difference is adjusted minus published. Percent difference is based on adjusted.

Representative MOORHEAD. You point out, Mr. Secretary, that some of those people have remediable physical handicaps. Is there any program to bring remedies to them?

Secretary WIRTZ. As far as the formal Government program is concerned, it includes most specifically the vocational rehabilitation program, which is in the Department of Health, Education, and Welfare, and administered through the State agencies. So, it falls further outside my jurisdiction than would permit a clear answer.

As far as our own people are concerned, the formal Department of Labor training program, so far as it goes, includes very few of the physically and mentally handicapped. I have qualified both answers, because as we both know, there is a great deal of private work going on in this interest. A good deal of this centers around the President's Committee on Mental Retardation, and the President's Committee on the Employment of the Handicapped. But a very large part of what is being done, as far as the physically and mentally handicapped are concerned, falls today outside the Government program, and I say this as—well, a confession of inadequacy as far as our training program is concerned.

Representative MOORHEAD. Mr. Secretary, referring to your statement you refer to the 110 recipients of Aid for Dependent Children who are in your work incentive program.

Secretary WIRTZ. 110,000.

Representative MOORHEAD. Thank you—110,000. Do you include those people as people who ought to be working?

Secretary WIRTZ. Yes. That, of course, involves several very complicated controversial questions.

You perhaps noticed a report about a week ago, in which an interview I believe in New York had indicated that 80 percent of those women wanted to work, wanted to take training.

Now, I am not just sure about that. I suppose if anybody is asked whether she wants to take training, the inclination is to answer, "Of course." So I am not sure about that.

We are proceeding on the assumption that in most cases the action of the Congress, last year, will not present a problem, and that we will find a receptivity to training, so it is not going to be a serious problem. But I am not sure what we are going to find on that. That program starts with us on April 1.

Representative MOORHEAD. It would seem clear to me that in some situations it would be much better for the mother to be with her children rather than on a job, or in an on-the-job training program; it would seem to be clear in other situations it would be much better for the mother to have the work incentive, and the pride of a job, income, and so forth.

Secretary WIRTZ. I agree.

Representative MOORHEAD. How do you make this determination in the 110,000 work-incentive enrollees that you will have this year?

Secretary WIRTZ. Two pieces in the answer.

First, in our advanced thinking about it, the identification of that fact is going to be made in every case. And second, that the—

Representative MOORHEAD. Who makes that identification?

Secretary WIRTZ. Through the State employment service officers working with the Manpower Administration. But a very important

point, Mr. Moorhead, is that until we supply large day care centers of one kind or another, we will have to go awfully easy about pressing that point. So, as an affirmative part of the answer, we, and by "we" I mean the Government and the country and particularly HEW, are just going all out right now on the development of child care centers. Without that development—I think we figure the need is only about 20 percent met so far—without the development of child care centers, to press that requirement would be cruel, thoughtless, and a mistake.

Representative MOORHEAD. But as the situation stands now, because of the statistics, you would not be cruel and oppressive; is that right?

Secretary WIRTZ. That is correct.

Representative MOORHEAD. Mr. Secretary, at the conclusion of your statement you invited inquiries on a broader base.

I would like to have you give us a brief statement as to what you see in the next year as far as collective-bargaining agreements are concerned—where we might look for trouble spots, where there would not likely be trouble.

Secretary WIRTZ. Yes, sir. Very quickly, and summarizing what we have set out in fuller form in the document transmitted to the committee last week, the situation is this:

We have known that 1968 was going to be a hard year as far as major contracts are concerned. As part of the answer to your question, about 4 million people are covered by collective-bargaining agreements which will come up for consideration this year. That is a slightly lower figure than last year. So it is not the total number. But, in terms of major disputes, this is a tight year. We enter it with the sobering realization that the copper strike today is now starting its eighth month, and that is a failure of collective bargaining, which there would be no point in minimizing. We balance against that the fact that there have so far this year been three or four quite significant private agreements which encourage us. There have been two agreements, the Railway Clerks, at the end of the last calendar year, and now the Brotherhood of Railroad Trainmen, which give us renewed confidence that the railroad people have found new strengths of private collective bargaining which is very important.

We are encouraged by the fact that the can settlement came and was passed so quickly on a private basis there is hardly any notice given it.

In terms of the problems ahead, there are quite a few of them, but they include most specifically steel, longshore, and aerospace. And I should mention telephones, which is likely to come to a head in perhaps fairly serious form next month. Those are the ones which stand out. But there are a number of others.

It is just best to take a dour view of it right now, I guess. And I do. I have a feeling that we are going to be surprised in finding that there is more strength in private collective bargaining than our recent comments on it have shown.

It is not our business, but this matter of strikes of public employees, State and local, is obviously very much on the country's mind, and should be included in the kind of list to which you refer.

Representative MOORHEAD. Thank you, Mr. Secretary.

My time has expired.

Chairman PROXMIRE. Congressman Rumsfeld?

Representative RUMSFELD. Mr. Secretary, I found your remarks this morning very interesting.

Reviewing your statement, and recalling your remarks in answer to questions, you have said that the United States has seen 7 years of unprecedented economic expansion. You have referred to it as extraordinary.

And I suppose it could be described that way.

But, what disturbs me is that I question whether it can be described that way if it is put in the context of a war economy.

Is it correct that at no place in your statement do you relate what is going on in this country economically to the war, and in no place in your statement do you adjust any of your figures to reflect the impact of the war?

Secretary WIRTZ. There is no—so far as I can think of—no reference to that.

Mr. RUMSFELD. For example, where you mention the national unemployment rate, and say by this measure we have done very well indeed—referring to the fact that the rate—in percent—stood at 6.7 in 1961, went to 5.7 in 1963, 4.5 in 1965, 3.5—3.8 in 1967, and 3.5 in 1968.

The lowest since the Korean conflict.

The Korean conflict represented a war economy, just as the economy today does.

Taking the last five words of your statement, it would seem to me, rather than saying we have done very well indeed, that just the reverse would be true—that if one compared the economy today with the last comparable war economy, we find that this is the benchmark, and that in fact we have a higher rate of unemployment today in a similar economy than we did during the last war economy. And, certainly, the dates that are indicated here reflecting the downturn in the rate of unemployment also reflect precisely the increase in the effort with respect to the war in Vietnam.

Now, not mentioning that seems to me to throw a very interesting statement—had it been put in perspective, a very useful statement—it seems to me it throws it right out as far as usefulness goes.

Secretary WIRTZ. I perhaps mistakenly assumed the reading by all the members of the committee of the report on which these hearings were based, and that matter is covered in detail on pages 89 to 91. I have gotten allergic to statistical comparisons, I feel almost self-conscious when I use them.

But we could perhaps advisedly take the period to which you refer. We ought to consider it on all its points.

For instance, we ought to consider that during that period prices rose—I will correct the specific times and figures for the record—but what I am about to say is very close—prices rose in a 9-month period by, I think, 8 percent. That was the situation then.

Now, we have avoided that this time. I realize this is a different point from the one you are making. And I want to come to the one you are making.

If we were to go back over a historical period—incidentally, we had to go to direct wage and price controls then—we would take

a look at 1958 and 1957, in which unemployment went to nearly 7 percent, and prices went up those years about 5 percent.

Representative RUMSFELD. Mr. Secretary, you say by this measure we have done very well. And, it seems to me, by your own statistics, by the very measure you have selected in the presentation you have made this morning, we have not done very well—once you plug in the fact that the economy is benefiting, if you want to use the word, from some very extraordinary circumstances.

Secretary WIRTZ. I don't think benefiting in any way. I love to think of the things we would have done——

Representative RUMSFELD. Don't we all.

Secretary WIRTZ. There is no question about it. Let us be plain about it. The test of whether you and I have a difference would lie in the answer to the question as to whether I think these figures are going to get worse upon the ending of the war in Vietnam. And I do not think they are. I think it will take us about 60 days to recover stride. There will be some readjustments, and in some particular areas it will take somewhat longer than that.

Representative RUMSFELD. In other words, if you subtract the impact of the Vietnam war from these statistics, you are saying you still feel we have done——

Secretary WIRTZ. Mr. Rumsfeld, if I thought different, I would resign from the human race. If I thought at this stage in the development of our economy, our fiscal, monetary policy, manpower—if I thought at this stage we were dependent for employment on a war, I would quit from the race. And so I feel very strongly.

Representative RUMSFELD. I am not suggesting either one.

Secretary WIRTZ. No. But it is——

Representative RUMSFELD. I don't want to lose a good constituent.

Secretary WIRTZ. It is directly on the point you are raising, because the implication of the question is that everything we have done depends upon the war factor.

Representative RUMSFELD. No; that is not my implication.

Secretary WIRTZ. Then I misunderstood.

Representative RUMSFELD. My questions relate to your statement—the paragraphs which begin “For many years,” in which you say, “we have now arrived at the lowest rate since the Korean conflict.” That means that it is a higher rate compared with the Korean conflict?

Secretary WIRTZ. Let's see.

Representative RUMSFELD. It must.

Secretary WIRTZ. That is correct.

On an annual average basis, the total unemployment rate was 3 percent in 1952, and 2.9 percent in 1953. Those are the lowest rates on record since World War II. On a monthly basis, the lowest rate was 2.5 percent, recorded in both May and June 1953.

Representative RUMSFELD. Maybe I am not asking a question, but rather, making a statement. I am challenging your statement that we have done very well indeed by the use of the very statistics you are using. And, if that is inaccurate, perhaps you can clarify it for me.

Secretary WIRTZ. I do not know whether it is inaccurate. Because of the reaction that there is to it here—I guess if I had to say it again—I would say it is the lowest rate since 1953. I thought by the

implication of the question that there was a suggestion that this accomplishment is a result of the military effort and the war activity. That is not my judgment of it. But, I think, by making the reference date, the Korean conflict, there is that implication. And it is that that makes me say that I think this record does not depend on what you call the plugging in of the military, and would be just as good without it, and will be just as good.

Mr. Ross. Mr. Secretary, the unemployment rate in 1952 averaged 3 percent, and in 1953 it averaged 2.9 percent.

Representative RUMSFELD. So, we are comparing 3.5 today with 3 to 2.9?

Secretary WIRTZ. If you take just those two periods. We would be glad to set out that whole stretch.

In general—there were the two sets of ups and downs in the later 1950's, and then we came into our responsibility on it in a purely political sense at a rate of about—let us see—it went to 6.8 percent in 1958—but I know you did not have the political implications in mind.

Let me just take the key dates, and the record for the last 18 years is that in the early 1950's it went down to 2.9 or 3 percent. It then went up and down during the 1950's, went to a high of nearly 7 percent in 1958, went down again, but went up to nearly 7 percent again in 1961—the average for the year was 6.7. It went down nearly steadily until 2 years ago and for the last 2 years it has leveled out. I do not believe that the war factors have been a serious factor.

Representative RUMSFELD. Well, I am very interested to hear that, because that has not been my impression. And if I had to speculate, I would think that the curve for the next 5 to 10 years, assuming there is a termination of the conflict in Vietnam, would more closely follow the previous curves than what you are suggesting.

Secretary WIRTZ. I think the significant thing, Mr. Rumsfeld—and there is nothing partisan about this—I think the significant thing is that the country, the Congress and the administration have learned in the last—and I make it 10 years, or whatever period—have learned how to make the economy its servant instead of its master. And I believe that there would be complete bipartisan support for turning whatever energies are released in Vietnam to the improvement of the human race at home. And I believe it would be done right quickly. And I believe it would be done within 60 to 90 days.

We are quite clear about those things which we would like to get on to faster.

So, in a very very sincere way, I say to you that I think—well, I cannot wait, and neither can you.

Representative RUMSFELD. I am afraid we have absorbed my 10 minutes—

Secretary WIRTZ. I am sorry.

Representative RUMSFELD (continuing). With one question.

Chairman PROXMIRE. I would like to pursue with you, Mr. Secretary, the notion that this economy is moving too fast, expanding too fast, and that our main danger is inflationary pressure.

This may or may not be your impression. It is the impression I have gotten from other administration witnesses, and many of the independent economists who have appeared.

Let us take a look at the economy. Because you are close to the statistical heart of our Government, I think your comments would be very helpful.

It seems to me that at best we have a mixed bag on the basis of the January statistics—it is awfully hard to argue that this is an economy that is booming too fast, that we need more restraint, that unless we slow down we are going to be in trouble.

It is true unemployment went to a 15-year low in January. But you know far better than anyone in Government perhaps what was concealed in those unemployment figures.

Number one, you had the fact that something like 500,000 women left the job market and were no longer seeking work.

Number two, the hours of work per week in the factories actually declined from 40.8 to 40.5, indicating less pressure on manpower resources; 40.5 is a figure as low as it has been since 1962. So, this indicates the pressure on manpower is not very great.

The rate at which our plant capacity was utilized is still only about 85 percent—15 percent idle. And, back in 1964, one of the arguments for reducing taxes was that our plants were operating at only 85 percent of capacity.

Industrial production, which was very disappointing last year, grew very little—only a little better than 1 percent—dropped in January; it did not increase, but it fell. Housing starts were disappointing. Inventories grew \$9.2 billion, and the expectations are they will continue to grow over the next 4 or 5 months because of the steel situation, and then decline, which will tend to slow down the economy.

Retail sales were up, it is true, but personal income was up far less than expected, and far less than it has been for a number of months.

There is no indication in consumer intentions that we can get that we can expect a boom from less saving and more spending.

The business investment in plant and equipment is expected to increase somewhat in this quarter, but then level off and we will get very little stimulation from that source.

So, under those circumstances, I would like to ask you this question.

You said that you were quite sure that with the surtax we would have less unemployment than we have now—at least I understood you to say that.

Secretary WIRTZ. Yes.

Chairman PROXMIER. If in June or July when we vote on the surtax unemployment is higher, significantly higher than it is now, will you still feel it would be a good idea for us to vote for this kind of restraint in the economy?

Secretary WIRTZ. I would reply just as honestly as I can to the question. Every factor you have mentioned squares with the information that I have, and contributes to making this what I think of as a complex question and complex problem. The things you mention drive me to what I admit as a kind of intuitive judgment that I am clearest about this whole thing in terms of paying bills.

Now, with respect to the statement that unemployment will be lower—Mr. Ross advises me just here as we talk that he thinks that is a dangerous statement to make, because we do not know what is going to happen even as far as the work force is concerned, as far as these various things go.

I am in effect confirming what I understand to be the basis of your statement, that there are elements of doubt, specially when we move to the second quarter.

Now, you asked me whether I would recommend to the Congress that there be a vote in favor of the surtax if by the middle of the year the unemployment rate seems to be heading up. I have two or three difficulties about that. First, the postponement of that vote presents me with what I think is a serious question.

I think it ought to be done now. I have some trouble evaluating that problem as it might exist then. I want to know what happened to the cost of living. If the cost of living keeps going up another 0.3 percent or 0.4 percent every month, as it has been for the last 6 or 7 months, then it resolves a lot of what would otherwise be, to me, economic doubts.

Chairman PROXMIRE. But that is the problem: In 1958, for example, we had almost 7 percent unemployment and serious inflation. We could have something like—not that bad, we hope—but something like that again. Where do you make your decision?

Secretary WIRTZ. I do not know. The last time I was through this, which was in the Korean period, the thing went up so fast we had to turn to wage and price controls. I do not think the country wants to do that right now.

As far as I am concerned, it is a matter of looking at a very hard equation, which I understand only partly, which includes the factors to which you refer. It also includes this factor of the inflationary developments to which Mr. Curtis, Mr. Widnall, and Mr. Rumsfeld referred. I think all those things have got to be balanced. And I come out with an affirmative answer to your question. But I have extended my answer out of respect for the elements which you mentioned, because I think they complicate it.

Chairman PROXMIRE. Well, now, I would like to get back just a minute to your argument with Congressman Reuss—or your response to Congressman Reuss—when you said that one answer to the difficulty created by the increased surtax is that there will be more people working because of the manpower training programs which you have. This seems to me to make the argument even stronger against what I would consider excessive restraint.

If you have 1,300,000 people trained who would not be otherwise trained, you are going to have more people seeking work who are trained and able to fill the jobs. You need more demand, not less.

This is an argument against the surtax, not for it. If you are not going to train these people—these people are consumers but not producers. But, if, in addition to being consumers they become producers, you need more demand in the economy. Your manpower training program is one eloquent argument against the surtax. We could go down to 3.2 percent or 3 percent unemployment without inflation.

Secretary WIRTZ. It is so complex that the point I am about to make will seem to you evasive. It is not. A large number of the people we are talking about are under 20, a large number of the 1,300,000 are under 20. A large number of the jobs we are talking about are part-time jobs which will enable them to stay in school. In my own thinking we will meet the problems you and I are both interested in when we move toward the point where a person under 20 is not unemployed—he is either in or out of school.

My point is, by programs of the kind we are talking about here, we could increase the number staying in education. It becomes that much more complex.

We can also, by these training programs, push these people into those areas in which there are still—Mr. Curtis suggested—some skill shortages, which are slowing up productivity.

I do not mean to discount the point you made. I think it is a more complex point. And I think a properly administered, directed manpower program, will see at least another 300,000 people, I believe more, moved into activity which will not compete.

Chairman PROXMIRE. This gets back to the problem that has been troubling you the most, and we have not answered in our questions, or in our statements up here.

As far as paying the bill is concerned, the best way to pay the bill, it seems to me, is have our economy as fully utilized as possible, with earnings as high and jobs as numerous as possible.

We all know that the 1964 tax cut—everybody says—asserts that it increased revenues. Taxes were lower, but revenues were higher, because the economy was stimulated. It is perfectly possible that the 1968 tax increase might reduce revenues, make it harder to pay the bill.

Secretary WIRTZ. The other side is that the manufacturing workers' real weekly earnings have not increased in the last 2 years. That gives us pause, necessarily—both of us sharing this view.

Chairman PROXMIRE. It certainly won't increase if we pass the surtax.

Secretary WIRTZ. I am not sure about that. If the surtax will avoid—as I think it will—will avoid that spiraling of costs, which has taken money out of his billfold every time it has gone in, then it does.

Chairman PROXMIRE. If it will; yes. Of course, that is something that is very hard to say.

Secretary WIRTZ. I am banking on its doing it. I think it is just too bad that you add almost 4 million jobs to an economy, and you have production of the kind we are having, and real weekly earnings in manufacturing stay almost level for 2 years, as they did between December of 1965 and December of 1967. That makes me think we have to do more than talk about the number of jobs. That is a serious matter, that spiraling.

Chairman PROXMIRE. The staff has called to my attention the last study you made on labor shortages. This was September 10, 1967, entitled "Labor Shortage Continues To Ease."

In view of the serious problem we have here—the economic policy problem this committee has in recommending policies to Congress—would it be possible to get a more recent updated study? Usually this comes every quarter. We have not had one for 6 months.

Secretary WIRTZ. They have stopped. That is what Mr. Curtis refers to as feeble. If it is the judgment of this committee that that series ought to be continued, I say to you right now we will reinstate it.

Representative CURTIS. Oh, yes.

Chairman PROXMIRE. It would be most helpful to us. It goes right to the heart of the matter.

Thank you, my time is up.

Mr. Curtis?

Representative CURTIS. That was a nice note to end on.

I am coming back now to my last remarks that the efforts of the administration to implement the jobs available statistics were feeble.

Isn't the real reason the administration has not pushed the jobs available statistics because of the opposition we have from the AFL-CIO?

Secretary WIRTZ. No. I make no bones about it. I have pushed those in complete disregard of and because I disagree with their position, and so has the administration. What the influence has been on the Congress, I do not know.

Representative CURTIS. Mr. Secretary, this, then comes around to the definition of what you interpret to be push, and what I would interpret to be push.

When the administration really wants something, we in the Congress have learned what happens.

Now, I do not think the President has ever spoken out personally on the importance of jobs available statistics, nor do I recall that you have ever made any public statement—except under cross-examination. But, can you direct me to one of your speeches where you talked about the need for jobs available statistics?

Secretary WIRTZ. Public speeches—I will try to find those. It is not the kind of thing that most audiences care about.

Representative CURTIS. Mr. Secretary, I am interrupting so that we will be sure you get the gist of my question. I am now talking about what you mean by pushing.

Secretary WIRTZ. I have argued myself black in the face with the Appropriations Committee, and the President's budget that—

Representative CURTIS. But you did not even submit a bill or request—

Secretary WIRTZ. Not this year.

Representative CURTIS. No; nor the previous year. As a matter of fact, the chairman of the Subcommittee on Appropriations, a very good friend of mine, John Fogarty—

Secretary WIRTZ. He was against it.

Representative CURTIS. Yes. And the AFL-CIO is the only organization that spoke before our subcommittee against the jobs available statistics. They are opposed to it, and frankly, this is what I identify as the reason the administration has not been forceful in getting this through.

We are talking about \$21½ million, I think. And you are already talking about half a billion dollars that you are planning to spend for job training and so forth.

This is how ridiculous it really is. This is a vital part of job training—not just manpower development training, but what might be done by the private sector.

That is the context in which I have been raising this.

Secretary WIRTZ. I understand.

Representative CURTIS. Well, now let me ask whether or not the Department of Labor has issued a report on the Human Investment Act, which is a bill that has been introduced by many Congressmen and Senators. The first question is: Has the Department made a report to the committee on this?

Secretary WIRTZ. I do not recognize the legislation.

Representative CURTIS. Well, the legislation is to try to encourage

private employers to train and retrain and gives a 10-percent tax credit for doing it. The first question is, Has the Department made a report?

Secretary WIRTZ. Yes; we have.

Representative CURTIS. The second question is, What is the report, or the position, or if a report has not been made, why hasn't it?

Secretary WIRTZ. The report has been made. We have testified to that. I have taken, specifically, the position to the use of a tax credit to stimulate training.

Representative CURTIS. Why?

Let me first put it in context.

You see, the administration did promote and had enacted into law a 7-percent investment credit to corporations for investment in new machinery. The point is that, if we are going to do this for new machinery, certainly, that which, to a degree, competes against new machinery ought to be equalized. And this is the significance now. You have a report I have not seen, this official report to the Ways and Means Committee, Mr. Secretary.

Secretary WIRTZ. The report to which I refer is testimony, is in the form of formal testimony before several committees.

Representative CURTIS. This is before the Ways and Means Committee. And, of course, you know our procedures—when a bill is introduced, we ask the various departments affected to submit their official reports on it.

Do you know whether—

Secretary WIRTZ. I will check to see.

Representative CURTIS. Please do. And if not, let us put in the record—so it won't be redundant—whatever testimony you think would relate to that.

Now, there is another act I am interested in—the Employment Incentive Act—H.R. 13777—which was introduced October 31, 1967. I introduced it; others have, too. Incidentally, Senator Percy has introduced the bill here in the Senate, with some cosponsors. And on page H14264 of the Record there is an explanation of this.

This is an attempt to gear in the minimum wage laws with these training programs.

Has the Department made a report on that?

(The bill referred to by Representative Curtis is reprinted below:)

[H.R. 13777, 90th Cong., first sess.]

A BILL To increase employment opportunities for individuals whose lack of skills and education acts as a barrier to their employment at or above the Federal minimum wage, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Employment Incentive Act of 1967".

STATEMENT OF PURPOSE

SEC. 2. The purpose of this Act is to increase employment opportunities for individuals whose lack of skills and adequate education acts as a barrier to employment at or above the Federal minimum wage, and thus to help provide useful employment and training opportunities for individuals who might otherwise be trapped in the cycle of poverty by persistent and recurrent unemployment or underemployment.

MINIMUM WAGE EQUIVALENCY REFUND

SEC. 3. Certified employers who employ certified workers at not less than the minimum wage applicable under section 6 of the Fair Labor Standards Act

of 1938 shall receive, in accordance with the provisions of this Act, a minimum wage equivalency refund (hereafter in this Act referred to as the "refund") consisting of a portion of the wages paid.

PAYMENT OF REFUND

- SEC. 4. (a) The refund shall be paid quarterly to those employers who—
- (1) have applied for and been issued employer certificates, as provided in section 8 of this Act;
 - (2) employ workers holding employee certificates, as provided in section 6 of this Act, at least forty hours per week;
 - (3) pay certified employees the minimum wage applicable under section 6 of the Fair Labor Standards Act of 1938 in addition to fringe benefits received by comparable noncertified employees; and
 - (4) report quarterly to the Administrator of the Wage and Hour and Public Contracts Division of the Department of Labor (hereafter in this Act referred to as the "Administrator") on the status, number, and total hours worked of employees holding employee certificates.
- (b) The refund shall be an amount equal to—
- (1) 40 per centum of the wages paid at the rate referred to in section 4(a)(3) to all employees certified pursuant to sections 5 and 6 for the first half of the period of such certification for each such employee; and
 - (2) 20 percentum of the wages paid at the rate referred to in section 4(a)(3) to all employees certified pursuant to sections 5 and 6 for the remainder of the period of certification for each such employee.

DETERMINATION OF ELIGIBILITY FOR EMPLOYEE CERTIFICATE

- SEC. 5. An individual shall be eligible to receive an employee certificate if—
- (1) his skill, training, education, or job experience is below that normally required for steady employment at or above the minimum wage, as determined by his local United States Employment Service office, and
 - (2) if unemployed, he or she has sought but has not been able to obtain employment at the minimum wage or above after a period of unemployment of five weeks or longer.

EMPLOYEE CERTIFICATE

SEC. 6. Upon application, the appropriate local office of the United States Employment Service may issue an employee certificate to any individual who meets the requirements set forth in section 5. The form of such certificate shall be prescribed by the Director.

DETERMINATION OF EMPLOYER ELIGIBILITY FOR CERTIFICATE

SEC. 7. An employer shall receive a certificate of eligibility to receive the refund for the employment of employees certified under sections 5 and 6 upon application, if the Administrator determines that—

- (1) the employer is covered by the provisions of section 6 of the Fair Labor Standards Act of 1938;
- (2) the employer applying for a certificate has not raised his hiring requirements following or in expectation of the enactment of this Act;
- (3) an adequate supply of qualified workers is not available despite reasonable efforts by the employer to recruit them;
- (4) the refund will not have the effect of impairing or depressing the wages, working standards, or opportunities for full employment of existing employees;
- (5) abnormal labor conditions, such as a strike, lockout, or similar condition, do not exist at the firm;
- (6) the employer will afford certified employees full opportunity for continued employment at the minimum wage or above after the expiration of the employee's certificate; and
- (7) the employer has a formal or on-the-job training program to upgrade the skills and enhance the productivity of certified employees.

EMPLOYER CERTIFICATE

SEC. 8. (a) An employer may apply for a certificate as soon as it decides to hire an individual eligible to be a certified employee under this Act. If the employer hires such an individual before its application is accepted, and the

application is subsequently accepted, the refund shall be retroactive to the date the employee was placed on the employer's payroll.

(b) An employer certificate, if issued, shall specify—

(1) the number of certified employees authorized to be employed at any one time, which shall not exceed 25 per centum of an employer's total labor force; and

(2) the effective date and the expiration date of the certificate.

Such certificate shall be in the form prescribed by the Administrator.

DURATION OF CERTIFICATES

SEC. 9. (a) The duration of employer certificates shall be one year, renewable upon finding of continued eligibility by the Administrator. In the event an employer chooses not to renew a certificate, he shall continue in the program until all employees hired under the previously existing certificate have completed the duration of their certificates.

(b) There shall be the following two classes of employee certificates:

(1) A six-month certificate for nonskilled occupations.

(2) A one-year certificate for skilled occupations.

The local office of the United States Employment Service shall issue a qualified individual a certificate of eligibility prior to his employment. After the certified individual is employed, the local office shall determine on the basis of his occupation whether his certificate shall have a duration of six months or one year.

(c) Not more than one employee certificate shall be issued under this Act to any individual and such certificate shall be nonrenewable.

EQUAL OPPORTUNITY

SEC. 10. No certified employer shall discriminate on account of race, color, religion, or national origin in the employment of certified employees.

ENFORCEMENT

SEC. 11. (a) The provisions of this Act relating to employer certificates and the distribution of the refund and all regulations pertaining thereto shall be enforced by the Administrator. He shall conduct investigations of possible violations of employer certificates upon—

(1) a complaint by either an employee or an employer under a certificate, or

(2) a complaint by a competitor of a certified employer, or of an experienced worker who claims to have lost employment or to be unable to obtain employment because of competition from certified employees.

(b) The provisions of this Act relating to employee certificates, their issuance, and all regulations adopted under these provisions shall be enforced by the Director of the United States Employment Service (hereafter in this Act referred to as the "Director"). He shall conduct investigations of possible violations of employee certificates upon—

(1) a complaint by either a certified employee or employer, or

(2) a complaint by an experienced worker who claims to have lost employment or to be unable to obtain employment because of competition from certified workers.

(c) If after notice and hearing the Administrator or Director finds that there has been a violation of the provisions of this Act, or regulations thereunder, the Administrator, in the case of an employer, and the Director, in the case of an employee, shall cancel the certificate issued under this Act, and deny the privilege of obtaining a new certificate for such period as the Administrator or the Director, as the case may be, shall determine.

ADMINISTRATION

SEC. 12. (a) The Administrator shall administer the provisions of this Act relating to employer certificates and payment of the refund.

(b) The Director shall administer the provisions of this Act relating to employee certificates.

(c) The Administrator and the Director are authorized to establish such rules and regulations as are necessary and appropriate to carry out their respective functions under this Act.

CRIMINAL PENALTY

SEC. 13. A certified employer who knowingly violates the conditions of an employer certificate or the other provisions of this Act shall be deemed to have committed a misdemeanor, and shall be subject to a fine of not to exceed \$1,000.

RECONSIDERATION AND REVIEW

SEC. 14. (a) (1) Any person aggrieved by the action of an authorized representative of the Administrator in denying or granting an employer certificate may, within fifteen days after such action, (A) file a written request for reconsideration thereof with the authorized representative of the Administrator who made the decision in the first instance, or (B) file a written request for review of the decision with the Administrator or an authorized representative who has taken no part in the action which is the subject of review.

(2) Any person aggrieved by the action of an authorized representative of the Administrator in denying a request for reconsideration may, within fifteen days thereafter, file with the Administrator a written request for review.

(3) Any person aggrieved by the determination upon reconsideration of an authorized representative of the Administrator may, within fifteen days thereafter, file with the Administrator a written request for review.

(b) (1) Any person aggrieved by the action of a local United States Employment Service office in denying or granting an employee certificate may, within fifteen days after such action, (A) file a written request for reconsideration thereof by the local United States Employment Service office which made the decision in the first instance, or (B) file a written request for review of the decision by the Director, or (C) file a written request for review of the decision by an authorized representative of the Director who is not attached to the local office making the decision in the first instance.

(2) Any person aggrieved by the action of a local United States Employment Service office, or of an authorized representative of the Director in denying a request for reconsideration may, within fifteen days after such determination, file with the Director a written request for review.

(3) Any person aggrieved by the determination upon reconsideration of a local office, or of an authorized representative may, within fifteen days thereafter, file with the Director a written request for review.

(c) A request for reconsideration shall be accompanied by a statement of the additional evidence which the applicant believes may materially affect the decision together with a showing that there were reasonable grounds for failure to present such evidence in the original proceedings.

(d) A request for review shall be granted where reasonable grounds for the review are set forth in the request.

(e) If a request for reconsideration or review is granted, the Administrator, the Director, their authorized representative, or a local United States Employment Service office may, to the extent he deems it appropriate, afford other interested persons an opportunity to present data and views.

SECRETARY'S EVALUATION AND REPORT

SEC. 15. Prior to March 1, 1969, and again prior to March 1, 1970, the Secretary of Labor shall make a report to Congress. Such report shall contain an evaluation of the program authorized in this Act, enclosing the number of persons employed and trained, the employment experience of individuals who have completed the program, the response of employers to the program and recommendations for improvement.

AUTHORIZATION OF APPROPRIATIONS

SEC. 16. There is hereby authorized to be appropriated \$72,000,000 for the fiscal year ending June 30, 1969, for payment of the refund for the employment of not more than one hundred thousand certified employees; and \$144,000,000 for the fiscal year ending June 30, 1970, for payment of the refund for the employment of not more than two hundred thousand certified employees. There is authorized to be appropriated such sums as may be necessary for administrative expenses for the fiscal year ending June 30, 1970. Such sums may be appropriated for each fiscal year thereafter as the Congress may hereafter authorize by law.

Secretary WIRTZ. I will have to check that particular piece of legislation. I would like to, before answering. I think we have not made a

formal report on it. And, so, I do not have it clearly enough in mind to know how broadly it raises a question to which we have given a good deal of attention; namely, the application, or the use of minimum wage rates in the training programs.

Representative CURTIS. It is hitting along that line. Let us leave the record open for your response.

(The information furnished for the record follows:)

SUPPLEMENTAL STATEMENT OF SECRETARY OF LABOR WIRTZ IN REPLY TO QUESTIONS
BY REPRESENTATIVE CURTIS

First, I will respond with regard to the tax credit for the expenses of employee training programs which would be provided under the Human Investment Act bills (H.R. 4574, 4578). Last year, at the request of Senator Percy, I submitted material for inclusion in the record of the hearings of this committee on this subject. (February 2, 1967, part 2 of the hearing record, p. 307). I indicated there that the Department of Labor was actively pursuing the subject independently and with representatives of the Treasury Department, but that all plans which had been considered had such serious defects that they could not be supported. Shortly thereafter in the Manpower Report of the President dated April, 1967, the President directed creation of a Task Force on Occupational Training with members drawn from business, labor, agriculture, and the general public. This Task Force now is engaged in a survey of training programs operated by private industry and will make recommendations as to how the Federal Government should promote and assist private training programs. The possible use of tax credits as one method of promotion and assistance is being considered by that Task Force. My own final conclusions on this subject will not be made before receipt of the Task Force report.

Second, with regard to the direct wage subsidy plan contained in H.R. 13777, the Employment Incentive Act bill, introduced last October. In principle this is the same as the direct wage subsidy proposal on which I testified last June in the hearings before the House Education and Labor Committee on the Economic Opportunity Amendments of 1967. (June 22, 1967, part 2 of the hearing record, pp. 1203-1208 and 1214-1215) A direct wage subsidy is not, in my opinion, the answer to our present problem. The views expressed there remain my views, and are reinforced by the strong support and response which private industry is giving to the Job Opportunities in the Business Sector (JOBS) Program announced by the President in his January 23, 1968 message to Congress, "To Earn a Living: the Right of Every American." This program will devote \$350 million to a new partnership between government and private industry to train and hire the hard core unemployed.

Representative CURTIS. In essence, it recognizes that certain people, at some stage of their development, probably are not economically worth the full minimum wage. Therefore, the employer pays that which they are worth, and you make up the difference in minimum wage through, frankly, Government subsidy. But then it phases out.

This would be a comment on my part, rather than a question. During the development of the social security bill last year, I was very concerned that we gear this in with the minimum wage laws and other laws, like child labor and so on. The Health, Education, and Welfare Department officials, including Mr. Cohen, were the witnesses. I kept asking to have the Department of Labor people come in, because I thought you were most familiar with it. Mr. Cohen reported to us that he had had discussions with someone in the Department of Labor and reported back that they felt, as we did amend it in certain ways, that it was properly geared in.

For the record, later, would you comment on how well you think we did or did not do a job in the social security legislation?

Am I coming clear to you with what I am asking?

Secretary WIRTZ. Yes; sure. There is a big problem as to the relationship of the minimum wage to the expansion of the educational program when it gets into that in-between area which we call work training. I do recognize the problem. It is a complicated problem.

Representative CURTIS. All I have is an indirect report as to what the Labor Department views are. But, I would appreciate, for the record, your comments on how well you think that we did do the job, or where you might suggest that we need to improve it.

We made great strides forward, I think, in trying to relate welfare to getting people onto their economic feet, as opposed to just keeping them in a constant position of welfare.

Secretary WIRTZ. That is right; it was a good job. We will, of course, know more in the next 2 or 3 years as to how well the new work-training program of title IV of the recently enacted Social Security Act amendments work, and will report back to you then, as the act calls for.

Representative CURTIS. I have—when I come back again—some specific questions for your response later.

I have had over a period of years a series of tax reforms which I think are most essential in trying to improve the mobility of labor. I think our tax laws are structured really in a way that they impede this.

One law, for example, is the deduction from gross income of going to summer school, night school, vocational training.

The laws are so archaic. They apply to a schoolteacher. She goes to summer school. She cannot deduct that as business expense unless the school board has told her she is going to be fired if she does not. In other words, "Are you holding your job or are you trying to improve yourself?" If you are trying to improve yourself, they won't give you a deduction. Yet, I would argue, in this day and age of automation, where skills become obsolete in 5 or 10 years, that the need for constant training and retraining is so important that our tax laws should not be an impediment here.

We have the same problem in moving costs, and the same thing on costs to maintain two residences. When the Chrysler plant moved from Evansville, Ind., to St. Louis, there was a depressed real estate market. A lot of people could follow their jobs to St. Louis, but they commuted back and forth. And yet, they were not given, as a business expense, the cost of maintaining two residences, because the archaic law says a man's residence is where his job is. I argue that today it is where his home and his family are. And then, there are the problems of the handicapped, where they have to have special vehicles, and all sorts of things.

I would like to have some help in these areas in getting our tax laws revised.

We just are not seeming to move forward at all.

Secretary WIRTZ. If you will add one more—and that is this. If I were to take my staff to lunch, for purely business reasons, I would first have to pay for it myself, and second would not be allowed the deduction as a business expense.

Representative CURTIS. I would be happy to work on that one, too.

Secretary WIRTZ. I would be glad to file a statement.

Let me be sure we have the area.

Those matters of tax practice involving and related particularly to business expense deductions which we feel might appropriately be

considered in connection with the fairness and the increase of employment, and particularly the employment of people to whom this would make a very real difference.

Representative CURTIS. It is the mobility of labor. A great deal of this is not the businessman. A great deal of it is the individuals themselves, Mr. Secretary. And, let this argument deter you, what good does it do to give an income tax deduction to a person who might be unemployed. I think our difficult problem in this training and retraining is the escalation that a person with a good job, if he will train for a higher skill, leaves his job open for someone. So, it is very meaningful, I would argue, to remove these impediments in our tax laws.

Secretary WIRTZ. We would be glad to file such a statement.

(Representative Curtis' bill for tax deductions for the above purposes, H.R. 5045, has been forwarded to the Department of Labor by the House Ways and Means Committee for expression of the Department's views. The report will be forwarded when completed.)

Chairman PROXMIRE. Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Several prominent economists, particularly Professor Brozen of Chicago, and Professor Campbell of Dartmouth, have made studies that indicate the minimum wage has reduced employment opportunities for young, inexperienced workers.

What do your studies show?

Secretary WIRTZ. They do not show that. It is required under section 4(d) we make annually, and file with the Congress the first of each year, a report on the effects of the minimum wage law. And in the most practical terms I can identify, every study that we have made so far does not support the conclusion that the minimum wage has a depressing effect on employment.

But I want to make this clear, Mr. Widnall.

This is a limited, careful, guarded statement that I have made.

There is no evidence in any of these studies to show affirmatively that kind of thing.

But I want to make this clear.

If the minimum wage for youngsters or for any other group in this country were, let us say, 50 cents an hour—as it is, for instance, in Japan—there cannot be any question but that there would be larger employment of that group which was given that exemption.

Now, the problem would be that it would have a depressing effect on our local standard of living all the way up and down, as it does in Japan.

And so I am trying to say in answer to your question that I do not think that there has been a reduction in youth employment because of the minimum wage law. And that is the point they make.

I do not recognize that if we had an entirely different approach to this problem, as indeed is true in a number of other countries, where there is a youth differential, it would affect that matter.

Representative WIDNALL. Have you considered recommending legislation to amend the minimum wage law, to permit a lower minimum wage for trainees, perhaps with a Government subsidy to make up the difference between the actual wage paid and the minimum wage?

Secretary WIRTZ. We have considered it, and have reached affirmatively the conclusion not to make the recommendation in that form.

I will tell you the area in which it seems to me most pointed. It is in the area of the handicapped worker, to whom there has been reference here before.

We presently have under serious consideration the question of whether we are taking the right approach to that. We now give sheltered workshops an exemption on one kind or another. We are seriously considering whether we should make recommendations which would say that is the wrong approach, that a handicapped person who works his head off all day is as much entitled to the minimum wage as somebody else that we are talking about here.

Now, if there is a noneconomic element in that situation, maybe we ought to make it up. And, so, my answer to your question is that we have considered the problem; we would not at this point recommend a differential on the age basis as they have in Holland and a number of European countries, the Scandinavian countries. We would not make that. But we have—we recognize a real question here.

Representative WIDNALL. The Monthly Labor Review last September indicated that in fiscal 1967 about 1 million jobs could be attributed to Vietnam.

Has the Department an up-to-date statement of the number of jobs that could be contributed to Vietnam military expenditures today?

Secretary WIRTZ. I would file a separate statement on that. If it is felt there is additional information beyond what is supplied in the Council of Economic Advisers' Report on that.

They do make some—they do have some discussion of that. And, if it will satisfy your point, Mr. Widnall, we will review that, and see if we have any additional information bearing on that point.

At the present time the Department of Labor does not have any later estimates of the employment impact of the Vietnam buildup than those through fiscal 1967 shown in the September 1967 Monthly Labor Review. The Bureau of Labor Statistics is presently trying to extend the estimates through fiscal 1968. However, essential data on contract awards for the entire fiscal year 1968 will not be available from the Department of Defense until later this spring. When this material is available, we will be able to complete the work and should have the information ready during the summer.

Representative WIDNALL. You undoubtedly have very up-to-date figures on that, because I am very much aware of the fact that some of the Government contracts are awarded on the basis of labor impact. And, where there seems to be a sloughing off in employment, aren't some of the contracts channeled into those areas?

Secretary WIRTZ. There is very little of that. There is a rider to the Department of Defense Appropriation Act which precludes directing a contract to meet the point you have in mind if it results in a higher cost.

Now, there are some limited advantages under the Small Business Act, and so on. But there is comparatively little—some of us have felt too little—of what you suggest.

But I would be glad to identify that.

Representative WIDNALL. Just one further question.

Last September a Federal compulsory arbitration panel awarded a 5.5-percent package to six railroad shop craft unions.

Do you feel the Federal Government itself is contributing to the wage price spiral by such action?

Secretary WIRTZ. I believe the form of the question, Mr. Widnall, implies administrative action to the exclusion of legislative action.

I think it was unfortunate that Congress has finally, on the recommendation of the administration, sent that case to that settlement.

If the question is whether I think that kind of answer to labor issues is a good thing, the answer is "No; I do not."

If your question is, Do I think that the administration contributed to inflation by the taking of that action. The answer is "No." The settlement which was finally reached was so close to what everybody knew would have been the settlement if the parties had settled it themselves, that all we did was to make up for their failure to discharge their responsibility.

But I do not count that settlement a material factor as far as inflation is concerned.

Representative WIDNALL. What bothers me a great deal is that for several years there was a firm effort on the part of the administration to have management and labor adhere to a 3.2-percent guideline. And all of a sudden that guideline was abandoned, and there does not seem to be any real guideline now. An appeal is made to a voluntary effort on the part of labor and management to hold increases and changes in benefits within reason.

Now, isn't there some goal, isn't there some maximum that the administration has in mind that would be beneficial to the economy, and really noninflationary?

There must be something that is reasonable.

Secretary WIRTZ. You are talking only about wages—because the breakdown was on the price side first.

Do I properly interpret your question as meaning there should be a specific rule for prices as well as for wages? Because if—

Representative WIDNALL. There is the same reason existing today that I take was in existence at the time the 3.2 percent guidelines was issued.

Secretary WIRTZ. My partial answer is this.

The reason for departing from the 3.2 percent was that the departure from the productivity, especially on the price side, made that no longer a tenable figure—because it meant when productivity went up 3.2 percent, and when wages went up by the same amount, there was no gain, because the prices had gotten out of hand. And, so, I have got to answer you that because there is apparently—there proved to be no way to keep the price factors in line—that 3.2 productivity thing did not work, in fact. Therefore, I would have to answer you that absent any way of keeping prices in line, I do not believe that we can fairly or effectively, either way, attach ourselves to a decimal point reflex of the productivity.

So, it is a long answer, but the answer is "No," I do not think we can.

Representative WIDNALL. Isn't it true, in recent months, productivity has not gone up?

Secretary WIRTZ. That is right. Prices have.

Representative WIDNALL. In comparison to prices?

Secretary WIRTZ. That is right. You say it has not gone up. It has

gone up much less, I think. Well, in the last quarter of 1967 it started to go up a deal more again. Early 1967 very little. And for the year, some place between 1½ and 2 percent, for the total private economy.

Representative WIDNALL. And this left inflation unattached.

Secretary WIRTZ. The wage increases and the price increases both, in disregard of the productivity principle, surely did, in 1967, contribute to inflation—both of them.

Representative WIDNALL. But there is no firm guideline now being provided by the Government. It is just voluntary submission to so-called standards, as to what is reasonable.

Secretary WIRTZ. It is true that neither the Economic Report of the President nor the Council of Economic Advisers named a specific figure this year. It did not last year.

It appears originally in 1962, in the Council of Economic Advisers' Report. It was in there up until 1967, and is not in the report as of now.

That is the only place that figure has ever been developed.

Representative WIDNALL. Thank you, Mr. Secretary.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Secretary Wirtz, I have just returned from 9 days of Lincoln Day speeches in your State and my State, Illinois. I spent a great deal of time in southern Illinois because of our economic problems down there.

The migration of our agricultural workers and people out of the mines continues.

We are turning out fine educated young people at Southern Illinois University, with no place to go to work. They are moving to St. Louis, Pittsburgh, and Chicago, to find jobs, separating families. And this is a problem that many States are experiencing.

Could we think about some of the programs that we might work on to solve some of this problem?

For instance, tax incentives to encourage establishment of businesses in rural communities have been proposed to stop the concentration of industry in our urban areas. I wonder whether it is not well to think in terms of providing special inducements for businesses that will go where we need them, such as where we have large pools of unemployment, where we need to hold people, to keep a community going and alive. We simply cannot keep crowding our urban areas at the present rates.

Secretary WIRTZ. The general problem or question is important.

The desirability of action of one kind or another which would have that effect would have our complete support. I would agree with you completely. I would question only one part, and that is whether the tax incentive is the most effective way of doing that. But aside from that, I know of no larger problem today than to try some way to reverse the tendencies that prompt people to pile on top of one another in the cities. More specifically, we will do everything we can to move in the other direction.

Senator PERCY. Would this also apply to the other areas where industry is going—the suburban areas, outside the city?

Would the same thing hold true for industries locating inside the inner city, where we also have large pools of unemployment, especially Negro workers?

Secretary WIRTZ. I am much less clear about moving, if I under-

stand your question—much less clear about this second point, which if I understood you, would involve moving businesses into the ghetto areas themselves.

I hope we are not going to become a country in which the cities are black and the countryside is white. And the whole problem, I mean as far as the population is concerned—the tendency is in that direction.

There is a good deal of illusion in some of the suggestions that the way to meet the problems in the slums and the ghettos is to bring businesses in there. In a very pragmatic way, one of the difficulties is that it takes a lot of time.

It probably makes much more sense to attempt to meet the transportation needs that are involved, and to prevent those steps which have led some people to describe the prospect to which you refer as being a gilded ghetto. I believe if we simply move into the ghettos those businesses which would supply the kind of work which can be done there, there would be some serious consequences. We have got to do some of that, and we are doing some of that. But I do not believe that is a long-term answer.

Senator PERCY. I was wondering about an area like the stockyards in Chicago, where, I think, in the last 8 years employment has dropped from about 17,000 to 2,500; 75 percent of that employment was Negro employment. They were paid very good wages. The decentralization and dispersal of the meatpacking industry has left the stockyards a pretty vacant area, without employment opportunities.

What can we do together in some sort of alliance for progress, Federal, State, local government, private industry, business organizations, to utilize that land area there, where several million people are close at hand, several hundred thousand available for employment. Nothing seems about to be done about it.

Secretary WIRTZ. We are hoping, of course, that the model city recommendation from Chicago will meet precisely that problem.

One of the important points of what you are saying is that we have to recognize this as more than an employment problem. It is housing, it is education, it is employment, and health—all four together. And any suggestion that we approach it as one or the other is going to be wrong.

So my answer to your question would be that we can—that the Congress has now provided in the model cities approach what seems to me the best answer, the best presently available answer to that kind of problem. Except for this.

There is a certain amount we can do through Government, and the rest of the answers ought to come from a coordination of private interests of one sort or another, and I think some of the emergences of that kind of thing is all to the good.

Senator PERCY. I am convinced, as I am sure you are, that we must involve private enterprise in this job of hiring the hard-core unemployed. The Job Corps simply is not enough, and it sometimes trains people for jobs that do not exist. Somehow we must pull in the whole forces of our employment process into this. I think industry has to do some of this kind of work, to start attracting the young people, who see in business a broader commitment than we used to see. There is more excitement in VISTA programs, Peace Corps programs, and yet, in this area there is exciting work to be done.

Has the Department of Labor developed any kind of pilot studies where we could see what the effect on industry could be? For instance, have you developed a project and experimented to see what impact it has on the social conscience of a given company? An example might be taking on and hiring a certain number of hard-core unemployed. I think Henry Ford is trying to do this; I think Eastman Kodak is trying to do it.

Has the Department of Labor—can it see itself as a catalyst to spread information on these programs to more businesses?

Secretary WIRTZ. It goes a good deal beyond that.

In the JOBS program—jobs opportunities in the business sector—the President, in his January 23 message, outlined a program, price tag \$350 million for the next 2 years—it is administered as far as the program part of it is concerned through the Department of Labor—that has been done. We hope that that will mean the employment of 500,000 hard-core unemployed in the 50 largest cities in the next 3 years. And I think it will.

In general response to your question, both the concentrated employment program, and the JOBS program rely very very strongly on the proposition that the right answer is private employment, and that the right way to reach that answer is through a combined participation by Government and the private employers in the working out of these programs.

Senator PERCY. My last question—I look upon labor leadership as responsible, patriotic and so forth. We have a crisis, a balance-of-payments crisis in this country. Tourists are asked not to travel. We have industry being asked not to invest abroad, even though they know that in the long range this will operate to the detriment of our economy.

Has any thought been given to having labor have a strike moratorium in industries that affect us in balance of payments, just as if it is a war problem. The copper industry, for instance, certainly is creating a tremendous drain now on us in our balance-of-payments problem. What is being done about this, to bring this forcibly to the attention of the American public and labor leadership, the detriment of that kind of continued strike?

Secretary WIRTZ. There has been thought. Two questions that I would have to include in answer to it.

When you say a strike moratorium, do you imply arbitration by law, or in some form as a part of that?

Senator PERCY. Something—just to bring about a settlement in a crisis.

Secretary WIRTZ. It cannot just be a strike moratorium. There would have to be the substitution of some method of determination.

I think you would find the most significant approach to this—in the attempt that was made in the steel industry to do just exactly this kind of thing. We were all encouraged in December that there was a possibility that they would voluntarily work out some kind of arbitration arrangement. It did not work out. But it reflects exactly the point you are talking about, because the interest of both the company and the union was in making some arrangement which would mean there was not a lot of offshore buying of steel.

So there has been that serious kind of conversation there.

I wish that had worked out. It was entirely private. We did not get into it. If the question is whether I think the circumstances warrant our doing it by law, my answer is "No." But if the question is whether it is a matter of good, sound development, my answer is "Yes."

You take into account, Senator, at this point, another thing that bothers us a good deal, and that is that a good many of the settlements which have been arrived at in collective bargaining have not been ratified by the membership. That point, too, would have to be considered. My general answer to your question is that the development is one which should be given strong consideration—I think not by law.

Senator PERCY. I would hope we could do as much in the area of getting advance assurances now from labor. As long as business is being asked not to invest for the next couple of years, since people are asked not to travel—is it possible to get assurances from labor for a couple of years now they are not going to strike those industries which would cripple our balance-of-payments problem.

Secretary WIRTZ. Or that the employers should not be adamant on their part. It cannot just be to stop the strikes. We have to substitute some method of settlement.

Senator PERCY. Thank you.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Secretary, I would like to ask one further question based upon what Senator Percy has opened in his last question.

As I understand it, there is about a billion dollars in foreign exchange involved in copper, and possibly with the addition of steel, which is being piled up too in contemplation of a possible strike. Now, why can't the President, on your recommendation, call in the leaders of industry and labor in copper and in steel, and say as a patriotic gesture they should agree to what George Meany calls voluntary arbitration in the national interest?

Secretary WIRTZ. Why can't he?

Senator JAVITS. Yes.

Secretary WIRTZ. My own reaction is that this matter should not at this point be subject to that kind of direct White House participation which has, on previous occasions, met with severe criticism, and I think properly, as far as the country is concerned.

On the desirability of doing all we can effectively and consistent with our system to try to accomplish the results to which you refer, I am a firm believer in that, as you know, and I answer with reservation only when you talk about putting the President directly into the dispute at that point. That I do not consider wise. I am humbled, of course, by the fact that the procedures on which Secretary Trowbridge and I have been working are at, least, yet not successful. But, I have no question about the good sense of what you are talking about, except as it injects the President as an individual.

Senator JAVITS. Mr. Secretary, is my figure correct? I understand it costs, roughly, \$80 million a month to bring in copper?

Secretary WIRTZ. Yes; that is about right. The trade balance effect of the copper strike—I have it in the daily figure, but it coincides with yours—is between \$3 million and \$4 million a day.

Senator JAVITS. And I am correct about the fact that that represents one-quarter of the whole imbalance in our interest payments?

Secretary WIRTZ. I would be out of my depth.

Senator JAVITS. To that must be added some figure for steel imports. It is true that they have risen materially through fear of a possible steel strike?

Secretary WIRTZ. Yes, sir.

Senator JAVITS. Nonetheless, you feel, notwithstanding the Vietnam war, it would be inopportune for the President to intervene on the manner I have suggested?

Secretary WIRTZ. I already answered. I am obviously in an area where the question of propriety and the degree of my comment on what the President ought to do in that situation has been about reached. But, I would say quite frankly, I would have the feeling that that personal participation would not at this point be a good idea.

Senator JAVITS. Now, on another crisis front, to wit the cities, do you see, Mr. Secretary, any need for another emergency job program, like we had in 1967, when we appropriated 75 million special dollars for the purpose?

Secretary WIRTZ. I cannot place the program as a separate program to which you refer. We have discussed earlier this morning the desirability of expanding the manpower program as a whole, as it is expanded in the President's recommendation, and I do support that. But I am not sure if you have reference to some particular program.

Senator JAVITS. May I just refresh you on it.

Last year the President sent a special message to the Congress asking for \$75 million for summer jobs. We voted the \$75 million upon the express request of the administration.

Now, I ask you, What about this year?

Secretary WIRTZ. I am not in a position to answer that.

Senator JAVITS. As yet?

Secretary WIRTZ. That is correct.

Senator JAVITS. I do not want to press you, Mr. Secretary. You know I have great respect for you.

Will you be prepared to testify at this time as to need on that score?

Secretary WIRTZ. I will be glad to testify as to the situation.

Senator JAVITS. Now?

Secretary WIRTZ. At any time.

Senator JAVITS. I am asking you, Do you see a need for summer jobs this year?

Secretary WIRTZ. I beg your pardon. I thought you meant on the basis of some further preparation. What I can say to you now is in pretty general terms, and would not go to the point of whether I think there ought to be a separate appropriation. I will say this to you. I think it is the heart of—meets the heart of your question.

There is no question but that—I mean it is a fact that a large part of that supplemental appropriation last year went into programs in the larger cities in the country. And that is not possible under the allocation formula as far as the general programs are concerned. The numbers are quite significant in the larger cities, and present a problem that is very important. And I could give you, or I could supply for the record—I do not have it immediately at hand—the effect, or—

yes, the effect of the supplemental appropriation last year in the major cities, which could not be matched without a supplemental appropriation. That is about the closest I could come to it.

Senator JAVITS. I think that is excellent, Mr. Secretary. I am very pleased you should be helpful to that extent.

Would you be kind enough to supply for the record the statistical substantiation for this statement?

Secretary WIRTZ. Very well.

Senator JAVITS. I ask unanimous consent.

Chairman PROXMIRE. Without objection.

(The statistical information referred to follows:)

NEIGHBORHOOD YOUTH CORPS SUMMER JOBS FUNDED IN 50 SELECTED CITIES, FISCAL YEAR 1967

City ¹	Final total (including supple- mental appro- priation)	Total ² (before supple- mental appro- priation)	City ¹	Final total (including supple- mental appro- priation)	Total ² (before supple- mental appro- priation)
U.S. total.....	\$ 294,269	\$ 194,581	Louisville.....	1,380	736
Total, selected cities.....	121,860	71,552	Memphis.....	850	652
Akron.....	350	305	Milwaukee.....	1,100	662
Atlanta.....	1,340	1,061	Minneapolis.....	1,000	623
Baltimore ⁴	3,000	1,937	Newark.....	2,610	1,444
Birmingham.....	700	437	New Orleans.....	23,900	11,197
Boston.....	1,150	872	Norfolk.....	1,000	
Buffalo.....	1,635	634	Oakland.....	\$ 2,047	\$ 635
Chicago.....	18,500	13,992	Oklahoma City.....	790	434
Cincinnati.....	1,260	985	Omaha.....	830	308
Cleveland.....	3,900	1,589	Philadelphia.....	3,215	2,417
Columbus.....	625	513	Phoenix ⁴	3,680	966
Dade County (Miami).....	1,250	1,120	Pittsburgh.....	3,700	2,164
Dallas.....	1,454	880	Portland, Oreg.....	510	416
Dayton.....	420	357	Rochester.....	1,042	172
Denver.....	450	294	St. Louis.....	1,080	795
Detroit.....	5,550	4,992	St. Paul.....	300	218
El Paso.....	398	308	San Antonio.....	2,142	886
Fort Worth.....	465	391	San Diego.....	1,539	1,098
Honolulu.....	925	550	San Francisco.....	\$ 1,450	\$ 242
Houston.....	1,622	1,004	Seattle.....	845	596
Indianapolis.....	875	875	Tampa.....	1,100	1,027
Jersey City.....	750	103	Toledo.....	420	398
Kansas City, Mo.....	817	759	Tulsa.....	240	161
Los Angeles ⁵	9,644	5,732	Washington, D.C.....	7,020	\$ 2,918

¹ Cities represent the sponsor's location as shown on the BWTP contract.

² Estimated.

³ Represents corrected figures.

⁴ Includes statewide programs.

⁵ Includes data for Long Beach.

Senator JAVITS. I might say, Mr. Secretary, as you know, my burning interest is—I think one of the reasons we avoided so far the dire eventualities in my city, New York, that were compounded in other major cities like Detroit, is the fact that our mayor was ready with a summer program when he got it funded, and gave a very considerable number of jobs. And I think it is critically important this year as it was last.

We have not yet come abreast of the basic problems of slums and ghettos adequately to dispense with this kind of emergency treatment. But, I will not press you further. I understand the limitations perfectly upon you as a Cabinet officer.

I have just one other line of questions I would like to ask you.

We are told that a number of programs must be undertaken to deal

with the present monetary crisis. One, tax surcharge, credit restraint by the Federal Reserve Board, various restrictions in investment, lending, travel, in order to correct our balance of international payments.

Now, two questions immediately arise there.

One, what unemployment are we to expect from—what addition to unemployment are we to expect from this program of retrenchment? We have a right to know what we have to pay for it—not only in dollars, in taxes, but also in the human terms—to wit, does the Department believe that if we go through with this program, there will be an inevitable increase in unemployment?

Secretary WIRTZ. No, sir; we do not.

We have discussed this some, earlier this morning. I would simply summarize the views expressed there. The chairman has advised me of Mr. Ackley's report to the committee, that a surtax could be identified with—the effect of a surtax could be identified with 300,000 unemployed.

My reaction to that is this. I do not argue with that—if that is what has been done. But I would have to rely, because I refuse to compromise with the idea of meeting inflation with unemployment—refuse to compromise with it one bit. My position would be that in other programs, in the training programs, programs of one kind or another, we can do what would be necessary to meet that impact.

I hope and I think we can.

Senator JAVITS. So that really it would be Government that would fill in to the employment diminution which would inevitably occur from credit and other restraints?

Secretary WIRTZ. I do not think it is that simple. How much we can accomplish, for example, with this jobs program, in which we rely upon a combination of Government resources and private resources, I do not know.

But I think perhaps quite significantly that can be done.

We indicated our willingness to pick up the full amount of the training costs in this kind of program.

I think, from my conversation with American businessmen, a good many of them are going to find enough self-interest, in terms of their customer power, of these individual employees and so on and so forth, to make some contribution, too.

But if the question is whether it depends upon an alternative expansion in which Government does have a part, the answer is "Yes."

Senator JAVITS. Mr. Chairman, I have one other question—because my time is up.

Mr. Secretary, the other corollary point which occurs immediately, when you discuss restraint of this kind, is, What about wages and prices? Are any controls contemplated—standby or otherwise—or is the administration satisfied to leave that as it is?

Secretary WIRTZ. The answer to the first part of the question is, "They are not contemplated." The answer to the second part is, "I think there is not satisfaction," and that that is reflected in the President's designation of a Cabinet committee to proceed with the representatives of labor and management, to try to find some further—some more effective form of an expression of not only the public interest, but of the principle of productivity.

Senator JAVITS. I thank the chairman.

Chairman PROXMIRE. Mr. Secretary, 25 minutes from now, the Senate will be called upon to vote on cloture on an open housing amendment. The President made his position emphatically clear. He hopes we will pass fair housing, or open housing.

I would like to ask you to address yourself to the effect such an open housing law would have on hard-core unemployment.

The principal statement you made this morning, which I thought was very excellent, was directed at this hard-core-unemployment problem. How important is this open-housing provision to the solution?

Secretary WIRTZ. My answer is, of course, unqualified. My only difficulty is in breaking it down.

If there are direct economic factors involved in terms of increased employment—one as against the other, I am not familiar with those. But my answer is not covered a bit by that. Because my point was, without meeting the kind of need that the open-housing provision meets, we will not be meeting the unemployment problem which we face. Or putting it affirmatively, the meeting of that problem is absolutely essential to what I define—to meeting what I define as the hard-core-unemployment problem.

Chairman PROXMIRE. Is there a clear convincing economic argument that jobs have moved to the suburbs much more rapidly than people? And many of the kind of jobs that the hard-core unemployed can fill are in the suburbs, that transportation is a seriously disqualifying problem for them?

Secretary WIRTZ. Yes, sir.

Senator PROXMIRE. I understand, in Washington, some women have to travel 4 hours a day on buses to get to and from their jobs. I am sure in many areas, many places people with jobs far away, many are too discouraged to commute these long distances, and to move, because they just cannot do it.

Secretary WIRTZ. On all of those points—I have no reservation. I meant to include all of those in my answer. And the meeting of those points is essential to meeting both the quantitative and qualitative unemployment problem that we have—more significantly, this qualitative point to which I was referring. My answer ought to be, I think, that that kind of legislation is absolutely essential to the meeting of the hard-core-unemployment problem.

Chairman PROXMIRE. Last year you gave us a very encouraging report on the benefit-cost ratio for manpower training programs. As I recall, I think you said that there was a payoff in saved social welfare costs in a period of a couple of years. In some of these programs, there was a payoff in terms of savings just from increased taxes paid by people who were not employed before, and now have jobs and are employed. This was in a matter of 4 years.

I know you are continuing to study it. Can you give us an updated picture of this?

Secretary WIRTZ. Yes. To whatever extent there has been any change, the savings factor has increased. I was interested in the fact—I noted last night, in the February 24 issue of the Saturday Review, there is a very interesting article on the urban crisis, by General Gavin and

Arthur Hadley. It is an interesting article. I must say that it combines imagination with—which I respect—with some arithmetic which I deplore.

But, on the point that you asked, they put a price tag of \$4,000 a head, per year, on a person——

Chairman PROXMIRE. The payoff?

Secretary WIRTZ. The cost, if we do not train them, is \$4,000 a head. Our figures on training them are going up now, incidentally, because we are moving further and further into the hard core. And our figure—I forget the figures I gave you last year—but we are talking now in a range—where a year ago we were talking in a range between \$1,500 and \$2,500, we are now talking in the range of between \$1,500 and \$3,500. And, if we were not, we would be wrong, because what this means is, we are moving on the hard core.

So, the cost, to whatever extent, what I gave you last year, has been refined—it points in the direction of larger costs per year if we do not do it, as illustrated by General Gavin's \$4,000 a year, and if I had to pinpoint, taking all the programs into account, our costs when we do it, the salvation cost now is between \$2,500 and \$3,000 once, or the alternative is that you lose \$4,000 a year the rest of their lives.

Chairman PROXMIRE. To the extent you can supplement this and break it down, and give us more information for the record, I wish you would. I anticipate that on this program, which asks an increase in appropriations, if Congress is called upon to spend more money, there may well be a serious fight in the Appropriations Committee on the floor. It would be very helpful to this committee to be able to make this kind of finding—because, obviously, if there is a rapid payoff from our spending more on manpower training, it is just bad from the standpoint of good banker-mentality arithmetic—it is bad not to fund this, and not to increase this, this is a superlative investment. It will pay back in a period of a very few years from increased revenues, and from reducing the deficit.

So, from the most conservative principles, it seems to me this is an expenditure which can be justified, and we would like to have the ammunition to do it.

Secretary WIRTZ. I would like to add to the record a careful statement of the fullest amount of the information we have.

(The information subsequently furnished for the record follows:)

REPLY TO QUESTIONS CONCERNING COST-EFFECTIVENESS STUDY OF MANPOWER TRAINING PROGRAMS AND ANTICIPATED INCREASE IN PER CAPITA TRAINING COSTS FOR SEVERELY DISADVANTAGED PERSONS

An unemployed individual with a family on welfare can cost the country roughly \$4,000 a year—and that is the only dollar cost. The cost in human terms—a wasted natural resource—is far higher. The same human being, trained, given the opportunity for rewarding work, and decently housed, may in five years be earning more than twice this amount. Not only would the Government save \$4,000 per year after a moderate initial investment in training and supportive services over a relatively brief period; it would then over a short span of years be directly and fully reimbursed through taxes collected from the individual. More importantly, the individual would contribute to society values that multiply his own pride and worth.

The Department of Labor is engaged in a cost-benefit analysis program in which preliminary studies indicate that approximately one-third of every Federal dollar invested in MDTA training is recouped within two years in savings from unemployment compensation, public assistance, and other Government expenditures.

This does not take into account the additional income accruing to the Government from taxes received as a result of the individual's productive employment. From an overall point of view the average net Federal benefit-cost ratio, defined as direct and indirect benefits to society (again exclusive of increased taxes paid) compared to the Federal investment per trainee, is 3.28 to 1 for on-the-job training, 1.78 to 1 for institutional training, in one year after training.

It must be recognized, however, that these results have been achieved with a relatively select, albeit disadvantaged, group of trainees, and with a substantial sharing of the OJT costs on the part of private industry. The best estimates we currently have available suggest that the employer dollar investment in training has been nearly triple that of the Government. Total estimated cost (Federal plus private) per individual completing OJT (including related instruction) exceeded \$2,800 of which approximately \$800 represented the Federal investment.

The training and job resources of the private sector are essential to the success of the manpower programs. If private industry is to share in the more difficult tasks now confronting us in aiding the most severely disadvantaged, a larger proportionate Federal investment is required. To ask industry to assume increased risks and expenditures concomitant with employment and training of severely disadvantaged persons in view of present employee productivity-profit ratios would be unreasonable.

That costs per trainee will increase as the severely disadvantaged are enrolled has been demonstrated many times. Research and experimental and demonstration programs under the Manpower Development and Training Act in many areas of the country, experience under the poverty programs, such as the Job Corps and Neighborhood Youth Corps, have reaffirmed the need of the most disadvantaged for extended and comprehensive training programs and related services if they are to succeed in breaking through the barriers to success whether self-imposed or resulting from a combination of social, educational, economic, and related factors.

As the Committee is aware, the Department of Labor is just now launching the President's JOBS Program which will enlist full industry support in hiring, training, and retaining in employment the hardest of the hard-core unemployed. Within the next few months, the Department expects to gain further insight into what industry considers to be a realistic estimate of the extra costs to an employer in endeavoring to restore these persons to employability.

Chairman PROXMIRE. One final point. Will you give us a breakdown of unemployment by city—you referred to it earlier; some of the members of the press here, I understand, have been asking for it; they do not have it. If you have it with you, it would be most helpful. We would like to have it. Do you have it duplicated?

Secretary WIRTZ. Yes; it is. I do not know about the matter of mechanics.

Chairman PROXMIRE. We will have our staff distribute it to the press.

Secretary WIRTZ. We will; yes.

Chairman PROXMIRE. Congressman Curtis?

Representative CURTIS. I want to second the remark just made, and say education has economic returns. Yet, our tax laws do not treat it as a capital investment; they treat it as current. And, in this business of so-called economy and establishing priorities, this would be of such high priority that we won't touch it. But I can identify the areas where, at least in my judgment, our expenditures could be cut effectively.

In September, the Monthly Labor Review said:

Independently conducted surveys of the cost effectiveness of the War on Poverty Program show there is little to justify optimism about the value of educational expenditures in general in ameliorating poverty and its conditions. However, expenditures on vocational training are thought to constitute an exception to this rule.

Does the Department agree with this evaluation, and if so, what changes are being recommended in the poverty program?

Secretary WIRTZ. Where does the statement appear?

Representative CURTIS. In the September Monthly Labor Review.

Mr. Ross. Mr. Curtis, am I correct in my recollection that this was from an article which was a kind of symposium of different views express by private individuals?

Representative CURTIS. That is true.

Secretary WIRTZ. The answer to your question is: I do not agree.

Representative CURTIS. Of course, I have felt that we did the proper thing in amending the Manpower Development Training Act to permit general education, as it were. But, that still had the discipline of tying it in with vocational training. You had to teach people to read and write in order for them to take vocational training. With the discipline of having a job in sight, the education was there. But, inasmuch as you do not agree, then—

Secretary WIRTZ. I agree with the second part, and would make the same statement about the first part.

Representative CURTIS. Another article in the Monthly Labor Review, September, said that the application of a minimum wage to agricultural work "will only speed the process of labor displacement."

Do you believe that the agricultural minimum wage will speed the movement of workers from farms to cities, and is this an objective of the Department of Labor?

Mr. Ross. Mr. Curtis, I would like to say again—is it not correct, this is not an expression by the Monthly Labor Review? Was this not merely reporting on an economics meeting, in which a private individual made that statement?

Representative CURTIS. I am sure this is so. There are all sorts of statements in the Monthly Labor Review, just as there are in the Congressional Record. I simply am identifying where the statement was made. I think your Labor Review does very well in presenting all sorts of views.

No; this is only identifying the source—

Chairman PROXMIER. If the Congressman would yield. I appreciate his sentiment. But, I must say, I got the impression, since it came from the Monthly Labor Review, it might very well have been an official statement by the Department.

Representative CURTIS. No. Actually it is the third question—in September.

Secretary WIRTZ. Our view of that, set out in the report filed with the Congress, the so-called section 4(d) report, filed last month—our view is contrary on that point, and is to the effect that the minimum wage law does not result in a reduction in employment.

Representative CURTIS. Let me clarify something. The Monthly Labor Review is not a review which presents the official view point of the Department of Labor; is it? It is simply a series of articles. You might have a statement by the Secretary of Labor, and you might have other things by top officials. But, as I have read it for years—and I again give it a very high mark—it has all sorts of authors.

In fact, I once wrote a little bit for it.

Secretary WIRTZ. On your side or mine?

Representative CURTIS. I have forgotten what it was, even.

Mr. Ross. I think I would say this, Mr. Curtis: The bulk of the articles are written by our staff members, so that insofar as statements of fact are included, we would represent this to be the fact, and that the Department of Labor considers it to be a fact.

Now, occasionally we do have a report of the type that you quoted from, where a meeting of the American Economic Association or some other conference might be reported on. We would state it as a fact that Professor So-and-So has this judgment. But I think that is a little different from the implication that statements of fact made by our own staff members are correct.

Representative CURTIS. Yes, Well, I am glad to have this clarified, because I was not reading that at all in that sense. That is the very reason I asked the question whether there was an agreement with that point of view.

Mr. Ross. Yes. If some article by one of our staff members made that statement, I would either think it was a bad article or else at least I would say I would take the responsibility for the veracity of it.

Representative CURTIS. Yes, Well, I use this material all along. One final question, Mr. Secretary.

I asked, before, about activities of the Manpower Utilization Board, which has now been supplanted under the new draft law by a new board.

Are you a member of this new group?

Secretary WIRTZ. No, sir.

Representative CURTIS. How does the Labor Department get its viewpoints into the consideration of the manpower utilization vis-a-vis the draft?

Secretary WIRTZ. We did on the the most recent occasion—simply addressed by memorandum that group with our views. You will know that under previous practice there had been the identification by the Department of Commerce, Department of Labor of a list of critical occupations and critical industries. That has now been, at our recommendation, stopped, because it was in my judgment a poor list. I am opposed to occupational deferments in general, with a few exceptions. And, furthermore, the local draft boards were making those decisions without regard to —

Representative CURTIS. The draft order says that from now on the local draft boards are going to make these decisions of occupational deferments. Now, how in the name of Heaven can the local draft boards have judgment over the overall manpower skills needed in the society? This is where we are. The Department of Labor then has no way of expressing judgment.

Secretary WIRTZ. We have expressed a judgment by the position we have taken, and that is that, except as there may be particular factors, there should not be occupational or industrial deferments.

Representative CURTIS. I think I would tend to agree with that. But that is not what the draft authorities have said. They have simply said, instead of anything being done in a central place, apparently these local boards had the power to give occupational deferments, on their judgment of what might be needed.

Secretary WIRTZ. Put it this way, Mr. Curtis. To whatever extent there has been a change, it has been a change which will have a marked effect in reducing occupational deferments. Because there

have been deferments before on an almost automatic basis, because they were covered in these lists. Now we have stopped that. There would still be some of what you are talking about. I think there will be less.

Representative CURTIS. I think I would come to a different conclusion on the use of occupational deferments: that this was not an automatic thing that we can both look at and see.

Secretary WIRTZ. I just do not like them—period.

Representative CURTIS. I am so distressed about the failure to do a rational job on manpower utilization by the military, and the draft laws. It is hard to discuss it. What position did the Department take on the latest rule on draft deferment?

Secretary WIRTZ. It was the joint recommendation of the Secretary of Commerce, HEW, Labor—I do not know whether it has been formally released or not—it was in complete support of the action taken.

Representative CURTIS. There was a limitation of the health service field, as I recall.

Secretary WIRTZ. That is right.

Representative CURTIS. Is that because your study showed there was a shortage in this field?

Secretary WIRTZ. No; I am a little out of my jurisdiction on this.

The consideration, as far as doctors and dentists are concerned, is that almost all of them go in anyway.

Representative CURTIS. I was going to mention that. But I thought the coverage was the broad field. Here is the reason I am asking you as Secretary of Labor.

This does deal with, of course, manpower utilization. I think that is essentially Department of Labor. Of course, HEW has a very close affinity to this.

Secretary WIRTZ. We have advised, at these points, Mr. Curtis—at the point of the Marshall Committee, in testimony before several congressional committees, that from the—from our standpoint, the economy presents no needs which have to be served at the price of what I think of as unfair differentiation. There is no manpower consideration which enters into that balance.

Representative CURTIS. I think I share that. I only wish that we could develop a rational system, which I think we could.

Mr. Chairman, I would like to ask unanimous consent that at the point where I was asking the Secretary about the Employment Incentive Act, that the act itself be put in the record. It is not too long.

Chairman PROXMIRE. Without objection.

(See p. 576.)

I would like to ask just one question for the record, before we adjourn.

Mr. Ross, you would be most helpful in this respect.

I have asked witnesses who have appeared from the Council of Economic Advisers, the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve Board—to indicate what specific prices are going to be affected by the surtax. They never come up with an answer. I start off listing some of them—food, no. Automobiles, no, probably not. Steel—no.

They cannot find any.

And I think it would be very helpful for you, as the man in charge

of the Consumer Price Index, if you could give us some indication of the effect of the 10-percent surtax on prices. If you can do so, and show us any indication of when you think the effect might be over a period of a year or so. And could you also give us the assumptions that you make with regard to the impact of the surtax on income—the result that you conclude we could expect on the surtax.

Mr. Ross. I would be glad to do whatever I can on that, Senator.

Chairman PROXMIER. I know it is a big order. Maybe it is an impossible request. But I think unless we get some specific analysis of the effect on particular prices, we are spinning our wheels—we just do not know what we are talking about.

Mr. Ross. Yes, sir.

(The following information was later supplied:)

The effect of the surtax upon personal income depends, of course, on the assumptions that are used in making this analysis. In general, it can be said that disposable personal income would be higher without a surtax than with one—by the amount of the surtax plus some multiplier effect.

However, since prices would be rising more rapidly in an economy not subject to increased taxes, the increase in real income without the proposed surtax is likely to be significantly smaller than the surtax. Moreover, if the realistic assumption is made that new monetary restraints would be necessary if the surtax is not enacted, these restraints could seriously reduce activity in the fields of housing and business investment, thereby cutting back (on an inequitable basis) some of the expected increase in personal income.

Without the proposed income tax surcharge, we would expect the 1968 price increase (GNP deflator) to be as much as half a percentage point greater than with it. This would place the rise close to 4 percent, compared with current projections of about $3\frac{1}{4}$ percent assuming passage of the tax. It is difficult to project beyond the end of this year, but it is quite possible that price increases in the neighborhood of 4 percent during 1968 would influence consumers' expectations and result in further rises subsequently. If that happens, the effects of not passing the tax surcharge would begin to show up clearly during the last half of this year, and probably would cause an acceleration of price increases early next year.

The prices that would advance the most if the surcharge were not passed are those for products that have high income elasticities. These comprise commodities and services for which the consumer has considerable discretionary power to spend or not spend. In this category it would seem applicable to place such items as home purchase, restaurant meals, new and used cars, recreational goods and services, some clothing items, furniture, appliances, and floor coverings. These goods constitute about 25 percent of the total weight of the consumer price index.

Chairman PROXMIER. Thank you very much.

Thank you, Mr. Secretary, and Mr. Ross, for an excellent presentation. It has been a most enlightening morning.

Secretary WIRTZ. Could I, Mr. Chairman, add to the record, at this point, an expression of what I know is a regret, shared by the members of this committee and by myself, about Mr. Ross leaving the Government to go back to the university world, and to take this opportunity to express just a very deep gratitude for what he has brought in the last $2\frac{1}{2}$ to 3 years to the kind of Government discussion which is illustrated here this morning, and which I think is so imperative to our being a Government instead of just a bunch of administrators. I am sorry to see him leave.

Chairman PROXMIER. I am delighted that you brought that up, Mr. Secretary. I have the greatest admiration and respect for Mr. Ross. He has done a superlative job. He has certainly won the confidence of

the Congress and the country. We are going to miss him very, very much. We just wish he were going to stay on here.

The committee will supply additional questions to you which we trust you will respond to in sufficient time for incorporation into the record.

Secretary WIRTZ. We will be happy to do so, Mr. Chairman.

Chairman PROXMIRE. Thank you very much.

We will reconvene at 10 o'clock tomorrow morning, and 2 o'clock tomorrow afternoon, for our final session.

(Whereupon, at 1 p.m., the committee was recessed, to reconvene at 10 a.m., Wednesday, Feb. 21, 1968.)

(The material which follows was subsequently supplied for the record:)

PRICES, COSTS, AND INCOMES

Question 1. What proportions of the overall rise in the Consumer Price Index were accounted for by its major components? (This type of information for 1966 was supplied for last year's record, appearing on page 295.)

Answer : Information is supplied by the attached table.

PERCENT CHANGE AND CONTRIBUTION TO TOTAL CHANGE, SELECTED CONSUMER PRICE INDEX COMPONENTS,
DECEMBER 1966 TO DECEMBER 1967

Component	Percent change	Percent of total
All items.....	3.1	100.0
Food.....	1.2	9.3
Food at home.....	2.3	1.7
Food away from home.....	4.8	7.6
Housing.....	2.7	29.2
Shelter.....	3.0	20.6
Rent.....	2.0	3.5
Hotel and motel room rates.....	4.8	6.6
Homeownership.....	3.4	16.5
Purchase, taxes, and insurance.....	3.6	10.0
Mortgage interest.....	1.5	1.5
Maintenance and repairs.....	4.6	4.9
Commodities.....	2.3	7.7
Services.....	5.7	4.2
Fuel and utilities.....	.8	1.3
Fuel oil and coal.....	2.6	.6
Gas and electricity.....	.7	.6
Telephone, water, and sewer.....	.2	.1
Household furnishings and operation.....	2.8	7.2
Textile housefurnishings.....	2.0	.4
Furniture.....	3.3	1.6
Floor coverings.....	.4	.1
Appliances.....	1.0	.4
Other housefurnishings.....	2.4	.7
Housekeeping supplies.....	1.3	.6
Housekeeping services.....	6.3	3.5
Apparel and upkeep.....	4.0	14.2
Men's and boys'.....	3.7	3.6
Women's and girls'.....	5.1	6.8
Footwear.....	4.1	2.2
Other apparel.....	2.4	1.7
Commodities.....	2.0	.4
Services.....	2.5	1.3
Transportation.....	3.6	16.9
Private.....	3.7	15.2
New cars.....	2.7	2.2
Used cars.....	9.3	6.7
Gasoline and motor oil.....	1.5	1.7
Tires.....	4.5	1.1
Auto repairs.....	4.2	1.4
Other auto expense.....	2.3	2.2
Public.....	3.9	1.7
Health and recreation.....	4.6	30.0
Medical care.....	6.4	12.9
Drugs and prescriptions.....	-.2	-.1
Professional services.....	5.5	5.0
Hospital services and health insurance overhead.....	11.0	8.0
Personal care.....	3.1	2.8
Toilet goods.....	2.0	.9
Barber and beauty shops.....	4.2	1.8
Reading and recreation.....	3.2	6.3
Recreation goods.....	0	0
Recreational services.....	6.1	3.4
Reading and education.....	5.1	2.9
Other goods and services.....	4.7	8.0
Tobacco products.....	6.3	4.2
Alcoholic beverage.....	3.5	3.1
Personal expense.....	4.2	.7
Financing charges.....	3.0	.4
Commodities.....	2.5	54.3
Nondurables.....	2.3	36.8
Durables.....	2.9	17.5
Services.....	3.9	45.7
Commodities less food.....	3.2	45.0
Nondurables less food.....	3.4	27.5
Apparel commodities.....	4.2	13.0
Apparel less footwear.....	4.3	10.8
Nondurables less food and apparel.....	2.8	14.5
New cars.....	2.7	2.2
Used cars.....	9.3	6.7
Household durables.....	1.4	2.4
Housefurnishings.....	2.1	3.1
Services less rent.....	4.3	42.2
Household services less rent.....	3.4	15.8
Transportation services.....	3.1	5.3
Medical care services.....	7.9	13.0
Other services.....	4.2	8.2

Source: U.S. Department of Labor, Bureau of Labor Statistics, Office of Prices and Living Conditions.

Question 2. The Council compared consumer price increases in major OECD countries. Are data available for a comparison of wholesale prices and prices of commodities important in international trade?

Answer: Data comparing wholesale price indexes of the United States and other major industrial nations are given in the attached table.

Most countries use foreign trade statistics to construct average value indexes of imports and exports which are used as deflators for the foreign trade sector of the national accounts. Indexes based on trade values do not ordinarily constitute reliable indicators of commodity price changes for use in balance-of-payments analysis, however, because the value categories are sometimes broad enough to include a large number of heterogeneous commodities. In the case of manufactured commodities especially, changes in unit value indexes often result from shifts in product mix rather than from changes in commodity prices.

Accordingly, the Bureau of Labor Statistics is developing a new program designed to obtain prices suitable for comparing price trends and, in some cases, price levels for important durable manufactured commodities sold by the United States and other major trading nations. Conceptual research for the program has been accomplished, plans for price collection have been developed and cooperative arrangements for the international exchange of information within the OECD framework have been discussed with other major exporting countries. Funds have been requested of the Congress to initiate the necessary comprehensive price collection program.

WHOLESALE PRICE INDEXES IN THE UNITED STATES AND OTHER MAJOR INDUSTRIAL COUNTRIES, 1955-57

[1960=100]

Period	United States ¹	Canada	France ²	Germany ³	Netherlands	United Kingdom ⁴	Japan ⁵
1955.....	91.4	92.7	77.9	91.1	99	89.0	(9)
1956.....	95.0	95.6	80.8	93.7	99	93.1	(9)
1957.....	97.9	98.2	84.7	96.7	101	96.6	(9)
1958.....	99.0	98.4	90.3	98.6	100	97.8	(9)
1959.....	99.8	99.8	96.4	98.5	100	98.5	(9)
1960.....	100.0	100.0	100.0	100.0	100	100.0	100.0
1961.....	99.6	101.0	103.0	103.1	100	102.7	(9)
1962.....	99.7	102.8	104.1	107.2	101	104.0	(9)
1963.....	99.5	105.0	107.2	108.1	103	104.7	102.9
1964.....	100.0	105.9	109.8	110.2	109	107.5	102.7
1965.....	101.7	107.9	110.4	113.5	112	111.6	105.2
1966.....	104.5	111.1	113.6	116.4	117	114.7	107.9
I.....	103.7	110.0	112.5	114.9	117	113.2	107.4
II.....	104.3	110.8	114.5	116.7	117	114.7	107.5
III.....	105.1	111.7	113.7	117.2	118	115.3	107.8
IV.....	105.0	111.6	113.5	116.6	119	115.1	108.7
1967.....	105.5						
I.....	105.2	112.2	113.2	116.6	119	115.2	108.9
II.....	105.2	112.8	112.0	116.3	118	115.2	109.0
III.....	105.7	113.4	112.6	115.9	119	116.1	109.8
IV.....	106.1						

¹ Total manufactures excluding farm products and other raw or slightly processed goods.

² Intermediate goods excluding food and fuel.

³ Investment goods.

⁴ Manufactured goods, excluding food.

⁵ Manufactured goods, total; component indexes are available for years prior to 1963.

⁶ Not available.

Sources: U.S. Bureau of Labor Statistics and Organization for Economic Cooperation and Development, Main Economic Indicators, various issues.

Question 3. What are the possibilities that the exceptionally low increase in productivity in 1967 will be followed by exceptionally rapid advances in 1968?

Answer: We expect a more rapid increase in productivity in 1968, reflecting the anticipated acceleration in the growth of real output, and the concomitant more efficient utilization of manpower resources in the production process.

If output grows at approximately a 4 percent annual rate, we would expect productivity in the private economy to advance by about 2½ to 3 percent. The better balance between production and unemployment should pave the way for a gradual return to the 1947-67 trend rate of productivity growth of 3.2 percent.

Question 4. What factors accounted for the plateau of real compensation and spendable earnings of production and nonsupervisory workers? How important

were such factors as changes in the industry mix, changes in sex or skill mix, consumer price changes, and social security tax?

Answer: The plateau of real compensation and spendable earnings of production and nonsupervisory workers was due to a combination of factors which offset the rise in hourly earnings.

The most important factor was the 3.1 percent rise in the CPI between December 1966 and December 1967. Next most important was a decline of about half an hour (1 percent) in the number of hours worked.

Two other factors affected spendable earnings. (1) As earnings rise the percent withheld for income taxes rises and, hence spendable earnings rise less rapidly than gross earnings. (2) Social security withholding taxes were increased 0.2 percent effective in January 1967.

Shifts of employment among industries were not a factor in the leveling off. The effect of these factors on the various series was as follows:

Gross hourly earnings rose 5.0 percent between December 1966 and December 1967. The decline in hours reduced this to a 3.9 percent rise in *gross weekly earnings*. The rise in social security taxes and in income taxes with the advance in earnings cut the gain in *gross spendable earnings* to 3.3 percent.

The rise in the CPI cut the gain in *real gross weekly earnings* to 0.8 percent and the gain in *real spendable weekly earnings* (i.e., for a worker with three dependents after Federal taxes) to 0.2 percent.

MANPOWER POLICIES AND PROGRAMS

Question 1. How does the level of the unemployment rate in the United States during the past two years compare to the rates in other advanced industrial nations of the free world—after adjustment for differences in concepts and methodologies?

Answer: The table below shows unemployment rates of eight industrial countries, adjusted to U.S. concepts. With the exception of Great Britain, all of the adjusted rates are based primarily on data derived from labor force surveys similar to the United States monthly labor force survey. The adjusted rates for Great Britain, which has not conducted a labor force survey, are based on a comprehensive 1962 comparative study of British and the United States unemployment rates.

Although the data have been adjusted for all known major definitional differences, it should be recognized that it has been possible to achieve only approximate comparability among countries. Nevertheless, the adjusted figures provide a better basis for international comparisons than the usually published figures which are based on labor force and unemployment definitions that differ from country to country and dissimilar methods of computing unemployment rates.

With the exception of the United States and Canada, most 1966 and 1967 figures and 1965 figures for Germany and France are preliminary estimates because all of the data necessary for the adjustment purposes are not yet available.

UNEMPLOYMENT RATES OF EIGHT INDUSTRIAL COUNTRIES ADJUSTED TO U.S. CONCEPTS, 1965-67

	Percent unemployed		
	1965	1966	1967
United States.....	4.5	3.8	3.8
Canada.....	3.9	3.6	4.1
France.....	2.3	2.4	3.2
Germany (Federal Republic).....	.3	.3	.9
Great Britain.....	2.1	2.3	3.3
Italy.....	4.0	4.2	3.7
Japan.....	1.0	1.1	1.1
Sweden.....	1.2	1.6	2.2

Source: U.S. Department of Labor, Bureau of Labor Statistics, Office of Foreign Labor and Trade.

Question 2. We used to hear the theory expressed that if only the unemployment rate could be held below 4 percent for a few years, the inflationary pressures would diminish as employers adjusted their recruitment and training practices and workers were trained, migrated, and searched more efficiently for jobs.

Do we have much concrete evidence to indicate whether and to what extent this may be correct?

Answer: In late 1965, the unemployment rate began to fall sharply, giving rise to fears that a general labor shortage and its resulting inflationary pressures were imminent. Through the first half of 1966 the Nation's job market was very tight, with manpower shortages appearing in some areas, occupations, and industries. In the summer of 1966 the tight situation stabilized, and by the fall it had eased considerably.

Although the easing in part reflected a more moderate growth of the economy, it also resulted from improved employer practices of various kinds as well as an expanded government training effort. Additional training programs were established and existing ones expanded, jobs were redesigned, new methods of recruiting were instituted, and in many cases unnecessarily high hiring specifications—age, sex, race, education, and experience—were relaxed. Combined, these actions served to ease the Nation's manpower stringencies.

Information regarding these developments comes to the Labor Department through a variety of methods. In general, the evidence has been fairly clear and unambiguous where employer training and recruitment practices are concerned. The Bureau of Employment Security and the affiliated State Employment Services are closely in touch with employers' manpower needs and hiring practices. The Department's various manpower training programs involve special efforts to meet existing or incipient shortage situations. In addition, the information from the continuing reports on employment, turnover, and job placements confirm the easing of the employment situation since 1966.

Question 3. Where are the labor shortages in the economy and to what extent are they general? Has there been any progress within the last year in the measurement of different dimensions of labor shortages—for example, in the detailed measurement of job vacancies?

Answer: In early 1968 the manpower situation appears to be much the same as it was during the last half of 1967, a time when the job market had loosened from the tight situation of late 1965 and early 1966. Occupational stringencies are being partially offset by increased numbers of available applicants. Demand for production workers in particular is well below 1966 levels, although unmet needs for professional and technical workers remain relatively high. Among the occupations most in demand are engineers, electronics technicians, registered and licensed practical nurses and social workers.

The easing of the job market has been geographically widespread. The number of areas classified by the Bureau of Employment Security as having low unemployment—one indicator of the geographic impact of labor shortages—has fallen from 66 in December 1966 to 51 at the end of 1967.

There has been only limited progress within the past year in improving the measurement of labor shortages. No comprehensive statistical program to measure job vacancies is currently in effect. Funds for such a program were twice recommended to the Congress in recent years, but the appropriations request was not approved. In light of the continuing need for information on job opportunities, the Department has been working to develop a limited program within its current resources. It may prove possible in the next few months to initiate a program to measure more completely the availability of current job opportunities. Such a program would provide some important insights into job vacancies and labor shortages.

Question 4. How advanced is the clearance system for matching job openings with available workers? How long will it be before Project LINCS, or the application of automatic data processing systems to placement operations, becomes operational on a broad scale?

Answer: (a) The present clearance system requires a local employment office to distribute employer orders and applicant qualifications by mail through State headquarters clearance section channels to other local offices throughout the country. Except for the LINCS experiment all matching of job requirements and applicant qualifications is done by manual search.

An *interim* clearance procedure designed to improve the present manual search system, pending nationwide adaptation of an ADP system, is about to be released to the field. It will permit local offices to deal with each other directly regardless of State lines, and eliminates the practice of referring applicants to the order-holding office for rescreening.

The interim procedures also require offices within large metropolitan urban areas to share orders by telephone or other electronic means of communication if available. This revision will eliminate the paper shuffling between offices in the same job market area and will result in a saving of staff and applicant time.

(b) Project LINCOS, the experimental use of computers to match applicant characteristics with individual job requirements, is now installed in professional placement offices in Sacramento, San Francisco, and Los Angeles. Since July 1966, this experiment has been an integral part of a much more comprehensive, contractor-assisted effort to develop model data systems meeting management, operations, and research information requirements throughout the Federal-State employment security community.

The first phase of this study was completed in May 1967 when systems concepts were approved. The second phase, development and implementation of prototype systems, is now underway. This will be followed by a third and final phase involving evaluation of these systems and their implementation nationwide.

Current major undertakings include the development and subsequent implementation of: (1) compatible automated data systems in each of three model State agencies; (2) a model Area Manpower Data System to support human resources development and manpower training operations in the tri-State New York City metropolitan area; (3) modifications of the experimental California LINCOS system; and (4) the Wisconsin agency's tests of worker-trait profiles as screening devices in computer-assisted placement.

The Project LINCOS and Wisconsin efforts are tests of file indexing, computer-oriented screening techniques, and other methodologies designed to meet discrete systems requirements in the area of bringing worker and job together. Results of these experiments will have significant impact upon model systems design and on computer-screening approaches to be introduced nationally.

Integration of existing computer applications in the model States will begin in September 1968. Implementation of the tri-State New York area Manpower Data System will begin the following month. An interim automated Federal reporting system will be implemented by January 1, 1969 to ease the considerable reporting burden of State employment security agencies. The three model State Systems are expected to become fully operational during 1970. Following their evaluation and the preparation of an orderly plan for nationwide implementation, exportation of these model systems or selected subsystems thereof to other States will begin within a reasonable period. Uncertainties with regard to financial resource availability and other variables such as equipment procurement cycles preclude precise assessment as to when these system will be operational throughout the States.

Question 5. With the post-World War II "baby boom" coming into the labor force, how rapidly will the labor force expand this year and the next few years? How rapid must be economic growth to absorb the growth in the labor force over the next few years?

Answer: Based on increasing population and trends in labor force activity, the anticipated increase in the labor force over the next few years is as follows:

	Anticipated net growth (in millions)	Percent increase over the previous year
1967-68.....	1.4	1.7
1968-69.....	1.4	1.7
1969-70.....	1.4	1.7
1970-71.....	1.5	1.7
1971-72.....	1.5	1.7

Assuming no change in average hours of work, the rate of economic growth necessary to absorb the increase in the labor force would be 1.7 percent plus the gains in productivity.

Question 6. How much information do we have on the migratory characteristics of ghetto dwellers? For example, how many are displaced from agriculture?

Answer: Little information is available about the former occupation of ghetto dwellers who are migrants to the city. We know that about half of large-city

Negro residents were not born there, although most have lived in the city more than 5 years.¹

Negro ghetto dwellers in the North originate chiefly from the South. The Southern distribution of Negroes by occupation for earlier decades suggests that Negro adults presently living in large cities were not overwhelmingly in agriculture.

In 1950, about one-fifth (23 percent) of Negro workers in the South were non-farm laborers and about one-fifth were farmers or farm managers (19 percent). Almost one-fifth (18 percent) were production workers (operatives or kindred) and 6 percent were craftsmen. Only 15 percent were farm laborers; 10 percent were service workers. From 1950 to 1960 the proportion of Negro farm managers and operators declined by more than half, and the ratio of farm laborers by only a little. The number working in industry in the South rose appreciably.²

Most studies of Negro migrants to cities conclude that although those migrating are lower in status than their counterparts already in the city, they are drawn from a segment that is higher in status than the general population in the place of origin.³

A study of *Hard-Core Unemployment and Poverty in Los Angeles*, issued by the U.S. Department of Commerce in 1963 and prepared by staff of the Institute of Industrial Relations of the University of California at Los Angeles, provides information about unemployed migrants' last job before moving to California. About 15 percent of the Negro and Mexican-American men and women had been in agriculture before migrating. More than one-third had been in semi-skilled work. One-third had been in unskilled jobs outside of agriculture. The remainder had been in service work (12 percent) or skilled occupations (7 percent).

One may therefore conclude tentatively that given the distribution and change in the occupational structure among Negroes in the South, and the characteristics of migrants, a substantial number of the migrants to cities had nonfarm occupations.

A few special sample surveys have recently been made from which data may be derived later. The Federal Government's 1967 Survey of Economic Opportunity will show the origin and occupation of persons living in poverty areas, but the tabulations are not yet run.

A study of households in Detroit following last summer's riots was made under the direction of Professor Ferman of the Institute of Labor and Industrial Relations at Ann Arbor. Questions about origin and previous occupations were asked and data might be obtained from this source. The study results have not yet been released.

A sample study now under way in Cleveland will provide data on the origin and characteristics of white and nonwhite migrants. This survey is being made by the Bureau of Social Science Research, Inc., located in Washington, D.C. Results will be available within the next several months.

Question 7. Given appropriate monetary and fiscal policies, what percentage of the labor force would be—

- (a) frictionally unemployed,
- (b) structurally unemployed but retrainable for employment in private industry,
- (c) structurally unemployed, retrainable, and capable of holding useful, but subsidized or government-provided employment,
- (d) employed full-time but earning less than \$3,000 a year?

Answer: There can be no precise indication of the percentage of the labor force that could be termed frictionally or structurally unemployed given appropriate monetary and fiscal policies. However, there have been some estimates that frictional unemployment—an irreducible minimum of unemployment covering normal labor turnover and seasonal fluctuations—might be reached in the range of 2 to 2.5 percent overall unemployment. Under present conditions of unemployment hovering around 3¼ percent, the balance of about 1½ percent might be termed structurally unemployed.

¹ Concluded from data on the mobility status of populations in lower-income neighborhoods of Cleveland and Los Angeles, 1960-65, and from annual reports on mobility of the population, by color. (See Census Bureau studies P-20, No. 156 and Series P-23, No. 18 and 21.)

² Table II-B-4 in *The Negroes in the United States*, BLS Bulletin No. 1511.

³ See Karl and Alma Taeubers' study *Negroes in Cities*, Chicago, Aldine Publishing Company, 1965. (Chapter 6.)

In addition to those included in the unemployment count, there are many others who are either underemployed (working part-time although available for full-time work, or working below their abilities), or who have not counted as being in the labor force because they have ceased looking for work. Many of these individuals find themselves disadvantaged in the same way as the structurally unemployed.

As regards the structurally unemployed but retrainable—whether for industry or for government—there are few practical limits. Nearly everyone is trainable or retrainable.

Data are available indicating the number of full-time workers who earn less than \$3,000 a year. In 1966, there were 6.5 million persons (8.6 percent of the labor force) who worked at full-time jobs and had incomes of \$3,000 a year or less. Some of these were unattached individuals or members of a family with other bread-winners, so not all could be characterized as "poor." It can be anticipated that with the appropriate manpower development programs, monetary and fiscal policies would provide an economic climate in which every full-time worker could be earning more than poverty level wages.

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 21, 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, Jordon, and Miller; and Representatives Bolling, Reuss, Moorhead, and Brock.

Also present: William H. Moore, senior economist.

Chairman PROXMIRE. The committee will come to order.

We expect other members to be along shortly.

We are honored this morning to have three of the Nation's most eminent economists. All of you are highly reputable. You are well-known to the Congress and to the country for your ability—representing one of the Nation's outstanding banks, and one of the Nation's outstanding firms in the area of forecasting and economic advice in general, and, of course, one of the great universities.

I suggest we begin with Mr. Olsen. I would also suggest, since there are three witnesses and there will be other members who will want to question in some detail, that if you gentlemen would want to abbreviate your statement at any point, try and make your comments in 15 minutes, if you could. We will insert the entire statement in the record as if read, and it will be available to all members of the committee.

We will start off with Mr. Olsen, and then Mr. O'Leary, and then Mr. Hart.

STATEMENT OF LEIF OLSEN, SENIOR VICE PRESIDENT AND ECONOMIST, THE FIRST NATIONAL CITY BANK, NEW YORK

MR. OLSEN. Mr. Chairman, I would like to thank the committee for this opportunity to speak on the Economic Report of the President and the Annual Report of the Council of Economic Advisers. While I will touch on a number of aspects of these reports, my major thesis is that the Council's economic strategy continues to underestimate the ability of monetary policy to influence changes in economic activity. This has contributed to the higher rates of inflation and interest we have today.

It is my hope that my remarks on monetary policy will add to those of others who have testified in earlier years before this committee. I have in mind here particularly those submitted last year by John M. Culbertson, professor of economics at the University of Wisconsin, and by Beryl W. Sprinkel, vice president and economist, Harris Trust & Savings Bank, Chicago, Ill. Hopefully, this growing body of

testimony will help to encourage a more penetrating look into monetary factors by Congress and the Council of Economic Advisers.

As this committee knows from past testimony, economists differ sharply over the relative merits of using fiscal policy (i.e., changes in tax rates) or monetary policy in influencing business conditions. The Council of Economic Advisers has assigned primary importance to changes in tax rates and placed monetary policy in a subordinate role at best. Because our national economic policies are being influenced so one-sidedly by fiscal theory, the debate has sharpened in recent years.

The Council's economic strategy seeks to fulfill the goals of the Employment Act of 1946: "Maximum employment, production, and purchasing power." We now have full employment. To maximize purchasing power we must restrain the pace of expansion. Here the Council maintains that monetary policy can do this only by pushing interest rates to excessive levels, disruptive to housing and falling generally with an uneven impact on the economy. The Council prefers to seek economic stability through higher tax rates rather than higher interest rates.

I do not quarrel with the desirability of a tax increase at the present time, given the Vietnamese war and the helpfulness of bringing fiscal needs to the attention of every taxpayer. But, I do question the validity of the Council's fiscal-monetary strategy for economic stability. Monetary policy can smoothly slow the pace of economic expansion if properly executed. The great danger is that monetary policy may become a captive of fiscal policy, thus seriously hampering its execution.

If it is to be effective in stabilizing the economy, monetary policy must not be made dependent on the requirements of fiscal policy or Treasury borrowing. If it is, we will continue to experience what we have had over the past 2 years—wide swings in credit conditions, high interest rates and high rates of inflation.

The Council credits monetary policy with the ability to stimulate the economy but not by itself, only in conjunction with fiscal policy. As its report states: "Through nearly 5 years of economic expansion, monetary policy reinforced expansionary fiscal measures * * * it made a major contribution to the advance of the economy by accommodating growing credit demands at remarkably stable interest rates."

A view that harkens back to the thirties holds that at low interest rates banks will not lend and the public will not spend additional cash; thus Federal budget deficits are needed to stimulate spending and the demand for credit. Today, interest rates are high and monetary policy has demonstrated its ability alone to increase bank lending, money supply and public spending. But a significant increase in demands in the economy can be realized only by an increase in money supply, or a faster turnover of money.

MONETARY POLICY AS AN INSTRUMENT FOR RESTRAINT

But the primary problem facing the country today is to restrain the economy. The Council notes in its report: "The ability of tight money to restrain the economy was clearly demonstrated in 1966, but so were its uneven impact and the troublesome side effects of a financial

squeeze." The events of 1966 have been used to discredit monetary policy as the primary instrument of restraint. But the 1966 credit squeeze was largely a matter of poor policy execution. Monetary policy not only should be used to restrain excessive demand but it must be used—tax increase or no tax increase—if we are to avoid still higher rates of inflation and still higher rates of interest.

Against the background of these two theoretical views, let us examine the experiences of 1966 and 1967. I know that much has already been said about the 1966 experience and I will be as brief as possible.

You must recall that during the second half of 1965 heavy defense orders were superimposed on a capital goods boom—a combination of events without precedent in recent economic history. This combination alone was sufficient to push the demand for credit sharply higher, but other stimulants to borrowing were introduced.

The 1964 program to speed up corporate income tax payments was accelerated further in early 1966. In addition, social security taxes were increased January 1 of that year. Corporations were also required, beginning in the second quarter, to speed up their payments to the Treasury of withholding and other taxes for which they act as collectors.

At the same time, monetary authorities began to move in late 1965 toward a less-expansive policy. Nevertheless, total bank reserves and money supply continued to grow at a relatively rapid rate in the first quarter of 1966. Beginning in the second quarter, Federal Reserve policy shifted abruptly toward a policy of severe restraint, which was, in retrospect, too sudden and too severe. Public statements made by monetary authorities made it clear that the Federal Reserve was trying hard to produce a sudden and sharp slowdown in commercial bank loans to business. However, considering the degree to which monetary expansion had just previously been stimulating growth of incomes, spending and credit demands, and considering the leadtime of corporate financial plans, it was unreasonable for monetary authorities to expect a prompt drop in bank loans to business.

Corporations had been hit, in a sense, by a temporary tax increase in the form of accelerated tax payments in the first half of 1966. This shows up in the marked increase in business borrowing over the tax payment dates in April and June of that year. (See table A.)

In effect, corporations were forced to borrow on behalf of the U.S. Treasury. The Federal Reserve did not accommodate this borrowing as it would have had the borrowing been done directly by the Treasury.

We had a situation in which American business was being asked by the Defense Department to tool up and staff for heavy defense needs at the same time that it was heavily committed to capital goods orders. It was also asked to help meet the Treasury Department's financing requirements. Yet the Federal Reserve aggressively sought, and expected, a prompt slowdown in business borrowing.

So hard did monetary policy squeeze in, trying to stop business borrowing, that it seemed to many to overlook the damage it was doing to the housing industry. It was, in my opinion, clearly a case of excessive restraint, of poor execution of monetary policy. Less obvious was the damage to the overall economy. Long historical experience demon-

TABLE A.—CHANGES IN BUSINESS LOANS AT WEEKLY REPORTING MEMBER BANKS OVER TAX DATE PERIODS

1964:		1966:	
March 11.....	-92	March 9.....	-167
March 18.....	+630	March 16.....	+1,309
Total.....	+538	Total.....	+1,142
April 15.....	+288	April 13.....	+150
April 22.....	-237	April 20.....	+158
Total.....	+51	Total.....	+308
June 10.....	-9	June 15.....	+1,253
June 17.....	+651	June 22.....	+641
Total.....	+642	Total.....	+1,894
September 9.....	-60	September 14.....	+336
September 16.....	+771	September 21.....	+762
Total.....	+711	Total.....	+1,098
December 9.....	-85	December 14.....	+345
December 16.....	+754	December 21.....	+745
Total.....	+669	Total.....	+1,090
1965:		1967:	
March 10.....	-189	March 15.....	+1,110
March 17.....	+1,171	March 22.....	+160
Total.....	+991	Total.....	+1,261
April 14.....	+85	April 12.....	-102
April 21.....	+77	April 19.....	+646
Total.....	+162	Total.....	+554
June 9.....	-12	June 14.....	+905
June 16.....	+1,215	June 21.....	+1,477
Total.....	+1,203	Total.....	+2,382
September 15.....	+926	September 13.....	+47
September 22.....	+278	September 20.....	+864
Total.....	+1,204	Total.....	+911
December 15.....	+991	December 13.....	+11
December 22.....	+544	December 20.....	+1,417
Total.....	+1,535	Total.....	+1,428

Source: Board of Governors, Federal Reserve System.

strates that persistent monetary restraint leads, sooner or later, to a business recession.

Once the tax payments were out of the way in June, business demands for credit did slow down. Beginning in August, in fact, commercial bank loans to business virtually stopped growing altogether, on a seasonally adjusted basis. The ultimate result of monetary restraint in 1966 was the minirecession of the first half of 1967. Indeed, the lag between cause and effect was unusually short in this period. A more patient monetary posture should have been undertaken, considering the kind of impetus behind business borrowing needs.

It is clear that severe credit restraint depressed housing in 1966. But we may be assigning too much of the blame to monetary policy if we fail to look at some of the earlier events. In 1962 and 1963, the Federal Home Loan Bank System expanded the flow of credit to the savings and loan industry.

This heavy, short-term indebtedness to the Federal Home Loan Bank System was carried forward into 1966 and limited the ability of the home loan banks to supply additional relief during that critical

year when such credit should have been available. The rollover of the excessive debt and new cash borrowings in a period of rising short-term rates added to the costs of savings and loan associations and restricted their ability to acquire mortgages. The liquidity breakdown is well explained in "A Study of Mortgage Credit" prepared last year at the request of the Subcommittee on Housing and Urban Affairs of the Senate Committee on Banking and Currency.

So the depressed housing market of 1966 had some legacies from earlier years which made the situation worse than it might otherwise have been. I offer this analysis because I believe that monetary policy, while at fault, may have been excessively condemned.

The implication that monetary policy succeeded in slowing down the pace of economic expansion only by causing a sharp decline in home-building and other areas of construction is an oversimplification. Monetary policy has a much more pervasive influence. The effects of a sharp slowdown or a cessation of the growth of money supply can be found in consumer spending and the demand for financial assets—stocks and bonds—as well as plant and equipment outlays. In any event, monetary policy has been generally credited with the moderation of the rate of economic expansion in the first half of 1967.

THE CONTRARY BEHAVIOR OF INTEREST RATES IN 1967

Many economists have long held that monetary policy influences the economy primarily through interest rates. In other words, rising interest rates gradually deter economic growth and falling interest rates encourage it. It is generally believed that the Federal Reserve can readily control the level of interest rates by adjusting the supply of credit. In 1967—and not for the first time—these views were disproved. The Federal Reserve became increasingly expansive, yet interest rates rose higher and higher. Moreover, the rise in interest rates did not harm business conditions; instead economic expansion speeded up in the course of the year. One important lesson we should learn from this is that monetary authorities do not have as much control over interest rates as they once assumed.

Expectations of borrowers and lenders play an important role in changing the structure of interest rates. In the spring of 1967, even after the Federal Reserve reduced the discount rate from 4½ to 4 percent, long-term rates continued the rise that began in late February. In the course of the year some rates reached the highest levels since the Civil War.

The rising volume of new corporate issues in the first half of 1967 was not unusual. In recessions—and the first half of last year has been tagged a minirecession—corporate treasurers generally seek to strengthen their debt structures. However, in the past, long-term interest rates have continued to edge lower despite the enlarged volume of new capital issues.

I would suggest that the sudden, unusual acceleration in the volume of new capital issues in the second quarter of 1967 was not so much a legacy of 1966 as it was the expectation of extraordinarily large Government financing requirements in the second half of last year and in 1968.

The original budget figures released by the administration in Janu-

ary projected a fiscal 1968 deficit of only \$4.3 billion on a cash budget basis. Consequently, in the early months of last year there was little awareness that the deficit in reality would be many times larger. The administration proposed enactment of the tax surcharge to become effective at midyear. However, by mid-March, word began to spread through the investment banking community that the Federal budget deficit was rapidly worsening and that Federal borrowing in the second half of the year would be staggering.

Corporate borrowers with long-term requirements were told to get in and get their money early before the Federal Government got to the market. This was a major factor in altering the expectations of both borrowers and lenders. Inflationary expectations were also enhanced by news of a worsening in the deficit. This, too, contributed to rising rates as lenders demanded higher yields to offset the effects of inflation on income.

The early assessment by the market of the Government's money needs proved accurate. Net issues of U.S. Government securities acquired by the public in the second half of 1967 totaled \$19 billion, a sharp contrast with the \$4 to \$5 billion in the second half of the 2 preceding years. (See table B.)

TABLE B.—NET ISSUES OF U.S. GOVERNMENT SECURITIES, 1965-67

[Billions of dollars; not seasonally adjusted]

	1st half	2d half	Year
Total securities issued: ¹			
1965.....	-2.4	6.1	3.6
1966.....	-7	7.0	6.3
1967.....	-8.3	21.0	12.7
Acquired by Federal Reserve:			
1965.....	2.0	1.7	3.7
1966.....	1.4	2.1	3.5
1967.....	2.4	2.4	4.8
Acquired by public:			
1965.....	-4.4	4.4	-1
1966.....	-2.1	4.9	2.8
1967.....	-10.7	18.6	7.9
Commercial banks:			
1965.....	-6.8	4.4	-2.4
1966.....	-5.5	2.2	-3.4
1967.....	-1.6	10.2	8.7
Nonbank financial institutions:			
1965.....	-2	-7	-8
1966.....	-6	1.5	9
1967.....	-2.9	3.1	2
Nonfinancial corporations:			
1965.....	-2.7	.6	-2.1
1966.....	-1.4	.2	-1.2
1967.....	-3.9	1.1	-2.7
Households:			
1965.....	2.4	.6	3.0
1966.....	4.7	3.2	7.9
1967.....	-2.0	3.4	1.3
Foreign investors:			
1965.....	-8	.7	-1
1966.....	-1.5	-1.1	-2.6
1967.....	.8	.7	1.4

¹ Excludes securities acquired by Federal trust funds, etc. Includes Federal agency issues and participation certificates. 7

Sources: Federal Reserve Board, flow of funds data.

MONETARY POLICY BECOMES a CAPTIVE OF FISCAL POLICY

The theoretical view that assigns little importance to monetary policy as a stimulant in the economy led to a great paradox in 1967.

During the year, administration economists were warning that impending inflationary pressures and overheating in the economy would require a tax increase. Nevertheless, monetary authorities pursued the most expansive policy since World War II without any word of caution from administration economists. It would certainly see that in the face of repeated warnings of an overheating in the economy monetary authorities would have followed a more cautious policy. The fact is, they did not.

While there are many considerations that go into the making of monetary policy, there is one I believe which deserves special attention. This is the extent to which the Federal Reserve seeks to create favorable market conditions for Treasury borrowing.

In the minutes of the Federal Open Market Committee meeting of July 18, 1967, we find the following:

In the course of the committee's discussion, considerable concern was expressed about the recent high rates of growth of bank credit and the money supply, particularly in view of the prospects for more rapid economic expansion later in the year. It was generally agreed, however, that the Treasury's forthcoming financing militated against seeking a change in money market conditions at present. Moreover, even apart from the Treasury financing, most members felt that it would be premature to seek firmer money market conditions at a time when resumption of expansion in overall economic activity was in a fairly early stage; and some also referred in this connection to the growing expectations that the administration would press for measures of fiscal restraint. In addition, some members expressed concern about the possibility that any significant further increases in market interest rates might reduce the flows of funds into mortgages and slow the recovery under way in residential construction activity.

Here we see—at a time when administration economists were warning of impending inflationary pressures and at a time when inflationary expectations were strengthening—a move toward a less expansive policy was inhibited by the need to support growing Federal deficit financing. It comes up repeatedly in the 1967 minutes of the Open Market Committee. A possible shift in policy was also postponed by hopes for a tax increase that never came and by fear of rising long-term interest rates, which continued to rise despite the maintenance of a liberal credit policy.

I would like to emphasize that it is not unusual for the monetary authorities to maintain "an even keel" in the money markets during Treasury financing operations. However, in 1967, the original budget deficit figures proved unusually inaccurate and the ballooning requirements of the U.S. Treasury had the effect of promoting a more expansive monetary policy than might otherwise have been the case.

I might add that this committee in its Joint Economic Report last year urged the monetary authorities to adopt "the policy of moderate and relatively steady increases in the money supply, avoiding the disruptive effects of wide swings in the rate of increase or decrease." The general range suggested by the committee was 3 to 5 percent with the minority recommending 2 to 4 percent for 1967. It was further pointed out that: "Sudden changes in the money supply give rise to instabilities in the economy."

From January through August of last year, monetary authorities permitted money supply to grow at a 9-percent annual rate; if time deposits are included the annual rate of growth was 13.4 percent. That came on the heels of a decline of 1 percent and a rise of only 3.2 percent,

respectively, from April 1966 through January 1967. We went from one excess to another.

It is apparent that the Federal Reserve tried hard to keep interest rates from rising last year. It is ironic, however, that the resulting increase in money supply and incomes is leading to more inflation and consequently higher interest rates. Given the lag effect of monetary policy, we are now feeling, and will continue to feel, the inflationary effect of last year's large increase in money supply.

I am aware of the fact that a good deal of the increase in Federal financing last year was required because of expenditures related to the Vietnamese war. But there has also been a considerable debate about the necessity to reduce nondefense expenditures to ease the pressures on the money market. A tax increase as well as reduced expenditures would, of course, have been helpful in reducing growing inflationary pressures. But the tax action would only have made this contribution if the monetary authorities—faced with less Federal financing to support—had shifted more freely to a less-expansive credit policy.

The widespread opinion was that a tax increase would by itself dampen demands sufficiently so that monetary policy could become more expansive and thus reduce interest rates. But a tax increase merely shifts purchasing power from the public to the Federal Government. The consumer buys fewer cars but the Government has more revenue to build more highways.

I would like to mention here an oft-repeated fact that a Federal deficit is not inflationary if it is financed in the National's pool of savings in competition with other private borrowers. It does become inflationary, however, when it is financed by the central bank, as was the case last year. When we run a substantial deficit at the same time that the money supply increases rapidly, we have evidence of the inflationary financing of the Federal deficit.

The notion that interest rates can be reduced by simply making more and more money available is not supported by the evidence of 1967. Rates may decline for a short time but they soon begin rising. People are not interested in money as such but rather in what it will buy. Consequently, more money turns into more demand for goods and services. Excess demand means price inflation. Price inflation enlarges demands for credit.

If the monetary authorities seek to meet the surge in credit demand with no interest rates increase, it means an even more rapid growth in money and more inflation. Even then, lenders cannot be expected to ignore the effects of inflation on a fixed income return.

To induce lenders to lend on fixed income obligations, interest rates must rise to offset the effects of inflation. Monetary authorities do not have to accommodate the Treasury, and they do not always. But if the Government is forced to borrow in competition with others as it often does, interest rates will rise and they may rise a good deal if the Federal Reserve maintains a neutral position. But the increase may be short lived if inflationary pressures are curbed in the process.

A moderately restrictive monetary policy may cause rates to rise for a time, but by reducing money supply and demands generally, it leads to lower interest rates. It reduces inflation. There are plenty of examples in the world showing that high rates of inflation court high

rates of interest. I make this point because the Federal Reserve has often, and in my opinion erroneously, been charged with making interest rates too high through a tight money policy. If there was anything the tight money policy of 1966 achieved it was a marked lessening of inflationary pressures and finally a reduction in interest rates. They peaked out in September, more than a month before the official shift toward less restraint.

THE ECONOMY AHEAD

In the last few months there has been evidence that the growth of money supply is beginning to slow down and that monetary authorities are pursuing a cautious policy of moderating the rate of monetary expansion. This contrasts sharply with the execution of policy in 1966. The current gradual application of the brakes is to be applauded.

If the monetary authorities continue this trend and avoid the excessive effects of "even keeling" Treasury financings, they will provide a major contribution toward easing inflationary pressures and ultimately lowering interest rates. A tax increase would make its major contribution in terms of reducing the need for "even keeling" operations on the part of the Federal Reserve.

In conclusion I would like to make these recommendations:

First: that the monetary authorities seek to avoid extreme swings in money supply growth as recommended by this committee in its 1967 Joint Economic Report. If excessive Treasury borrowings create pressures in the money market, pushing interest rates higher, then it is the fault of fiscal policy. This should serve as a red light. If the Federal Reserve tries to keep interest rates from rising by accommodating Treasury needs, then the authorities may be opting for inflation. You may differ with their choice of action, but, at least, we would know what they are doing.

Second: I would urge enactment of a tax increase. This action would help lesson inflationary expectations and would bring home to all taxpayers the problem of fiscal management.

Third: I would like to recommend that this committee sponsor a major study of monetary-fiscal policies, inviting papers from non-Government as well as Government economists. The search for better stabilization techniques should be encouraged.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Olsen.

And now Mr. O'Leary.

STATEMENT OF JAMES J. O'LEARY, CHAIRMAN OF THE BOARD AND CHIEF ECONOMIST, LIONEL D. EDIE & CO., INC.

Mr. O'LEARY. I think, in the interest of saving time, Mr. Chairman, that, as you suggested, I will try to summarize what I have to say, and not actually read the prepared text. I assume that the text will be printed in the record.

My statement is based on three tables which you will find at the end of my text. I might say what I am going to do is, first, outline to you my thinking about what the outlook for 1968 is on the basis of certain assumptions—the outlook for the economy as a whole in GNP terms.

Then I am going to try to translate what that means for financial markets. I noticed the other day that this committee asked some of the Federal Reserve people that question. I have tried in the second table to do that—to indicate what the implications are for financial markets, in my particular projection of the economy.

And then, I am going to discuss certain problems that I think the economy faces, and what policy actions I think are needed.

Let me start out by saying, first of all, that obviously, as we face the outlook for this year, there are tremendous uncertainties. There are uncertainties with respect to Vietnam, uncertainties with respect to the question of whether we will or will not have a tax increase. There are uncertainties with respect to whether we will have, this year, an international monetary crisis. There are uncertainties with respect to what the consumer will do—whether he will continue to save at such a high rate.

So, as you look to 1968, you have to make certain assumptions. And the assumptions that I have made are, first of all, that defense spending will be, roughly, in accord with what the budget calls for. I fully appreciate the fact that this may not actually be the case, but it is necessary to make some assumption, and my assumption is that the spending will be in accordance with the budget. I am also assuming there will not be—that the 10 percent surcharge will not be enacted.

I am assuming, further, that personal savings, rate of personal saving, will stay in 1968—

Chairman PROXMIRE. You are assuming that the 10 percent surtax will not be enacted, and, therefore, all these projections are based on that assumption?

Mr. O'LEARY. That is right. That the surcharge will not be enacted. I am assuming also that personal savings, the rate of personal savings, will stay about as high in 1968 as it did in 1967, when it averaged out around 7.1 percent. In other words, my assumption is that the same uncertainties that were influencing the consumer in 1967 will be in the picture today—that is uncertainty about Vietnam, uncertainty about price increases, uncertainty about a lot of things, whether there is going to be an international crisis—all of these elements of uncertainty—we are assuming they will continue to exist.

These are all very conservative assumptions in the sense that we shall probably have somewhat higher defense spending, and there is the distinct possibility the consumer might return to some of the old patterns of spending. So that I think our assumptions are reasonably conservative in terms of the outlook.

Now, I will tell you what the outlook is.

We are estimating that in 1968 gross national product will increase about 8 percent. In other words, we are estimating that in 1968, GNP will increase to about \$850 billion. That is a \$65 million increase. It is somewhat higher than the Council is assuming in its projection. I think they have a figure of around \$846 billion or \$847 billion.

Chairman PROXMIRE. It is a little lower if you recognize the Council assumes they will get the surtax, and they say that will make a difference in fiscal 1968 of \$14 billion of GNP; for calendar 1968, \$7 billion. So, you are a little bit lower than they are.

Mr. O'LEARY. Right.

Now, one of the main components—as you can see in that table, we are estimating that personal consumption expenditures will rise from \$492 billion to \$526 billion, up about 7 percent. We think this is a reasonable assumption. The big thing that is going to occur here is that personal income, assuming that the unemployment rate stays below 4 percent, and that you get some lengthening of the work week, will rise strongly, particularly in the first half of the year, when there will be an extra fillip to personal income through the increase in the minimum wage, and through increased social security benefits—something in the order of \$5 billion in the first half of the year.

Even applying a 7 percent or better savings rate, you come out with this sort of picture on consumer expenditures.

I should say, generally, that we see the first half of the year much stronger than the second half. Our pattern of GNP would be as follows—for the entire GNP, a \$19 billion increase in the first quarter, \$19 billion increase in the second quarter, and then a dropping off to \$14 billion and \$13 billion in the third and fourth quarters.

That is the pattern.

Of course, our thinking is that in the first half we will get the added benefit of the building of steel inventories, and also the pickup in some of the purchases of automobiles lost last year during the strike, and also the additional benefit of the increased income that will flow in through the increase of the minimum wage and the additional social security benefit payments. So, we see the first half stronger than the second half.

That is the pattern.

I think the consumer expenditure figures are fairly conservative in their position—if you accept our flow of income figures. We do have the durables up 10 percent. We are anticipating there that the big factor will be an increase in automobile sales up to a little over 9 million cars in total, and that will account for a large part of the increased durable consumer expenditures.

We also are figuring that housing will be quite strong this year. Our forecast would assume starts, total starts, of 1.5 million, and we think that the higher level of starts is going to help the durable goods side of the sector somewhat.

In the Federal area, as I have indicated, in the defense spending part of this, we are roughly in accord with the budget. We are a little higher than the budget, because we think there will be some updrift in defense spending. We have seen some things happen already—the sending of 10,000 additional troops to Vietnam, and a few other things that are developing, such as the \$100 million for South Korea—that suggest maybe a couple of billion dollars updrift in the defense spending area.

I do not think there is much question about the other expenditures—State and local—this has been a pattern developing, and also the other Federal spending is in line with the Budget.

In the fixed investment area, under nonresidential fixed, we have a 7-percent increase. Now, that is an area in which some economists would quarrel with us. Some forecasters feel that capital spending is not going to rise to that extent. The more standard forecast would be an increase of maybe 5 percent. We are one of the groups that do a survey of capital spending, and last September our survey results

showed a 5- to 6-percent increase, and we are now in the process of resurveying these same corporations and the returns now suggest that the 7-percent figure is probably going to be in the ball park.

We expect the rate of residential expenditures to rise in the first quarter of this year to \$29 billion, and then to flatten out at about \$30 billion in the remaining quarters. The pattern we have is a little stronger first half in housing starts than in the second half.

We expect a big increase in business inventories. This is probably the most difficult part of the whole GNP accounts to forecast. We could be wrong on this. The rate in the fourth quarter was \$9 billion—this is total inventories—and our thought is it will rise to something like \$11 billion in the first quarter of this year, something like \$14 billion in the second quarter, and then go off to \$10 billion and \$9 billion in the second half of the year. That will be the pattern in the inventory field.

Now, if you will turn to the next table, what we had tried there is to put in for 1968 some of the figures on the financial flows that we think will be consistent with our GNP forecast.

I am not going to comment on all these figures. According to our estimates, the total uses of funds will rise to \$86½ billion this year, versus \$80.2 billion in 1967. And, you may want to ask some questions later on the table. I am not going to take the time to run through all of it. But I think there are parts of it that are of particular interest to you.

You notice under corporate bonds that the aggregate net increase in corporate bonds in 1967 was \$15 billion. We are estimating the figure for 1968 to be \$11 billion. This is a pretty significant figure.

Our feeling is that in 1968, for some of the reasons that were already mentioned by Mr. Olsen, there will be a lesser volume of net issues by corporations. For one thing, I think, last year they stockpiled some money. I also feel that expectations on the part of corporate borrowers are changing this year. Their general expectation is that perhaps in the second half of the year they will be able to get lower rates. I think there will be more corporate financing through the banking system this year. Corporations will tend to turn more to the commercial banks for financing, and wait for bond yields to come down. Last year the expectations were that rates were going through the roof, and they all rushed in to sell bond issues. I think there will be some lesser pressure in the corporate bond areas this year.

However, you will notice that we put one- to four-family mortgages up to \$13½ billion, and we have put multifamily and commercial mortgages up to \$10½ billion versus \$8.2 billion. I think that to the extent that corporate demand for funds is less, institutions will turn to the mortgage market to a greater extent.

Now, shifting to the lower part, to sources of funds, you will notice that in the case of the mutual savings banks, we have an estimate of \$4.7 billion in there for 1968 versus \$5.2 billion in 1967, and for the savings and loan associations, \$8½ billion versus \$11 billion. This is a reflection of our feeling that, as the year goes on, there will continue to be a slowing down in the flow of funds into these institutions, so that the net new money that they get this year will be less.

Now, you might say how does that tie in with the stepup in the net increase in home mortgages and other mortgages, and our reason-

ing there is that last year these savings institutions tended to rebuild their liquidity. We are also assuming, let us say, that the Federal home loan banks, which are in much more liquid positions, will increase sharply their advances this year to the savings and loans, and that will give them additional money. The figure of \$13.5 billion on home mortgages also assumes a substantial volume of FNMA purchases. So, I do not think it is inconsistent, but it shows some important shifts in this market.

We think there can be that amount of home mortgage money made available.

Another very important figure is—under “Commercial banks,” we have reduced net available funds from commercial banks to \$30 billion. Now, here is where I think the rub may be in this situation. This may not be large enough to accommodate total uses. I suspect we are probably low in terms of our figure on U.S. Government up at the top. We have a \$14 billion figure. Other people who make these estimates indicate it may run as high as \$16 or \$17 billion. Where I think the rub is going to come from is in whether the Federal Reserve will permit the commercial banks to expand their loans and investments to the extent needed to accommodate the uses we foresee. There are some people who feel that, in order for this to balance out, the Fed will have to permit the banking system to expand their loans and investments somewhere in the order of \$37 billion or \$37.5 billion.

So Federal Reserve policy becomes a very important ingredient in this picture of whether these uses are to be accommodated.

Now, let me turn, then, to the problems underlying our forecast.

First, we are assuming that wage compensation will continue to increase at say 6 to 6½ percent, and that the consumer price index will continue to rise at something like a 4-percent annual rate, which is the current rate.

Now, if that is true, it touches off other problems. One of them is that foreigners are going to be looking at the United States in terms of an economy that is expanding strongly, at least over the next several months, with prices moving up and costs moving up rather sharply. And, it is the sort of thing, I think, that will lead to a decline in the confidence on the part of foreigners and foreign central banks in the ability of the United States to discipline itself. And, I think that this forecast that I have made of the economy here, involving some escalation in prices, probably, is not going to be healthy from the point of view of preserving our whole international monetary system, and it has implicit in it, in the next 4 or 5 months, some rather rough going for the U.S. dollar in terms of the possibility of gold outflows.

Then another aspect of this is that, assuming that prices are moving up, and assuming that there is a good deal of uncertainty abroad about the dollar, there is a danger that the Federal Reserve will be pushed, in my opinion, to go too far in terms of credit restraint.

If you look at what the Federal Reserve has been doing, one of the main impacts of its policies so far has been to slow down the flow of time deposits into the banks. There is a third table which I do not want to take the time to run through. But the rate of net increases in time deposits in the commercial banks, including CD's, and all the different

types of time money has slowed down quite considerably already, and the same thing has happened to the savings institutions.

The danger is that, if the Fed becomes nervous about the international confidence in the dollar, they may step on these credit brakes a little too hard at this time.

Therefore, this points to me the need for some fiscal restraint in this picture.

The other thing that is troublesome to me is that, with the sort of projection we are making, I cannot see long-term interest rates coming down very much, in spite of some reduction in corporate bond offerings. It seems to me that as long as a substantial increase in prices is occurring, as Leif Olsen pointed out, you get an inflation premium on interest rates. People do not want to buy fixed-income obligations with the price level moving up the way it is. And this, to me, is a serious imbalance in the economy, because what happened is that the level of short- and long-term rates is so high that the minute the Fed moves in to tighten credit, it touches off the whole process of disintermediation—the flow of funds out of the savings institutions. And the Fed's hands are relatively tied in terms of its ability to use credit restraint. This is why the Federal Reserve has been asking for a tax increase. I think they feel they are boxed in and cannot do very much in this situation, and about the only way to stop this inflationary process is to get fiscal restraint in the picture.

There is a very serious need to do something to stop this inflationary process, the rising prices. I feel very strongly that the most important need here is to obtain fiscal restraint. And I would like to see it come through Federal expenditure cuts. This would be the better way to do it. But, I doubt that sufficient cuts can be effectuated.

The problem is that we face, over the next several months, a rather critical situation, both domestically and internationally. I am forced to the view that we need the 10 percent personal and corporate income tax surcharge to do the job. Beyond that, I think we need monetary restraint. But I think it has to be done in tandem with fiscal restraint. Otherwise monetary restraint could be used too strongly, and we could create a very serious problem in this situation.

I am not predicting it is going to happen.

The other thing I would say is that it seems to me it would be a good idea to remove the gold cover and free up all our gold.

I will stop at that point. I am afraid I took more than 15 minutes. (The prepared statement of Mr. O'Leary follows:)

PREPARED STATEMENT OF JAMES J. O'LEARY

There has never been another time in my experience in which greater uncertainties faced the business forecaster. The biggest of these is the uncertainty about the course of events in the Far East and the trend of defense spending. But there are other difficult questions. Will Congress increase personal and corporate income taxes—and how soon and by how much? Will inflationary pressures force the adoption of direct Government controls over wages and prices? Will individuals continue their high rate of saving, or will they begin to spend more freely? Will an international monetary crisis be precipitated by weakening confidence in the U.S. dollar? These questions by no means exhaust the list.

It is hard to recall any other point of time in which the economic, political, and social problems facing our country and the world as a whole have been more difficult and critical.

THE PROSPECTS FOR GENERAL BUSINESS ACTIVITY AND THE FINANCIAL MARKETS

My forecast of general business activity in 1968 is outlined in the table "Estimated Comparison of Selected Economic Indicators" attached to my statement. I expect a very strong expansion of business this year, particularly in the first half. This forecast makes three very important assumptions: (1) that Federal defense expenditures will be in accord with the budget—a very conservative assumption in view of developments in the Far East; (2) that Congress will not enact a personal and corporate tax increase; and (3) that the rate of personal savings will remain at about the same level as in 1967.

Without an increase in taxes, the Federal deficit on a national income accounts basis will run as high as last year—in the \$12–14 billion range. It will thus be a powerful force for economic expansion. In addition, although I expect that monetary policy will continue to move toward less credit ease, I believe that the authorities will nonetheless permit a very large increase in commercial bank loans and investments this year.

As shown in the table, we expect that GNP will expand from \$785 billion in 1967 to about \$850 billion this year, an increase of \$65 billion, or about 8.3 percent. A little less than 5 percent of this will be *real* and about 3.5 percent will be the result of an increase of prices. Our pattern is for a stronger first half, with GNP rising by about \$38 billion. The rate of expansion in the second half is expected to decline somewhat—to \$27 billion. We anticipate that the unemployment rate will remain below 4 percent and that the workweek will lengthen somewhat. We also expect that labor compensation will increase at 6–6.5 percent annual rate.

The higher rate of expansion in the first half is based on (1) the buildup of steel inventories in expectation of a strike on August 1; (2) a catching up of automobile sales and production after the strike of late last year; and (3) an increment of \$5–5.5 billion of personal income due to the rise of the minimum wage rate and social security benefit payments.

Turning to the components of GNP, we are estimating that personal consumption expenditures will increase from \$492 billion in 1967 to \$526 billion in 1968, or by 7 percent. As indicated earlier, we are not counting upon any significant decline in the rate of personal saving. Consumer confidence will still be affected by uncertainty about Vietnam and taxes, as well as by rising prices. In spite of a high rate of personal saving, encouraged by record interest rates, the sharp rise of personal incomes which we are estimating will produce the 7 percent increase in consumer spending.

Aside from the rise of personal income, there are two factors which explain our forecast of a 10 percent increase this year in expenditures for durable goods. One is that we think that total sales of automobiles will rise to about 9.1 million cars. The other is that we expect housing starts in 1968 to total about 1.5 million units, thus swelling the demand for durable consumer goods.

Turning to government purchases of goods and services, we are estimating that Federal defense expenditures will rise by \$5 billion, or 7 percent. This is in line with budget estimates. Our figure is likely to be far under the mark for two reasons. Even under the Federal budget there probably will be an updrift of defense spending of about \$2 billion. Beyond this, if we increase our troop commitment by as much as 100,000, we could be involved in a defense spending increase of \$3–4 billion at a minimum. The increase of "other" Federal purchases of goods and services is in line with the budget. The 12 percent increase of state and local government expenditures is in accord with the experience of the past several years, which we do not expect to change.

Under our model, gross private domestic investment is expected to increase by \$17 billion in 1968, or 15 percent. Under "fixed investment", we are estimating that the nonresidential portion will rise by 7 percent. This is somewhat higher than the 5–6 percent increase indicated by the various surveys of capital spending. In periods of general business expansion, the capital spending surveys usually undershoot the mark. We think this will be true in 1968.

Residential construction expenditures in the fourth quarter of 1967 were running at a \$28 billion annual rate. Our pattern calls for a rise to \$29 billion in the first quarter of this year and then level at a \$30 billion annual rate in the last three quarters. We expect that the total of housing starts will be somewhat higher in the first half than in the second, with the rate about 1.5 million starts for the year as a whole. Rising prices will hold up the total expenditures in the second

half even though the rate of housing starts falls off moderately. The main limitation upon housing will, of course, be availability of mortgage financing.

Perhaps the most difficult sector of the GNP to forecast this year is business inventories. In the fourth quarter of last year inventories were being accumulated at an annual rate of \$9 billion. We anticipate that the rate will rise further to about \$11 billion in the first quarter and to \$14 billion in the second. The rate may be expected to decline, in our model, to \$11 billion in the third quarter and \$9 billion in the fourth. For the year as a whole, we expect an \$11 billion accumulation of inventories, compared with \$5 billion in 1967, during much of which inventories were being reduced.

We are estimating a decline of net exports to \$4 billion this year due to rising imports and some slippage in our exports as increasing costs and prices hurt our export position.

Finally, we are estimating that physical output, as measured by the Federal Reserve Board index of industrial production, will rise by about 6 percent this year, with most of the increase occurring in the first half.

The second table attached, entitled "Financial Flows, 1961-1968", provides estimates of uses and sources of funds in the money and capital markets in 1968. They are based upon our GNP forecast and the assumptions which underlie it, notably that the tax surcharge will not be enacted. As you will see, we are estimating that total uses of funds will rise by \$6.3 billion above the record total of \$80.2 billion last year.

Time permits only selective comments upon items in the table. We are estimating that the total net increase in corporate bonds this year will amount to about \$11 billion, compared with the record \$15 billion in 1967. There are two main reasons for this reduction: (1) corporations undoubtedly stockpiled funds last year to some extent in anticipation of a credit squeeze; and (2) corporations are likely to rely more heavily this year on borrowing from the commercial banks in anticipation of a decline, as the year goes on, in corporate bond yields. As you will see, we have raised the net increase this year in bank loans to take account of this.

We have also raised the net increase in mortgages on 1-4 family properties to \$13.5 billion, compared with \$11.8 billion last year. As you will note in the lower portion of the table, we expect that the net increase in funds available from mutual savings banks and savings and loan associations will be somewhat lower this year due to the "pull" of higher interest returns on investments in the open market. Since these two institutions make a large part of the total mortgage loans on 1-4 family properties, it may at first seem inconsistent to raise the estimate for the net increase of 1-4 family mortgages. Our reasoning is that last year the mortgage lending institutions added substantially to their liquid asset holdings and that they will use some of this liquidity to increase their mortgage holdings. Also, the Federal Home Loan Banks are in a much more liquid position to make advances to the savings and loan associations. Finally, if there does prove to be a decline in corporate bond offerings, money should be released to the mortgage market. This will, in particular, increase availability of funds for the financing of multifamily and commercial mortgages, which is the principal reason for raising the net increase of such mortgages to \$10.5 billion this year.

As will be noted in the lower panel of the table, we are estimating that funds available from the commercial banks will increase by \$30 billion this year, compared with the record \$34 billion in 1967. This is in accord with the view that the Federal Reserve will slow down the expansion of credit moderately this year but that it will be careful not to precipitate a credit crunch.

My forecast of general business activity and of financial flows does not suggest much relaxation of pressures in the money and capital markets this year, assuming no action by Congress on the tax surcharge. The likelihood is that during the first half of the year short- and intermediate-term interest rates will stiffen further as credit demands rise and Federal Reserve policy moves toward lesser ease. It is also probable that during the first half long-term rates will be very firm, and they may indeed edge up from current levels to the peaks of last November. With the slackening in the rate of business activity in the second half of the year, we shall probably see some softening of both short- and long-term rates.

THE PROBLEMS AND DANGERS

The forecast which I have presented suggests some very troublesome problems and dangers which I would now like to consider briefly.

1. Since mid-1965, with the exception of the first half of 1967, the conditions of strong demand and low unemployment have spawned a rise in wages well in excess of the increase of productivity. As a result, we have set in motion a spiral of costs and prices, with wage cost rising at a 6 percent rate and the price level moving up at a 4 percent rate. Since wage contracts are negotiated for a period of two or three years, the large increases in compensation get embedded in our cost structure. Rising wage costs lead to higher prices in a spiral under conditions of high employment and strong demands. It is difficult to see how this spiral can be broken without deflation of demand.

2. The escalation of wages and prices in the United States is the basic force weakening foreign confidence in the dollar. Foreign public and private holders of liquid dollar assets are not happy about seeing the value of their holdings decline at a four percent rate each year.

The President's New Year's program to cut the deficit in our balance of payments by \$3 billion can help to restore confidence in the dollar, but it does not get to the heart of the problem. Last year, our export surplus—which must be kept strong if we are to solve our payments problem—was cut by the declining competitive position of many of our products in foreign markets as prices rose. We must bring a halt to inflation if we are to narrow our payments deficit.

Failure to halt inflation presents the danger of continued speculation against the dollar. Last November, we saw how relentless the speculators can be in bringing down a currency. Unless we succeed in bringing inflation under control in the United States, we run the great risk of further large sales of gold by the United States and the danger of wrecking the international monetary system.

3. Since early 1966, the failure to employ fiscal restraint to curb inflation has created serious imbalances in the economy, and the same problem is likely to be with us this year. The "credit crunch" of 1966 was the direct product of the failure to employ fiscal restraint. The full burden of halting inflation was placed on the Federal Reserve authorities and, as interest rates rose sharply, the outcome was a traumatic "disintermediation" process for the financial institutions and a liquidity crisis. In the process, housing was dragged down to a very low level.

We again face the danger that failure to employ fiscal restraint to halt inflation will place a heavy burden upon monetary restraint. There are already alarming indications that we are on the way to disintermediation. As shown in the attached table entitled "Data on the Money Supply and Related Factors", the annual rate of increase of time deposits at all commercial banks fell to 6 percent in the past three months, compared with a 17 percent rate of increase in the previous nine months. In the larger commercial banks, the rate of increase of time deposits has fallen to 7 percent during the past three months compared with a 15 percent rate of increase during the previous nine months. Similarly, the annual rate of increase of larger denomination certificates of deposit has dropped to 13 percent from 21 percent during the previous nine months. The annual rate of increase of other certificates of deposit has fallen to 10 percent during the past three months compared with 26 percent in the previous nine months. Savings deposits in commercial banks have been expanding at only a 1.4 percent rate during the past three months compared with 5.3 percent during the previous nine months.

The mutual savings banks and the savings and loans associations are also experiencing a similar decline in the rate of inflow of deposits. The reason for this trend, of course, is that interest rates on competing investments in the open market are pulling funds away from time deposits in the commercial banks and savings institutions. The danger is that, without the aid of fiscal restraint, the Federal Reserve authorities will be forced to step too hard on the credit brakes to halt inflation and to protect the dollar in foreign exchange markets. The result could be another liquidity crisis and a choking off of housing.

4. So long as prices are rising strongly, we are going to have very high interest rates. With the value of the dollar declining, the attractiveness of fixed-interest obligations falls and interest rates take on an inflation premium. Interest rates are not going to come down from their present very high levels until we succeed in getting inflation under control. At the present high level of interest rates, the Federal Reserve cannot exert credit restraint without quickly touching off the disintermediation process.

THE POLICY MEASURES NEEDED

The time is long overdue for us to recognize and act upon the fact that we cannot have both guns and butter. It has long been clear—and it is even clearer today—that we need a strong measure of fiscal restraint. I subscribe enthusiastically to the view that Federal spending must be brought under control. I would welcome a cut of several billion dollars in Federal expenditures because this would be the most effective way to exert fiscal restraint. But, in my view, we face a national and international financial emergency, and I doubt that expenditures are going to be cut by several billion dollars. This is why I strongly support the prompt enactment of the 10 percent income tax surcharge. I can see no other way to obtain the fiscal restraint so urgently needed to halt inflation and to strengthen the dollar abroad.

With enactment of the surcharge, the Federal Reserve authorities will be permitted to move gradually and carefully toward lesser availability of credit. Teamed with fiscal restraint, monetary restraint can be used in a balanced way to take the steam out of inflation.

Although there are many aspects of the President's New Year's balance of payments program which I dislike because they interfere with the free flow of goods and services and free capital movements, I nonetheless think the program is needed on a temporary basis until inflation is brought under control.

Finally, it makes sense to remove the gold cover behind Federal Reserve notes. There are risks in doing so. It may remove some of the pressure to halt inflation, and it may also encourage a rise in gold purchases by foreigners. On balance, however, it seems to me that it is desirable to remove the gold cover.

In conclusion, then, it is my judgment that the risks this year are on the side of too much exuberance in the rate of economic expansion. They are on the side of an escalation of wages and prices. Preservation of confidence at home and abroad in the value of the dollar requires a balanced use of fiscal and monetary restraint.

ESTIMATED COMPARISON OF SELECTED ECONOMIC INDICATORS

	1967	1968 ¹	Percent change
FRB index (1957-59=100):			
Total.....	158	167	+6
Manufacturing.....	160	169	+6
Durable.....	164	173	+6
Nondurable.....	154	162	+5
Mining.....	123	124	+1
Utilities.....	185	197	+6
Income and expenditures (billions of dollars):			
Gross national product.....	785	850	+8
Personal consumption expenditures.....	492	526	+7
Government purchase.....	176	192	+9
Gross private domestic investment.....	112	129	+15
Net exports.....	5	4	-----
Personal consumption expenditures.....	492	526	+7
Durables.....	72	79	+10
Nondurables.....	218	229	+5
Services.....	202	218	+8
Government purchases of goods and services.....	176	192	+9
Federal.....	90	96	+7
National defense.....	73	78	+7
Other.....	17	19	+12
State and local.....	86	96	+12
Gross private domestic investment.....	112	129	+15
Fixed investment.....	107	118	+10
Nonresidential.....	83	89	+7
Structures.....	27	28	+4
Producers' durable equipment.....	56	61	+9
Residential.....	25	30	+20
Changes in business inventories.....	5	11	-----

¹ Estimated.

FINANCIAL FLOWS, 1961-1968

[In billions of dollars]

	1961	1962	1963	1964	1965	1966	1967 ¹	1968 ¹
Uses of funds.....	44.2	54.2	58.5	67.1	72.1	68.9	80.2	86.5
U.S. Government (direct issues, agencies and PC's).....	7.7	7.9	5.0	7.0	3.5	6.7	15.9	14.0
State and local obligations.....	4.9	5.0	6.7	5.9	7.4	5.9	9.4	9.5
Corporate bonds.....	4.6	4.6	3.9	4.0	5.4	10.2	15.0	11.0
Corporate stocks.....	2.5	5	—, 3	1.4	-----	1.2	1.7	1.5
1-4 family mortgages.....	11.4	13.0	15.2	15.7	16.0	10.4	11.8	13.5
Multifamily and commercial mortgages.....	5.1	7.9	9.3	10.0	9.5	8.5	8.2	10.5
Banks loans.....	2.2	4.7	5.4	6.5	13.6	10.8	6.3	10.5
Loans from finance companies, etc.....	1.5	3.0	2.7	4.2	4.7	6.9	4.1	6.0
Consumer credit.....	1.7	5.5	7.3	8.0	9.4	6.9	4.3	8.5
Foreign borrowers.....	2.6	2.1	3.3	4.4	2.6	1.4	3.5	1.5
Sources of funds.....	44.2	54.2	58.5	67.1	72.1	68.9	80.2	86.5
Insurance companies.....	6.1	6.7	6.9	7.3	8.4	8.4	9.1	9.5
Uninsured pension funds.....	3.9	4.0	4.4	4.9	4.9	5.9	5.9	7.0
Mutual savings banks.....	1.9	3.6	4.0	5.2	4.7	3.7	5.2	4.7
Savings and loans associations.....	9.3	9.4	11.1	10.6	8.4	3.6	11.0	8.5
Mutual funds.....	1.9	1.9	1.2	1.8	3.1	4.0	2.5	4.0
Commercial banks.....	12.8	17.1	19.3	19.5	27.3	15.2	34.0	30.0
U.S. Government (direct loans and cash balances).....	2.6	4.6	2.4	4.0	3.7	7.0	2.8	6.0
Funds from net issues of financial corporations.....	.8	-1.1	-1.1	4.9	1.3	7.6	3.5	6.0
Foreign lenders.....	2.7	2.2	1.9	2.5	0.4	—, 8	3.2	2.0
Households and other sources.....	2.2	5.8	7.4	6.4	9.9	13.8	4.0	8.8
Memorandum, trade credit.....	3.2	3.6	3.1	6.1	6.3	4.0	4.4	5.0

¹ Estimated.

Note: Total may not always add due to rounding.

Assumption: No income tax surcharge will be enacted.

Source: Period, 1961-66, Federal Reserve Board; period, 1967-68, L. D. Edie estimates.

DATA ON THE MONEY SUPPLY AND RELATED FACTORS, FEDERAL RESERVE BANK OF ST. LOUIS (SEASONABLY ADJUSTED)

1. *Federal Reserve Credit*.—annual rates of change (adjusted for reserve requirement changes)—average of 4 weeks ended Feb. 7, 1968 from 4 weeks ended: Nov. 8, 1967, +11.3; May 10, 1967, +9.1; Aug. 9, 1967, +10.3; Feb. 8, 1967, +12.6; 1957-66, +7.4.

2. *Total Reserves*.—all member banks, annual rates of change, average of 4 weeks ended Feb. 7, 1968 from 4 weeks ended: Nov. 8, 1967, +7.1; May 10, 1967, +8.3; Aug. 9, 1967, +9.2; Feb. 8, 1967, +9.8; 1957-66, +3.1.

3. *Reserves Available for Private Demand Deposits*.—annual rates of change, average of 4 weeks ended Feb. 7, 1968 from 4 weeks ended: Nov. 8, 1967, -8.7; May 10, 1967, +2.9; Aug. 9, 1967, -2.1; Feb. 8, 1967, +3.6; 1957-66, +1.5.

4. *Money Stock*.—annual rate of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +4.9; May 3, 1967, +7.6; Aug. 2, 1967, +5.1; Feb. 1, 1967, +7.1; 1964-66, +2.4.

5. *Money Stock Plus Time Deposits*, annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +5.4; May 3, 1967, +9.9; Aug. 2, 1967, +7.5; Feb. 1, 1967, +10.5; 1957-66, +6.0.

6. *Time Deposits*, all commercial banks, annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +6.0; May 3, 1967, +12.1; Aug. 2, 1967, +10.1; Feb. 1, 1967, +14.1; 1957-66, +12.1.

7. *Certificates of Deposit*, large commercial banks, annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended (seasonally unadjusted): Nov. 1, 1967, +12.8; May 3, 1967, +14.3; Aug. 2, 1967, +10.7; Feb. 1, 1967, +19.5; 1964-66, +20.3.

8. *Business Loans*, large commercial banks, annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +11.5; May 3, 1967, +7.1; Aug. 2, 1967, +4.3; Feb. 1, 1967, +7.7; 1960-66, +9.7.

[In percent]

	Annual rate of increase	
	Last 3 months ending Jan. 31, 1968	Previous 9 months
Time deposits at all commercial banks.....	6.0	17.0
Large commercial banks.....	7.0	15.0
Larger denomination CD's.....	13.0	21.0
Other CD's.....	10.0	26.0
Savings deposits.....	1.4	5.3

	Percent
Ceilings on rates:	
On savings deposits.....	4
On CD's of 90 days or more maturity.....	5
On CD's of \$100,000 or more.....	5½

Chairman PROXMIRE. Thank you, Mr. O'Leary.
Professor Hart?

STATEMENT OF ALBERT G. HART, PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY

Mr. HART. May I say a few words before I get to my brief statement?

In the first place, I would like to express appreciation from the standpoint of the economic profession of the way the joint committee works as a point of contact between the economists and the responsible policymakers in Congress.

This is an extremely valuable thing. It raises the prospects of the profession making a real contribution, and the fact we know from time to time we are called upon is I think healthy for our way of looking at things. It keeps us a little bit more in touch with policy problems in a very healthy way.

If I may, I would like to comment also briefly on a point raised by Mr. Olsen, which I think might well be worth more discussion later.

He mentions a competition between two theories of the effect of policy on the economy, one of which stresses monetary forces, while the other stresses fiscal forces.

It seems to me this competition is real, and that the fact that these theories are in competition, rather than being brought together to work harmoniously in our analysis, reflects a point of weakness in the work of the economists up to date.

The so-called fiscal theory leaves too much of the monetary side of things out of account. It has a pro forma way of dealing with interest rates which I think is decidedly artificial and does not really serve our purposes.

On the other hand, the so-called modern quantity theory, which puts the stress on money, relies entirely too much on mere numbers and algebra, and it has not produced the right kind of demonstration of a mechanism through which the monetary forces work.

One must respect the kind of feel of the financial situation represented by Mr. Olsen but lacking either formal analytical reasoning or definite quantitative analysis which relates the theories to the evidence, the so-called modern quantity theory remains weak.

A major contribution to the integration of these views has just been printed in the form of an interim report in the Federal Reserve Bul-

letin for January. This is a study by the Federal Reserve-MIT group, under the leadership of Frank Modigliani who is certainly one of the really fruitful minds in the profession.

There is a good deal of further working being done in this direction. I am working on some aspects of this myself.

My sense is that within a few years we will be able to produce a much more sensible integration of these two views. But I think that Mr. Olsen is correct in presenting them as being for the moment competing theories, neither of which is really satisfactory; and I think we should not conceal that there is a weakness in our economics at that point which impairs our ability to give first-rate policy counsel.

While the statement is brief, I think I can state what I have to say still more briefly, and if I may, I will accept the privilege of incorporating the statement, and making a few summary remarks.

You will have noticed that Mr. O'Leary puts a great deal of stress on the uncertainty of the situation in the large, and point by point as he analyzes aspects—each one of these has a lot of uncertainty.

It is plain that behind his presentation there is a certain amount of integration which does not appear on the surface. To some extent these uncertainties of his items are offsetting, and if there is less of one thing there will be more of another, which is implicitly taken account of in the way he presents things.

For all that, it seems to me the fact that we are at a crossroads and do not know which way the economy is going is the salient fact of the policy situation.

In particular, obviously, the overshadowing uncertainty of all is the economic impact of the war in Vietnam.

The budget picture seems to be that we have rather crested over, and that this should run, roughly, level. It seems to me this is the kind of thing that does not happen, this is the kind of cost that goes either up or down. And I would say here—as I would also say of a lot of the business decisions—that the decisions which will settle this are still open, or insofar as they have been taken, they are behind the scenes. But, I think, on the whole, they are still open.

It seems to me there is such a thing as a policy which can hedge our bets, so that the policy will work fairly well over a range of possibilities. The object of the game is not to find the policy which would be best if we took our best guess and called that a certainty, but to find the policy which will give enough freedom of action so that things can turn out well over the range of uncertainties.

One aspect of this is the question of cost-price problems. If we knew the economy was going to soften, let's say that the Vietnam war was going to be terminated, and we could wind it up and release these tensions, we might be able to postpone this cost-price question.

It seems to me this postponement would be too risky, and that the recommendation that has been made for setting up an agency (outside the Council of Economic Advisers) to focus on the problems of the wage-price guideposts is a sensible recommendation at this point.

I must say when you list the kind of thing that seems to be possible to improve the price mechanism, this leads into a very wide swinging line of activity.

My general position would be that our wage-price structure has

shown a great deal of resistance to inflation. There is an inherent anti-inflationary bias in the way the price-wage mechanism works in the United States, and it has almost sufficed; but the evidence seems to be that when employment is really good, there is an appreciable creep. If we knew it would not accelerate, this might be all right—even from the standpoint of the people who retire on fixed incomes, if interest rates are 1 percent per annum higher than otherwise, because everybody knows prices are creeping up by 1 percent per annum, this is pretty good compensation. But there is always a danger it may accelerate.

It would seem to me that there is quite an interesting list of possibilities for improving the price-wage mechanism. I have made some suggestions in the statement; and the general stress would be on trying to restrain price increases where the firms that are thinking of marking up the prices have a real alternative of producing more goods instead.

The favorable experience of the United States with price control in World War II (and also in the Korean War) testifies, I think, that many firms which are seriously interested in raising prices are also in a position where if the price rise is barred, they can put more goods on the market instead of raising the price. This is very specifically anti-inflationary. It increases our ability to raise employment without setting up inflation, and to a considerable degree get us out of policy dilemmas. This is, obviously, not easy, but it is a direction in which there definitely is room for much more effective policy than we have had. The efforts to deter price increases have concentrated entirely too much I think on areas where there was not room to increase output.

As to the tax surcharge, it seems to me that a policy of hedging our bets against uncertainty does call for the surcharge. If I had to bet with expenditures on a fixed schedule—if I had to bet as to whether the tax surcharge was or was not likely to actually pull down activity, I might bet that it would. But, it seems to me that contrary to the usual situation, we are in a position where it would be quite easy to organize a rather prompt increase in expenditures. Contrary to Mr. O'Leary, my feeling would be that nondefense expenditures really need to be expanded. In the existing situation, I can see that there has to be pressure upon them, and, in fact, we have a number of programs related to the war on poverty which are being compressed—although they are ready for expansion, and I would advocate their expansion on a number of grounds. It seems to me that if we have the tax increase, and it proves to be more than is necessary to finance the budget now in prospect, we could hedge our bets by being in a position to expand these expenditures rather rapidly—we should say, thank God, and go to it.

In ordinary circumstances, I do not think one can count on short-term flexibility of expenditures to take up the slack. But in the 1968-69 situation, it seems to me that we have this in reserve, and should be only too glad to do it.

As to the mix of monetary and fiscal policies, we have been relying, it seems to me, too much upon monetary restraint in the last few years. Within reason, one can substitute monetary restraint for fiscal restraint. As I said earlier, the theory of this is not as clear as it should be. We do not really know as much as we should about how the mechanism works. But, if you have a fiscal policy which would be too

inflationary with the existing monetary policy, the effects can be offset by tightening monetary policy.

It seems to me, though, that we have got out of the field of good substitution possibilities—that we are trying to do too much of monetary policy—and that we should try to get back more to the center of the range of possible substitution. If monetary policy is overloaded, it does more damage than a better balanced combination of monetary and fiscal policies.

On the whole, it seems to me that the danger that without the tax increase (if we do get an acceleration of expenditures), the danger that the Federal Reserve may have to put on another very serious pinch is quite real.

The Federal Reserve has almost certainly been expanding too fast—I would agree with what I think is the view of both of the other speakers in this matter—in the last while, and will almost have to create some financial strain.

But it will be possible to carry out this operation in a much more sure-footed way, I think, if we can be reasonably sure our taxes are not inadequate.

Accordingly, it would seem that the bet hedging strategy does call for moving toward a stronger tax position at this time, and that to a considerable degree, we can hedge our bets by keeping decisions open on some of these expenditure programs.

Thank you, Mr. Chairman.

(The prepared statement of Professor Hart follows:)

PREPARED STATEMENT OF ALBERT G. HART

The economic outlook for the rest of 1968 and into 1969 appears to me extremely uncertain. The overshadowing uncertainty is of course the economic impact of the war in Vietnam. Official estimates indicate that the buildup has been terminated, and that we can look forward to some sort of plateau of economic effects from Vietnam. This projection I brand as unlikely. While I suppose there are horizontal routes from the crossroads where the United States now stands, it seems to me that of the roads we are at all likely to follow, one leads uphill and one down. I am among those who feel the United States should disengage. If we can and do disengage, economic tensions will ease (even though there may well be some transitional expenditures to face). If further escalation takes place, as seems all too likely, tensions will intensify.

Even if we could adopt a horizontal projection of the Vietnam war's impact, we would confront a "mixed situation". Some markets have a real inflationary feel. The level of unemployment is the most favorable in a number of years, and the last news about it seems reassuring; though we must note that overtime work has been much curtailed and that recent accession rates have been below the peak. On the other hand, it is easy also to cite indications that a recession may be in the making. Besides the drop in working hours and in manpower accessions (which are among the "leading indicators"), we have the stock market movement to suggest that many key decision-makers feel the situation as headed for decline rather than inflation; and the cresting over of capital appropriations of major manufacturing firms several quarters ago also suggests recession. But I would note that almost all the bearish indicators can be read to register not so much a *probable decline* as an *increase of uncertainty*.

Faced with an uncertain future, some policy-advisers would hold that the best we can do is to figure out which of the possible futures looks most likely, and to offer the advice that would be best if we knew this particular course of events was a certainty. I would urge that we can better that solution by recognizing that uncertainty may have no "certainty equivalent". In face of uncertainty, it always makes sense to look for a line of action that will work out reasonably well across a wide range of possibilities, rather than one that may be excellent but also may work out very badly in some probable contingencies. That is,

policy should take the form of a *hedging strategy*. In the present situation, it seems to me that such a hedging strategy is not too hard to design.

COST-PRICE PROBLEMS

Like the Joint Economic Committee—and like many other economists concerned with “macro-economic” issues—I have been watching over the years the working of the mechanisms that set prices and wage rates, and asking whether those mechanisms could be altered to strengthen the inherent resistance of the economy to inflation and make it safe to push harder toward high employment and toward such objectives as easing urban problems and mitigating air pollution. Recent advances in the price-level confirm the impression that these mechanisms leave room for improvement. Yet on the whole, it seems to me that the postwar record is reassuring: we *almost* have enough inflation-resistance to give employment policy and development policy a free hand within the range of actual availability of real resources.

There is undoubtedly a tendency for wage rate to outpace productivity at times when employment and profits are high. The fact that prices of industrial products ran level from 1959 through 1964 is not quite evidence of a satisfactory working of the wage-price mechanism because the unemployment rate throughout these years ranged from 5% upwards—appreciably worse than acceptable levels. Yet the mechanism *almost* works. Even the 2%-per-annum rise in industrial prices we have experienced since late 1964 might be livable as a long-term rate if we could be confident it would not accelerate; even retired people can face such a rate of secular price-increase if along with it they benefit from an interest rate a couple of percentage points higher than they would otherwise get. It would seem to follow that far short of a revolution in wage-price-setting, moderate improvements might bring us from almost-satisfactory to satisfactory performance.

There is a good deal of interest lately in proposals to do better than previously with the policy-instrument of “wage-price guideposts”, setting up a special agency (distinct from the Council of Economic Advisers) to formulate and apply the guideposts. If we could be sure that the inflation-threat was about to dissipate, we could afford to set this question over for consideration another year. But as part of a hedging-strategy for 1968, the step of setting up such an agency seems to me appropriate. It may well be urgently needed later in the year; if not, it could well use a breathing-spell to clarify the problems, taking the chance to consult a number of those who will be affected. We may take it as virtually certain that the United States will experience a few months at least of inflation-threat every few years, and few years pass without a few moves on the wage-price front that seems to increase our inflation-vulnerability, so that we are not likely to see such an agency sitting idle or drifting off into unintended or inappropriate lines of activity for lack of business in its own jurisdiction.

It seems to me that policy in recent years has wasted a good many opportunities for constructive intervention in wage-price processes. In particular:

(1) In applying “moral suasion” to big companies to avert price increases, it seems to me that attention should focus on *situations where a margin of capacity exists*, and where therefore there is a real option to take the benefits of a stronger market in increased sales-volume rather than in higher price. To put more output on the market at a constant price is directly anti-inflationary. In contrast (think of the copper market in the last few years) to hold down price when suppliers have no capacity and cannot satisfy the demand produces a disorderly market; and to a considerable degree the price increase is simply generated in the industries that use the product in question. Release of surplus goods or relaxation of import restraints should be used as a *reinforcement of physical volume* in such cases. Certainly it is inappropriate to bargain with suppliers, as the government recently did in the case of aluminum, and *withhold* surplus that could be placed on the market in consideration of holding down price under conditions where output cannot rise.

(2) Where supply cannot or should not be expanded and demand cannot be satisfied at a low price, there is much to be said for an excise tax, to give “rationing by price” at the consumption level without creating a windfall profit which in turn may stimulate inappropriate wage increases. The automobile excise seems to me a case in point. Given congestion, air pollution,

etc., I cannot put a very high social value in 1968 on getting more cars into use by price cuts. Profits in the auto industry seem more than adequate, and an increase in profits sets up an inflationary focus in the wage-structure, since other workers will feel they have a claim to keep pace. I would infer that the wage-price machine will work worse if we terminate this excise, and might work better if we increased it again.

(3) The general pattern of taxes upon profits may make the wage-price mechanism more inflationary by bunching available profits more than necessary in years of high activity. I have in mind particularly the averaging of losses in a company's bad years against its profits in good years. Existing tax rules use a mixture of carry-forward arrangements that reduce taxes in a peak year because the company previously had losses, and of carry-back arrangements that enable companies to claim refunds in loss years because they previously paid taxes on the profits of good years. From the standpoint of persuading workers to exercise wage restraint, it is less than no help to give the employer a tax abatement in years of high profit.

(4) Just as it makes sense to ask employers to forgo price increases when they could instead put more goods on the market, it makes sense to ask workers to forgo wage increases when they could instead be expanding employment and production by absorbing more workers into their activities. I do not mean by this simply or even primarily that there may be more employment for labor of the existing types at lower wages. I am thinking in particular of the combinations of work rules, building codes, etc., which close the doors to employment of workers below rather high skill-levels. Consider as an important example the possibilities of rehabilitating slum housing in ways that give employment to slum dwellers. Proposals to this end immediately bump into the fact that even if unions are fully open to everybody with their traditional skills, the rules as to who can do what kind of work simply bar the use of really unskilled labor. Here and in many other areas, we operate as if the contribution to a job of anybody whose work is worth less than some fairly high hourly work is worth nothing at all. The claim to an increased wage-rate should be viewed as stronger in industries where enough flexibility is created to make room for workers who start from the skill-levels the under-privileged members of society actually have, than in industries where the starting-point is kept out of the reach of such workers.

It will be plain that these opportunities for improving the wage-price mechanism cannot be dealt with strictly within the frame of reference of a labor dispute or of a publicized industrial price-increase. Any agency assigned the responsibility of framing and administering a guidepost program will have to deal with cases, and do what it can in these cases by publicity, and by advice to private parties and public officials, even though the frame of reference limits drastically what can be done. But my view is that the primary problem of such an agency would be to work back from these cases and try to design an improvement of the frame. If its basic standard is one of getting the private economy to expand output and employment rather than push up prices and wages, its most valuable diagnoses and policy proposals may well lie outside its immediate area of responsibility—in such areas as tax policy or standards for property-rehabilitation in model cities.

THE MONETARY-FISCAL MIX

Since the United States of economy began to show signs of "overheating" in 1965, our basic instruments of restraint have been monetary. To a considerable degree, it is possible to exercise restraint when needed either through monetary policy or through fiscal policy (taxes and government outlays). But to rely too heavily on either the monetary or the fiscal instrument may do serious damage. It seems to me that we are well out of the range where we can substitute one instrument for the other, and into the range where more fiscal restraint is needed to permit an easier monetary policy and obviate the risk of a "crunch".

The administration's proposal of a tax "surcharge" seems to me to have a rather satisfactory form—except for the fact that many members of the public seem to think the suggested figure of 10 percent applies to *taxable income* rather than to *tax otherwise payable*; it would be less confusing to talk about "adding a tenth to people's tax bills". The magnitude is enough to make a noticeable impression on the economy, without being so great as to risk a severe shock. The proposal to set a termination date of June 1969 also makes sense to me. It offers incentives to *postpone* some outlays, and should thus store up a backlog of demand for a

time when we are likely to need it. It cannot be guaranteed, of course, that no extension will be needed; but the form of the proposal does guarantee that extension will not be made without appropriate consideration, subject to a presumption that taxes should revert to non-emergency levels.

Some of my colleagues in the profession of economics feel that the tax increase should not be recommended because if a recession sets in, it will not be needed and the economy may even need stimulation. But in terms of hedging-strategy, I would answer that the United States is in a position where a number of highly-desirable expenditures for urban problems and the like, which were just ready for an expansion I would recommend, have been cut back to help offset the inflationary pressure. If it turns out that the budget with the tax increase and without the expenditure-items that have been lopped off is too restrictive, and that economic activity tends to fall off, there is an unusual amount of scope for expanding outlays quickly by picking up some of these programs. Furthermore, in this spring's budget-making process, I would guess that the Congress will be more inclined to continue a nucleus of some of these activities (rather than close up the reduced programs on which an expansion can build) if the tax increase is enacted. Consequently I disagree drastically with those of my friends who feel that opposition to the war in Vietnam should be expressed by opposing the tax increase. Opposing the war myself, I feel that the tax increase is necessary to minimize the extent to which the war kills off the programs we ought to be carrying on within the United States. Those who feel that pushing the war to a successful military conclusion is feasible and is the best way to clear the way for our national objectives should also welcome the prospect that the tax increase will limit the cutbacks in domestic programs related to the war against poverty. In short, I hold that this should be common ground for people with a variety of opinions.

Chairman PROXMIRE. Thank you very much, gentlemen. These are very excellent papers. I especially appreciate your emphasis on monetary policy. We have not had enough of that. We did not get enough of it from either the Federal Reserve Board or the Treasury. It is good to have so clear and concise an emphasis there. And, it is good to have Mr. O'Leary's response to the question we were unable to elicit an answer to from Mr. Martin on what would be the demand and supply—the ingredients involved—in the so-called credit situation. And we certainly value Mr. Hart's very helpful analysis.

Now, I would like to start off by asking you gentlemen this.

All of you seem to stress uncertainties. Mr. Olsen, Mr. O'Leary, Mr. Hart all agree that this is a hard year to forecast.

International developments might change the situation dramatically. If the situation remains the same in Vietnam we have one set of possibilities. If we have to escalate very greatly, and possibly send troops to Korea, of course, the situation is different.

Under these circumstances, I am very skeptical about the wisdom of a tax increase because it does seem to be a firm commitment that is extremely hard to withdraw from.

I have asked witnesses in the past to cite a single tax increase that has been repealed before its expiration date. We have gotten no examples. In fact, it is hard to find one that was allowed to expire on its first expiration date. I suspect if unemployment is rising but prices are rising, too, in July of 1969, we might very well continue the surtax, rather than repeal it.

Congress hates to change taxes. Business hates to have changes if they are not fully justified.

So, under these circumstances I am concerned with this prescription of policy. And I am especially concerned in view of Mr. O'Leary's very helpful analysis of the timing of the economic expansion.

You say, Mr. O'Leary, that in the first quarter you expect a growth in GNP of \$19 billion, second quarter, \$19 billion, and then quite a sharp slowdown. The rise will be only about 70 percent as big in the second half of the year—\$14 billion in the third and \$13 billion in the fourth. In all probability the tax increase won't hit until the third quarter of the year. Most people will agree it should have hit the first of January. It is not going to. It won't hit until after the first of July. On the basis of much of what we have seen in the past, it is unlikely to have much effect, because of the lag in changing consumer-spending patterns.

Under these circumstances, let me start off with Mr. Olsen. Would you still feel that we should go for a 10-percent surtax, rather than emphasize expenditure reductions?

MR. OLSEN. Well, I still would favor a tax increase, although I must say that my preference is to seek a reduction in expenditures. I must say that the two are not—do not represent alternatives. The reduction in expenditures is an absolute reduction in the level of demand of the economy, whereas in a tax increase, as I indicated, to a great extent it represents a shift of demand from the private sector to the Government. So that actually you can achieve, I think, somewhat more with an expenditure reduction than you can with a tax increase in that respect.

But I do feel that the size of the Federal financing which is implied in the absence of a tax increase, and the propensity of the Federal Reserve to even keel Treasury operations, suggests we have a continued excessive expansion of money in the absence of a tax increase.

Now, I have stated that I believe monetary policy can achieve the same results as the tax increase. What is being sought here is a restraint on the private sector of the economy. And the approach that is being applied now is a gradual slowdown in monetary expansion—I believe it can achieve largely the same effects that would be sought through a tax increase.

However, I do think that given the Vietnamese war, which poses such uncertainties in the sense that all through this period defense expenditures can suddenly balloon, and also the fact that I feel that when fiscal needs are as great as they have become in the last year and a half, that it is desirable to bring this to the attention of taxpayers in the form of a tax increase, rather than to risk, as we have over the past 2 years, to impose not a tax increase, but excessively high rates of inflation on the electorate as the alternative.

If I may take another moment to say another one of the policy problems we face here is that the State Department and the Defense Department are largely looking at an economy which begins at the shores of the United States and moves out, whereas the Commerce Department and the Council of Economic Advisers has been looking at an economy which begins at the shores of the United States and moves inward. And the war in Vietnam has been particularly difficult because it is a war of attrition to a large extent. We have no timetable on its conclusion. It has been—assumptions have been made it will conclude at the end of this fiscal year—the next fiscal year. The ups and downs, the demands of the expenditures there, have raised havoc with economic policymaking in this period of time.

A war, by its very nature, demands a certain sacrifice on the part of the private sector of the economy. We have sought to conduct this war with a minimum pain on the private sector of the economy. And by doing so, we have risked and experienced excessive rates of inflation.

Chairman PROXMIRE. Let me interrupt at that point to say—all of us agree there is a terrible inequity of sacrifice—that American soldiers in Vietnam are making a terrific sacrifice, and the rest of us are not making any sacrifice at all. I suppose, unfortunately, some benefit from this situation.

At the same time if we look at it economically, it is awfully hard to see this is a war economy in the usual sense. I have before me the special analysis of the Budget, which shows that in 1956—certainly not a war year—we were spending 9.6 percent of GNP on defense; in 1958, 10.2 percent; 1962, 9.3 percent. This year, including Vietnam, we are spending 9.1 percent. That is 1968. And it would seem, unless there is a big escalation in Vietnam, it is unlikely we will spend more. Furthermore, defense indicators we are getting suggest that the impact of all military expenditures on the economy is lessening.

Under these circumstances does it really make economic sense to say we have to somehow take it out of our hide with a tax increase or some other sacrifice?

Mr. OLSEN. Yes. But I would measure the impact of the war not in terms of the defense expenditures as a percentage of total GNP, but rather in terms of the total size of the increase in Government expenditures over expenditures in previous years. Also the demands of the Government on the—

Chairman PROXMIRE. Then you get right back to the argument made by some people—I have not made it very much—that, Why shouldn't the Government make the sacrifices? The Government is making the big increase in spending.

Mr. OLSEN. I would certainly stress that. And I have, all along, felt that expenditure cuts should be achieved. The lamentable fact is that so far apparently the expenditure reductions have not been sufficient to satisfy the Congress. And in the meantime, with this impasse, time is passing, and we are continuing to incur for us a very high rate of inflation.

Chairman PROXMIRE. Mr. O'Leary?

Mr. O'LEARY. Well, your question is a very good one, and the general approach that it takes is one that I think has a good deal of merit to it, and certainly is part of this whole picture.

My own assessment of the situation is that in spite of the uncertainties that we face, the risks, I think, are all on the side of over exuberance in the economy. That is my feeling. So that—

Chairman PROXMIRE. Don't you think there are risks also in having unemployment rising next July and August, in view of the riots in our cities that occurred last July and August, in a nation in which we have 3 million unemployed, and in which the people who are hit hardest are the very people in the ethnic groups that are likely to be ignited by it?

Mr. O'LEARY. That is the difficulty. There are complexities to this. But the risks that I would put are these:

First of all, I think that we should have had a tax increase early in 1966. And I continue to feel this way. Because I think since early 1966

we have been putting too much pressure on monetary policy. That is the reason we had the fiasco that we had in terms of the credit crunch in the middle of 1966. So I have been consistent on this.

I think one of our difficulties here is that in focusing so strongly on the very low unemployment rate, and trying to get that unemployment rate down, we have created a situation where over a period of time we may cause some very, very unfortunate developments.

Chairman PROXMIRE. We are also focusing strongly on growth. We grew very poorly last year. We had a poor record. This committee, it seems to me, should be concerned with getting maximum growth. That is part of our directive from Congress. We grew in real terms only 2½ percent last year. We grew less in absolute terms than the Soviet Union did. This is most disappointing. And I am concerned with the possibility that we might abort our growth in the coming year by too much restraint.

Mr. O'LEARY. I do not argue with that—I want to see us grow just as fast as possible. I want to see unemployment as low as possible. But as I see it, we have some very serious difficulties here in that we have had an escalation in prices—it may be and is to a large extent the product of Vietnam. But the fact is, we have it. And some things are happening which are extremely alarming to me. A general philosophy is growing in the investment markets that fixed income obligations are not a good investment. What you are seeing is a phenomenon, for example, of the life insurance business, for the first time in history, in a major sort of way getting into the mutual fund business. And they are trying their best to find products that they think will appeal to the equity consciousness of the public. This is the reason interest rates are so high. One of the things that is bound to occur—in trying so hard to get growth and very low unemployment—is a decline in the value of the dollar. And then you have decisions taken in the investment area which I think represent a dislocation.

One of our problems is, as I see it—that as a result of this process, we automatically get relatively high historic long-term interest rates—the highest long-term interest rates in history.

Now, the difficulty with that is that when you have interest rates at that level, you automatically create very serious problems for monetary policy.

As the Fed has to come in now to tighten credit, after it has gone through this period of excessive ease, what is it up against? It is up against the fact that just as soon as it begins to tighten, it touches off a disintermediation process, because the rates that now exist are virtually at the regulatory ceiling rates for these institutions? And you would say, Why not raise the ceiling rates?—they are regulatory. The effective ceiling is what these institutions can earn. They are not earning on their assets what they are currently receiving. For example, life insurance companies today are investing their new money at anywhere from 7 to 7½ percent. But, what are they earning on the average on their assets—less than 5 percent. And the same thing is true of savings banks and savings and loan associations. The rate of return they pay to depositors must be based on the rate of return they are earning on assets they have acquired over a period of time. So, you cannot get out of this box by lifting the ceilings. The minute the Fed moves toward tightening credit at this stage of the game, it automati-

cally touches off the sort of process that occurred in 1966. And, so, what happens? They cannot tighten credit very much. They know they are in a box. And you get this sort of problem.

You also get a problem in the short run which I think is terribly important. You talk about unemployment. I think you get the problem of the fact we have been running a deficit in our balance of payments for a long period of time, and the rise of prices that is going on today is not going to help our balance-of-payments situation.

Chairman PROXMIRE. The surtax is not going to help it. We cut taxes in 1964 for the express purpose of benefiting our balance of payments and it worked. Unfortunately I did not have the figures when we had the economists here, yesterday, on the balance of payments. But it worked.

The Secretary of the Treasury said the thing to do to improve our balance of payments is to reduce taxes—and he was right. In 1965, our balance of payments improved dramatically; 1966 it improved even more. There are good reasons for that. Now, I submit you cannot have it both ways. If a tax cut helps our balance of payments, a tax hike will not hurt our balance of payments.

Mr. O'LEARY. I supported the tax cut in 1964. And I think it was the right thing to do under the circumstances. But, I can tell you this: Before the President announced his January 1 program I was committed to go to Europe, and be in London and Paris, in the early part of this year. The one thing over there that is being watched like a hawk, in terms of whether the U.S. dollar is something that they want to hold, is whether we pass the surtax.

They are not taking any comfort in this January 1 program. This does not mean a thing to them. The thing that is important to them is whether the U.S. Government is going to have the courage to discipline itself in the fiscal area. They see our rising prices and the lack of action in the fiscal area as evidence that the dollar is going down the drain. And, between now and June, if we do not halt inflation, we are going to get more runs on gold, and the whole international monetary mechanism is going to be in jeopardy.

I am worrying about unemployment in the sense that if we wreck the international monetary system, we could go through a period of deflation that would be much more serious than the slight concern we have now of whether unemployment is going to be a little lower in the second half of this year versus the first half. These are the stakes we are playing for. We have built something in the last 25 years in terms of an international monetary structure. Why run the risk of wrecking that whole thing simply over what I would regard as a relatively modest increase in taxes in a period in which we are overextending ourselves, with a war going on in Vietnam, threatening to expand to Korea.

Chairman PROXMIRE. My time is long past due. I would appreciate, Mr. Hart—I know it is asking something—if you defer your reply. Congressman Brock?

Representative BROCK. Thank you, Mr. Chairman.

You know, one of the things that bothers me about all this discussion is that we seem to be justifying the tax increase largely on psychological grounds rather than economic grounds.

The argument is made that in the puritanical sense we must raise

taxes because we all have to share the burden of Vietnam. The argument is made—and I am fully aware of it, Mr. O'Leary—that the great single thing that they are looking at in this country, is the imposition of a tax increase, for evidence of fiscal responsibility.

The question we have here, though—certainly we have to consider the psychological factors. But can we ignore the economic factors? Are there sufficient economic justifications in terms of the kind and quality of inflation that we have today?

I would ask you this question: Is there an excess of demand in this country today, which is forcing prices up?

Mr. O'LEARY. I would say first of all, the level of demand is high enough today to effectuate the cost-push type of inflation which we are getting. And I think that is the crucial thing. The level of demand, at \$19 billion a quarter, I think, is excessive. But, it seems to me, that is not the important question. The important question is whether in this climate the increased costs that have been built into our system can be passed on in the form of price increases and apparently the level of demand is high enough to accommodate that. Otherwise the price increases would not occur.

That is No. 1.

You suggest that we are overemphasizing psychological factors. But the simple fact of the matter is that you cannot separate the psychological from the economic.

If you look at any economic treatise, you will find that economics in recent years, since J. M. Keynes' "General Theory" in the middle thirties, has a tremendous amount of psychology in it. It emphasizes psychological expectations. I suggest that the rise in interest rates in 1967 was largely the product of expectations. And I think what happens this year is going to be the product of expectations.

So, when you say, Can't we get down to fundamental economics—take the consumer spending, for example. Why is consumer spending not as strong as you might expect it to be? It is basically consumer psychology. Why did interest rates rise so high last year in the face of the massive credit ease by the Federal Reserve? It was basically psychology. You cannot depart from the psychology. And if Europeans—no matter how much we say we have an \$850 billion GNP, and we are such a marvelous country—think that we are not disciplining ourselves in the fiscal area, and that the dollar is going to deteriorate in value, that is the important thing they will operate on. And, that is why I am so worried. I think we ought to be changing some of this psychology.

Why are the life insurance companies out starting mutual funds? Because what they are saying is that what we have ahead of us is a 4-percent increase in prices built in over a period of years, and they better get into the common-stock field.

Representative BROCK. I am not arguing with you that we should not include psychology as a part of our decision process.

Mr. O'LEARY. I am sorry if I am so vociferous. I feel strongly about it.

Representative BROCK. I do think we have perhaps put excessive emphasis upon the psychological aspect.

There is a factor in the tax increase which has not been discussed, and that is the simple fact it does relieve pressure on monetary policy,

and on the policy of the Fed. And there is an obvious need to help finance the Federal debt. When they do that, they do increase the monetary supply, and they do create additional inflationary pressure.

Now, this is where you get into an immediate economic justification for a tax increase. But we do not talk about that.

Mr. O'LEARY. If I did not emphasize it, I would like to do so. One of my reasons for wanting the surcharge, or fiscal restraint, is to take some of the pressure off the Fed, and to permit the Fed, in a more orderly way, to facilitate Treasury financing. That is one of the big objectives. I would agree 100 percent with you there. And I think this would be healthy.

Another thing I think is true. I think if we got the surcharge, you would see long-term interest rates come down fairly markedly. I think psychologically it would have that effect.

Some people would quarrel with me—but this is my judgment.

Representative BROCK. You mentioned earlier you had a very deep concern that the Fed might step on the credit too hard.

Mr. O'LEARY. Yes.

Representative BROCK. It would be almost impossible for them to step on the credit too hard at this particular juncture with the quantity of the deficit that we have projected for this year and next year. Very difficult for them to step down too hard.

Mr. O'LEARY. What you are saying is the same thing I was saying. Namely, that the Fed is in a box in the sense that, since most of the Treasury financing is going to have to be done with the commercial banks, the monetary authorities are going to have to permit an expansion of the money supply to accommodate that, so that they are restricted in what they can do. I would say they are also restricted, because if they step on the credit brakes very much, they will tip off the disintermediation process and hurt the housing industry pretty badly.

Representative BROCK. We went through that in 1966. I do not think there is a member of this panel that would disagree with you, that we would very much wish we imposed a tax increase in 1966. My question is today, with the different qualities involved.

Mr. OLSEN. I differ a little bit. I do not believe that the Federal Reserve would necessarily create disintermediation if it were to pursue a cautious slowing down of greater monetary expansion, such as it has demonstrated in the last few months. To a great extent the market is becoming more sophisticated, and they are aware that a slowdown in monetary expansion leads to a slowdown in economic activity, and this brings interest rates down. It is the way in which monetary policy is executed that is important.

Mr. O'LEARY. I don't disagree with that. You notice I said if they step on the brakes too hard. If they pursue a cautious moderate reduction in availability. I would agree.

Representative BROCK. Mr. Hart, would you want to comment?

Mr. HART. Yes.

It seems to me that as to whether there is a substantive necessity of coming in with a tax increase, there are two or three points to be made. One is the interrelation with this cost-push process.

If we want the trade union people to be reasonable about their wage demands, and if we want the employers to feel they should show resist-

ance to wage demands, the aspect of the tax surcharge which hits profits is the right kind of thing. The notion that profits are subject to a bite changes the climate to some degree in wage negotiations. From this standpoint, a surcharge of 10 percent may even be too small. But the notion that tax rates are higher at times when corporate profits are higher is favorable to a better development of the wagemaking process. This is one of the points, which I did not get into orally, in my prepared statement.

From this standpoint, I would be inclined to agree that we have a pricemaking machine which at times of high employment and high profits tends to generate wage increases. True, profits have been subject lately to something of a squeeze. They are not as high as we might expect—given the right expansion of gross product. But, they are still high enough to create a rather favorable situation for wage increases. We would like to ask the unions to be reasonable. But, to say they should be reasonable for the benefit of the shareholders is not quite that attractive a proposition.

Representative BROCK. A little hard to sell.

Then I want to pursue something. Go ahead, Mr. Olsen.

Mr. OLSEN. I only want to say—in answer to your question as to whether we have excessive demand at the present time—a rate of inflation of 4 percent represents excessive demand. Even indeed if you have a certain slack in the economy, it still means you have excessive demand if you have that rate of inflation.

Representative BROCK. Can that demand be more in the public sector than in the private?

Mr. OLSEN. That may be to a certain extent.

Representative BROCK. If that were true, wouldn't it be equally important to cut expenditures?

Mr. OLSEN. Yes; I would agree with that, definitely.

The other is that while the tax increase would be helpful in either case, corporate or individual, a tax increase on corporations alone would not necessarily do the job if the individual or noncorporate sector demand continues to be strong. Corporate management in sitting down to negotiations even if a tax increase is reducing their earnings—where they have orders piling up, on the other hand—they are going to yield to excessive demands under those cases because of the strong demand they face. So, I think a tax increase must be across the board for the whole spending area.

Representative BROCK. I read an interesting article in U.S. News by the president of the First National City Bank on the balance-of-payments proposals. I would like for you to comment on what specific steps you recommend we might take in the balance-of-payments area, the immediate liquidity problem we have. If you adhere to the President's program, I would like to know that. If not, I would like to hear some alternatives.

Mr. OLSEN. Well, as you may appreciate, we get asked this question every day in our business world, too. And one of the best answers is that the options open to us have rapidly been reduced—in the process of attrition that has gone on here for the last few years. But I still hold to the view, despite the fact that it is more of a long-term approach in effect, that we must seek to improve the surplus on our current account, and we must seek to reduce Government expenditures overseas

wherever possible. The private sector can do a great deal to benefit the balance of payments, and indeed has been a big income producer throughout this entire period.

A tax increase in this respect would be one of the best things that we could undertake to do, and despite the fact that its effect would be to a great extent psychological, it is worth something, because confidence is a very important factor at the present time—given the very delicate nature of our balance-of-payments problem, as Mr. O'Leary indicated.

So that I would feel that one of the first and immediate steps we could undertake would be the tax increase.

Secondly, I would certainly back away from any indication of further controls. The controls area that we have entered into is extremely dangerous. Controls can have perverse effects frequently that are unforeseen at the time those controls are put into effect.

I just might mention one area alone. Foreigners hold something in the neighborhood of about \$13 billion of portfolio and long-term investments in the United States. And if they at any time suspected that those dollars might be blocked in the United States, if we move toward controls, you could get a rather rapid pull-out of funds of that sort.

So, the controls area has some great danger attached to it.

Representative BROCK. I am sorry I am going to have to interrupt. My time has expired. If you have further comments, gentlemen, I would be very grateful if you would submit them for the record.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

I would like to pursue monetary policy, which all of you can address yourselves to.

It seems to me there are three views of monetary policy floating around—there may be more.

One is Professor Milton Friedman's view—to put an educated horse in charge of the Fed and have him create money at the rate of 3 percent a year. That is considered by many a little too mechanical.

Then you have the view of the Joint Economic Committee, in which there is a considerable agreement between Republicans and Democrats—though, as you would expect, Democrats would be 1 percent more liberal in the money created, and Republicans 1 percent more conservative. But, allowing for that, and putting the two parties together, our Joint Economic Committee advice, which nobody much takes, is to create money at the rate of 2 to 5 percent a year; in years of slower growth and greater unemployment, aiming toward the high side of monetary creation, and in years of inflationary pressures, to create money on the low end of the register. Beyond that, we admit our incapacity, in the present state of the art, to come to grips with such criteria as interest rates, bank credit, and so forth.

Then you have the third group, the Federal Reserve, which, unless you gentlemen can give me a better definition of it, seems to be largely anti-Friedmanite. Mr. Friedman is sort of a red rag to the bull. The one thing the Fed does not want to do is to seem to be doing what Mr. Friedman advocates. Thus, as Mr. Olsen pointed out, in the period April 1966 to January 1967, the Fed created money at a negative rate, minus 1 percent, and then in the next period, January to August

1967, they swung the ship in the other direction and created money at the rate of 9 percent on an annual basis.

We do not learn anywhere from reading the minutes of the Open Market Committee or from anything else just what are the factors which the Fed feeds into its computer. We read the minutes, and we see that somebody says we have to help the Treasury this morning, or somebody else says even though our inner voice tells us we ought to ease up on money creation; nevertheless, what will this do to the housing market?—so, better not do it. And another says—the administration has a tax program coming up, maybe we should go on for a while doing what we are doing, even though we know it is not exactly the right thing to do.

I cannot possibly work out any formula from this. There seems to be those three views. At the moment, until we know more, until the Modigliani study is carried forward, and we get some answers, the Joint Economic Committee's proposed monetary policy is the best of the three—the least harmful.

I would welcome your comments, Mr. Olsen.

Mr. OLSEN. Well—

Representative REUSS. And do not be polite to us.

Mr. OLSEN. As you know, from my prepared remarks, I have already endorsed the Joint Economic Committee's view on monetary policy to avoid the wide swings.

I am not unmindful, however, of the fact that the execution of monetary policy is made difficult by the wide swings of fiscal policy. And this, of course, was the main part of my remarks to you.

However, I do feel that in this respect we should let fiscal policy worry about monetary policy instead of vice versa. Because, otherwise, you get an overall perverse policy, which misses entirely the target of high growth at relatively stable prices. And I feel that the range proposed by the Joint Economic Committee here at least aims at that kind of an approach, I think—rather than the wide swings which the Federal Reserve has pursued.

Representative REUSS. Mr. O'Leary?

Mr. O'LEARY. Well, my answer would be quite along the same lines. I would put it this way.

In the early sixties we heard a lot about the new economics. And, basically, I am pretty much a disciple of the new economics. In the period of the early sixties, when we needed a strongly expansionary policy, we took the approach which I think was right—the tax reduction. I subscribed to that. I think it was necessary.

But I think implicit in the new economics is the idea that fiscal policy and monetary policy will work together, and just as in the early sixties it made sense to cut taxes, it seems to me that since mid-1965, with the escalation of the war in Vietnam, and the movement of the economy to full employment, it made sense to raise taxes, or at least to cut expenditures, or to exercise fiscal restraint. Let us put it in those terms—so we do not enter into the question of whether it would have been better to raise taxes or cut expenditures.

But, just as it was right in the early sixties to ease things from a fiscal point of view, from mid-1965 on, I think, we ought to have applied more fiscal restraint.

Now, it is recognized that the new economics works all right from the fiscal standpoint in a period in which there is slack in the economy, but it does not work on the up side. In 1966, when the Fed stepped in and tried to tighten credit, it precipitated a credit crunch. The monetary authorities now face again the danger that, with interest rates so high, they will again touch off disintermediation and another credit crunch if they tighten credit to combat inflation. The Fed is now at that point where it is difficult for them to tighten at the rate they need to, because with the level of rates where they are, they are, up against two limiting factors. Without fiscal restraint, the Treasury will have a huge job of financing which the Fed must support.

The other is, if they tighten credit very much, they are going to precipitate disintermediation.

So, in effect, what happened here in the new economics is that you have pretty much taken away the freedom of monetary action, and we are not exerting any flexibility in the fiscal area, and the sad prospect is that there is nothing to hold this inflation back without fiscal restraint.

That is the thing that worries me.

I subscribe to what I think is the Joint Economic Committee view of monetary policy. But I think also implicit is the idea that fiscal policy would have some flexibility. And, if that is the case, then let us get some flexibility on the fiscal side, so that the Fed does not have to go through these tremendous gyrations, so it can be more even keel, so it can stay within these relatively small limits.

Representative REUSS. Mr. Hart?

Mr. HART. I would be very much in agreement with what Mr. O'Leary just said—that the notion of flexibility in fiscal policy is fundamental, and I do find myself thinking of a tax surcharge partly as a demonstration that we mean something by flexible policy. Everybody was very enthusiastic a few years ago over the fact that, at least, we had arrived at a rationalistic tax policy. On one occasion we made a tax cut which was then appropriate, and would have been appropriate sooner—if this remains the only exhibit, we are in a position where the only flexible element of policy, after all, is monetary.

I had occasion the other day to rewrite a textbook chapter. We used to keep a score chart on Federal Reserve policy. And down through 1951, one could argue that Federal Reserve policy was almost always wrong. Since that time it has been right almost all the time, if we assume that you could expect a very rapid impact. Of course, as someone said the other day, the policy of leaning against the wind should be leaning against next year's winds, perhaps, and this is a difficult trick. But their action has generally been rather appropriate to the situation at the time.

However, from about the beginning of 1966 onward, they have been in a position where they have no way to be right. And it seems to me that the reason that the Federal Reserve has had no way to be right has been that fiscal policy apparently had got into a one-way street.

If I thought that we were taking a major unemployment risk by a tax rise, I might be somewhat worried. But, as I said a few months ago, we have these expenditure programs which are crying aloud to

be increased, and for which the machinery for expansion is already present.

If unemployment did increase, these programs could be expanded, and would in good part pinpoint their effects right at the places where additional unemployment would be creating hardship. So that I find myself feeling that the unemployment risk that we would get into is acceptable, doubly acceptable because we have had experience of high employment lately. We can afford to take unemployment risks now as we could not in 1964 when our recent experience had all been of subnormal employment.

Representative REUSS. If I may recapitulate what I think is the point of view on which all three of you gentlemen agree—it is that, one, both monetary and fiscal policy are mighty important, and both should be at least modestly flexible. Is that correct?

Mr. O'LEARY. Right.

Mr. OLSEN. As the discussion went across, it drifted away from my own point of view. If I may make a point.

First, I perhaps should confess some of my past transgressions, because I have not been in favor of a tax increase over the past two and a half years. I delivered a paper before the Tax Foundation, a meeting at which the chairman was present, entitled, "The Case Against the Tax Increase." And I still find that a tax increase has certain problems. But, I am in favor of a tax increase at this time because of the war, because of the balance-of-payments problem on which it has a psychological effect, which I do not think can be understated. And the war, in which defense expenditures are \$25 to \$30 billion higher than they otherwise would be, cannot be dismissed lightly.

But I do argue with the suggestion that what we are putting in place here is a stabilization theory which would call for flexible changes in tax rates as may be needed in a mix with monetary policy. I think it is unrealistic to expect that Congress can be made an easy partner to a stabilization policy in which changes in tax rates would be undertaken quickly and easily. I think it has been demonstrated this is a very difficult thing to do.

Representative REUSS. I do not think your colleagues have said a highly flexible tax policy. I think they have said a flexible fiscal policy.

Mr. OLSEN. Yes; to be sure. At the present time the argument seems to be so much on the tax increase side—you are quite right—flexible fiscal policy in this case. But the Council's argument, however, is centered largely on changes in tax rates. And so, I may point my remarks at that proposal. Increases in tax rates produce increases in revenues, which have implications which go far beyond stabilization. One can argue for a tax rate increase, for a stabilization purpose, which on the other hand may be related to expenditure programs. It may be difficult to determine what is being sought—stabilization or new spending programs. So that I think it would be a bad mix, in which we sought to achieve flexible changes in tax rates as a stabilization process over a long time.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PROXMIER. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman. I think maybe one thing that is emerging from this testimony is that the new

economics is running up against the old politics. And this is one of the problems we have.

But, to get back to economics—I agree with you, Mr. O’Leary. I think we should have had a tax increase last year. I committed myself to support it last year.

However, I am not sure there is not a different picture facing us this year. This is strictly economics—not the fact that it happens to be an election year.

You clearly predict a stronger first half of this year—I refer particularly to page 2 of your projections of gross national product where you cite a rising \$38 billion in the first half, and a dropping off to an expansion rate of \$27 billion in the second half. This is, as I understand it, based on the assumption that Congress would not enact a tax increase.

Mr. O’LEARY. Right.

Representative MOORHEAD. Do you have, or did you compute, on the opposite assumption, that Congress would enact a tax increase that would probably really not bite until, let’s say, the middle of the year, around the first of July? Did you make any projections? Presumably it would cause the \$27 billion to decline; is that not correct?

Mr. O’LEARY. If they did enact the surcharge. I think we should say, and lay it right on the table, something that I think we all recognize. Economic forecasting is not an exact science. And this being so full of uncertainties, it is extremely difficult to rationalize this.

You see, my reason for the surcharge goes very heavily to the danger we face with respect to the whole international monetary system.

I am not too convinced that whether we do or do not have this surcharge is going to have an awful lot of impact on the domestic economy. What I feel is that to the extent we do have a surcharge, then the Fed will pursue a comparatively easier credit policy. If we do not have the surcharge, they are going to have to be tighter.

Part of the reason for the softer second half, in my thinking, is not only the fact that we will be over the steel inventory accumulation, and over the special stimulus in the automobile area, but part of my reasoning is that, if you do not have the surcharge, then the Fed is going to have to move in—they will be careful about it—but what they are going to have to do is provide less credit than the market wants to sustain that rate of advance of \$38 billion in the first half. What they are going to do is, through credit restraint, to top off the business expansion. We would expect it to go off in the second half on this basis, because, I think, implicit in this is some slowing down in the rate of flow of mortgage credit as the year goes on.

What I am assuming is this: If the surcharge is enacted, the monetary authorities may not be driven to tighten credit. They may go fairly well through the year accommodating credit demands. You could say that, let us say, in 1967 the Fed permitted an expansion of loans and investments of some \$35 billion—you could say they might wind up providing \$37 billion in 1968, and that this would be somewhat less easy—it would be somewhat less easy relative to the expansion going on in the economy. I suspect that the way the Fed is going to behave—that it will still permit one whale of a big increase in loans and investments on the part of the banks, but that, relatively speak-

ing, they will in effect be sort of leaning against the wind, and tightening in that sense.

My own sources and uses of funds figures, I think, may overdo it, because we have a figure in there for an actual cutback in availability. It may turn out that there won't be a cutback. It may simply be a slightly larger figure, but not enough to accommodate the business expansion.

So, I think that the second half, in a sense, is going to be a product of the fact that the Fed will have to do something, and that this will be part of that slowing down process. Part of my thinking is, if you had the surcharge, you would have a better balance between fiscal and monetary policy, and you could cool off fears in the international area. I think if we had somewhat more fiscal restraint and lesser monetary restraint, we could probably go through this period, barring some major escalation in the Far East, in a better-balanced way, particularly in terms of growth of employment, that would look pretty good. It might not look too good in terms of the price rise.

Representative MOORHEAD. As I understand your testimony, you would not vary your predictions very much as far as GNP is concerned?

Mr. O'LEARY. That is right.

Representative MOORHEAD. But, the individual items going into the total might vary.

Mr. O'LEARY. That is right. You would get better housing, for example, than I think will happen if you put too much pressure in the monetary area.

Mr. OLSEN. Just briefly—Jim O'Leary and I have almost identically the same figures on GNP, and even in the accounts. But we are assuming that the tax increase is enacted. As you may notice, both of us, however, place the key on how monetary policy responds. How it responds if there is a tax increase and how it responds if there is no tax increase. And we would assume with a tax increase the monetary authorities might very well pursue a somewhat more expansive policy than they would in the absence of a tax increase, because they would tend to follow the fiscal theory of the Council, that the tax increase by itself would dampen demand, and, therefore, they must offset that, and be somewhat more expansive than they otherwise would be.

Representative MOORHEAD. Professor Hart?

Mr. HART. I would like to comment.

In the first place, I would say that I suspect a large proportion of the academic economists would be in the camp of the Council of Economic Advisers rather than Mr. Olsen's. We would say that fiscal flexibility cannot be very real unless there is some kind of tax flexibility.

Government expenditure has been the great destabilizer of the U.S. economy since World War II, and while there are a few items of expenditure which are open to manipulation from the standpoint of stabilization, broadly speaking, the fluctuations in expenditure happen in spite of economic stabilization considerations, rather than because of them. And admitting that there are political difficulties, and that temporary tax changes have a way of perpetuating themselves, yet,

it seems to me that the time shape of a proposal to have added taxes that will expire in June 1969, is rather favorable.

By the way, this is just the kind of thing which ought to help substitute fiscal policy for monetary policy. One hopes, in a time of tight demand, to get demands postponed. One of the things monetary policy can do is to create a prospect that if you postpone your financing you can get it on better terms, so why not slow down expansion now and wait until later? A temporary tax increase has also some of these dimensions. It suggests that the market won't expand quite that fast insofar as consumer spending is being pinched. It suggests that the availability of internal funds will be better later than in the next year or so. It seems to me that this is the kind of policy which points toward a safe sort of tapering off of a boom—that we can hope to get some investment demand, in particular, postponed until past the expiring date of the tax, at which time we will have time to turn around on policy. If there is a tendency of the economy to sag off then, the demand that had been left over will be there to sustain things. This is the kind of adjustment we usually hope to get through monetary policy. But, when monetary policy is running so far on the tight side, and yet cannot be tight enough to avert mild inflation, postponement of demand through monetary policy is not working out terribly well.

Representative MOORHEAD. We had some testimony that enactment of a tax increase would cause unemployment. The figure, as I recall, Mr. Chairman, was 300,000 additional unemployed in the first full year that the tax increase would be felt.

I take it from your testimony that you gentlemen would not agree with that projection; is that correct?

Chairman PROXMIRE. That was the estimate of Chairman Ackley in response to a letter I wrote him.

Mr. HART. I have not seen the reasoning that underlies the statement. But it seems to me that all of us on the panel agree that we hope to get essentially the same level of fiscal activity with less price and wage rise.

Representative MOORHEAD. What do you think of doing this by a partial surcharge and partial tax reform?

Mr. HART. I like the idea of getting at the loopholes extremely well. It seems to me there has been a deterioration of the American tax system in recent years through the opening of more and more loopholes, and it is always in season to improve those. If we have a situation where there is a prospect of doing something about it, Heaven forbid we should miss the chance. Yet, in terms of timing it seems to me this has the drawback that we need some time to get the full benefit of it, and that we certainly hope loophole-reform would not be temporary. Of course, if we can get the loophole thing fixed, it ought to set forward the date when we can have a reduction of tax rates; and the combination of lower rates and a wider base is, of course, very attractive.

The damage done by taxes is largely a function of the rates, and the economic benefits are largely a function of the revenue. So, to the extent you can get more revenue and lower rates, this is highly desirable.

However, in terms of what ails us—it is a little extreme to call it a crisis situation—in terms of what ails us in 1968, it seems to me that the timing of the loophole closing is not the most favorable. Obviously, it would do us more good to get this through now, in terms of timing, than to get it through a year later. And, if the fact that here is something of a fiscal crisis creates a sense of urgency, fine. It is also true, on the other hand, that loophole-closing is one of the most time-consuming types of tax legislation. And, if consideration of tax reform is going to get in the way of getting anything else done until an agreement has been reached on that, it sets back the date at which anything will happen in the way of tax increases.

Representative MOORHEAD. Thank you, Mr. Chairman. My time has expired.

Chairman PROXMIER. I would like to go back to Mr. O'Leary before I come to Mr. Hart, who has waited so long to answer that first question. But, Mr. O'Leary, I think you walked right square into it—and I think that Mr. Moorhead did a fine job of pointing up the weakness of your case.

Now, I want to say I have great respect for you. I think you are an excellent forecaster. But, you have done something that very few witnesses do in sticking your neck out. You have given us the figures. And with those figures, I think that your case for a surtax disappears.

Here is why.

You predict July 1 the economy will slow down to an increase at an annual rate of $2\frac{1}{2}$ percent in the last half of the year. We just worked out the figures. And, that is what it worked out to. This is unsatisfactory on anybody's estimate.

I do not know an economist who says this economy should go along at a $2\frac{1}{2}$ -percent increase. This means increased unemployment. It means very serious business problems in the country; that our growth is much too slow. And I emphasize this is without a surtax. With a surtax the economy might not grow at all. Unemployment would really soar.

Now, your argument that the surtax won't slow the economy down further contradicts the position of the Council of Economic Advisers. You and Mr. Olsen take that position. You say the surtax is just going to shift the kind of production of goods and services into more housing and less of some consumer goods.

I think you are absolutely wrong, because I do not think there is that much flexibility. But, on the assumption you are right, the surtax wouldn't have a price effect. It would do nothing about inflation.

Either the Council has to show you are going to get a diminution in the production of goods and services, or you won't get any really significant effect on inflation. You cannot have it both ways. The only way you can reduce the demand is to reduce demand; reduce effective demand—less is purchased, and there are fewer jobs.

So, it seems to me it is very inconsistent for you gentlemen to say that the surtax is not going to really have any effect on gross national product, unless you agree it is not going to have any effect on prices. If it is not going to have any effect on prices, it is not going to have any effect on the balance-of-payments problem really, and it is not going to do what the President and everybody else argues it will do—including the Council. They say it will slow down inflation.

Mr. O'LEARY. May I be the first to reply?

Chairman PROXMIRE. Please.

Mr. O'LEARY. Well, you know, I have been reading the newspaper account of these hearings, and some of the transcripts, so I was well aware when I came in here today I would be hit because of the fact I have the second half relatively less strong than the first half.

Chairman PROXMIRE. That was a good honest forecast.

Mr. O'LEARY. So, I felt that I was going to be leading with my chin, in that it would provide you with the opportunity to make your case.

But I think you are 100-percent wrong about this. I think you are just deluding yourself. This is the way we have been talking for two and a half years, and there is more to this thing than simply whether we are going to have a little more unemployment in the second half of the year, or whether the rate of growth is going to slow down. I think there are some basic structural difficulties here that have to be knocked out of this economy on the longrun basis, or the growth of this country—

Chairman PROXMIRE. You are saying we have to have the unemployment, the slowdown, in order to do something effective about prices?

Mr. O'LEARY. Absolutely.

Chairman PROXMIRE. Now you are changing your position. A minute ago you said the surtax was not going to reduce unemployment.

Mr. O'LEARY. I am saying if you get the surcharge, if we can demonstrate to the world that we have the courage to take action in the tax area, and not be afraid of the politics of this thing—and I am not suggesting you are, because I have tremendous respect for Senator Proxmire.

Chairman PROXMIRE. I do not run this year.

Mr. O'LEARY. My feeling is that, first of all, if we are to avoid an international crisis, we have to show the world that we have the courage to discipline ourselves when we have prices and wages moving the way they are. And, to my way of thinking, if we do not do that, we are, between now and the second half of this year, running an unreasonable risk in terms of wrecking the international monetary system.

Chairman PROXMIRE. You say we have to show the world that we can stabilize our prices. We have done the best job of any country in the world. In the last 7 years, no country can compare with us. In the last 2 years Germany and France have done a little better, that is true. But over the years we have done much better. They can hardly say to us, "You are leading the world in an inflationary direction." The fact is that we have done better than they have.

Mr. O'LEARY. All these things are true. All I can tell you is if you sit and talk with people in Paris and in Zurich the—

Chairman PROXMIRE. Who have listened to the people from this country tell them over and over we have to have the guts to pass a surtax, and that this is the answer to our problem. That is what they know about our country.

After all, if we sent an expert to Germany to comment on the German economy, the first thing he would be to talk with the top people in the German economic establishment, and the German Government, get their views; and then he would be likely to offer them as sound if he respected the German experts. And I suggested that is just what the Europeans are doing to us. They think a surtax is necessary

here because this is what Fowler asks for, Samuelson, the establishment, the people they regard as competent—so they say that must be it. This European call for a surtax is just an echo.

Mr. O'LEARY. The important thing is that the password over there is that this is an election year, and there won't be any surcharge, that the economy will be permitted to go merrily on its way and expand strongly with inflationary excesses. What they are saying is that this is an evidence of the fact that the United States does not have the ability or determination to discipline itself.

Chairman PROXMIRE. Maybe they say that. But what difference does it make? What do we care? The fact is that the cut in taxes in 1964 was proposed, among other things, because it would help our balance of payments, and it did. You cannot have it both ways again. Now they say you need a tax increase because that will help our balance of payments. And, I cannot understand how a tax cut helps our balance of payments, and now a tax increase does, when conditions, really, if you analyze them closely, were a lot similar in 1964 to what they are today.

Mr. O'LEARY. You ask what difference it makes. It makes quite a bit of difference, because they hold billions of dollars of liquid dollar claims, and once they lose confidence in the dollar they can convert it into gold.

Chairman PROXMIRE. What does the tax increase do? It reduces the profitability of the American investment. It hits the corporation income profits with a 10 percent reduction. It makes investment here less attractive. Then, in addition, what you and Mr. Olsen have been saying is that it is going to reduce interest rates. But, if it reduces American interest rates here, what happens to the flow of funds? They flow abroad. So funds flow abroad for two reasons. One, because our profits are less, and the return is less, and the yield is less and it makes less attractive investment. It flows abroad for another reason because our interest rates are less as compared with theirs. So, from the standpoint of balance of payments, I think the arguments are all the other way.

Mr. O'LEARY. I think what Leif said earlier is perfectly true. That is, what we have been doing in the whole area of capital movements, and in terms of free flow of goods, is we have been moving toward restrictionism in this country—this is another dimension of this thing. We started with the interest equalization tax, and now we have the \$3 billion program. How does this tie in with the traditional policy of the United States for free expansion of trade and exchange?

Chairman PROXMIRE. I agree with that.

Mr. O'LEARY. Why are we doing it? We are doing it because we had to come forward with a crash program that was the product of the fact that we are not—we have not done anything in the fiscal area. This was a stopgap thing. This is what Europe is saying. Europe is saying—Mr. Johnson put forward a stopgap program, a hastily conceived one, because he cannot get a tax increase through. And, furthermore, it complicates the problem. You start to trace what the ramifications of this are. This \$3 billion program could be the very thing that would make it extremely difficult for the British to work out their problem.

Chairman PROXMIRE. Well, I disagree with you on the source of the balance-of-payments problem.

Mr. O'LEARY. Are these risks worth running over what I think really ought to be an increase in taxes to pay for the fact that we have a war going on?

Chairman PROXMIRE. The fact is, though, that the private sector, as far as international balance of payments are concerned, is still in healthy balance. It is the public sector. We have troops stationed in Europe. A Vietnam war. These are the elements that have really contributed to the deterioration in our balance of payments.

I would like to ask Mr. Hart to answer my first question, which was related to the fact that—unpredictability would suggest that a surtax is a mistake. And I would like to stress to you that I would agree with what I think is your own bias, and mine, too—that we should not reduce the Government investments in human resources, that the anti-poverty program should be increased not reduced, that manpower training programs should be increased, not reduced. I think we have such an irrational system, however, of our Government expenditures, with our supersonic transport, our space program going on heavily, our public works programs, which are very, very hard to justify under present circumstances, have always been cut back in similar situations. I think there is plenty of room for some restraint there, where we can be fast on our feet, and restore the spending if we need it—rather than in emphasizing a tax commitment which is going to freeze us into a tax position for several years.

Mr. HART. Well, may I tie this in, with the question you raised as to whether one seriously expects price effects in the United States. When you are comparing 1964 with 1967—

Chairman PROXMIRE. I was comparing that in terms of the balance of payments.

Mr. HART. Yes. At that moment we had had a record of several years of stability in the level of industrial prices, and in labor cost per unit of industrial output. And there was reason, looking forward, I think, to feel that our position internationally was solid, and also any inflation risk for the United States was over the horizon, and there was time to turn around and do something about it if it intensified.

Now, at the present time we have a recent record of a rise in the industrial price index, a rise in cost per unit of output which represents partly wages and partly the rise in social security contributions—which has made a difference of the order of a couple of percent I think in that relationship—and the consequence is that it is not unreasonable to say that the relation between tax cut situations and the balance of payments is rather different in kind.

It seems to me that a tax increase of the dimensions we are talking about should be expected to have fairly intense anti-inflationary price effects. It changes the climate of wage price policy. If the decisions that are made this spring are made knowing that this tax will be in effect a year from—

Chairman PROXMIRE. It seems to me this is a very slow, awkward and cruel way to do it. We had a situation, for example, in 1958, with almost 7 percent unemployment, the kind of situation where you certainly think you would not have excessive demand. Yet, in 1958, we had a high rate of inflation—in fact higher than it was last year.

So, under these circumstances, it seems to me, if you are going to sufficiently slow down the economy with a surtax, and create a psy-

chological situation with sufficient depth and time to slow down wage determination, it is going to take a long, long time. That is not the way to do it. The way to do it is to have a wage-price guideline policy with bite in it, a specific figure, the kind of thing that is unanimously recommended by four experts who appeared before us, including Mr. Sheahan, who has written a fine monograph on it for Brookings.

This is the way to bite at the wage-price situation rather than go way around Robin Hood's barn and hit it through a tax increase that can do so many other things.

Mr. HART. However, if our firm is confronted with a situation where a full volume of output can be sold at higher prices—so that we cannot stand interruption of output because we are going to lose sales we could otherwise have—and where profits are going to be satisfactory, this is the sort of situation where it is very hard to look to the guidelines. At best, there have always been some settlements that came outside them. I would certainly say “Yes,” it is a good idea to do something fresh and more effective and better aimed in the way of guidepost work. And, yet, I would say that this is complementary with a policy which aims to make it more doubtful that employers can expand sales and raise their prices, too, and which makes it pretty certain that the tax bite on profits will be larger. With such a tax situation, it involves less inequity to ask the wage earners to accept sacrifices than what wage earners concede goes right into the pockets of the stockholders. The notion that the stockholders are having to make sacrifices through the rise in corporate tax is something of a sweetener to the notion that the unions should be more moderate, in the wage figures they will accept.

Chairman PROXMIER. My time is up.

Just one parting thought. It is my feeling that when members of militant labor unions have their pay envelopes reduced by an increase in the withholding tax, they are not in the mood to have their leadership ask for a weaker increase in wages. There is a real tendency for them to ask for more to make up for what they have lost by the increase in withholding when their take-home pay is reduced.

Mr. Brock?

Representative BROCK. Just one quick comment on your point, and then I would like to go back to balance of payments.

I think the thing that concerns most of us, and the Senator is voicing a pretty substantial sentiment up here when he talks about it, is the difference between a tax increase and the guidepost. At the very time when we broke out of this very stable structure we had going for several years was the time we abandoned the guideposts. And now we see a situation where, after abandoning the guideposts, the settlement pattern is about double what the guidepost was. And I think there has to be some relationship between the two.

Now, Mr. O'Leary, I would like to go back to your argument for the tax increase as it relates to the balance of payments. I have heard this argument made so many times, about \$14 billion investment in this country—if foreign investors lose confidence in us, they are going to pull that money out.

Now, let us be honest about it.

That money is over here because it makes a profit for them. There is a yield out of this economy, a profitability that they cannot obtain

at home, or it would not be here. Money finds its level. It is the most fluid commodity of all. And that capital is not going to be pulled out of here unless we are getting into a situation where this economy is not profitable or the particular investment is not profitable.

I do not see this dramatic drain of \$121 billion. I do not see any prospect of it.

When you are talking about the fact that we may have 4 percent inflation in this economy, you cannot talk about 4 percent as if it were a domestic situation. It is a relative situation: 4 percent as it relates to what in France, or in Germany, or what in England.

If it is 4 percent and 3 percent there, there is only 1 percent disadvantage. And if they are getting 5 percent on their investment, 1 percent still leaves them a net profit of 4 percent more than they had before.

I do not see the direct relationship that is implied by your premise.

Mr. O'LEARY. I think the line of reasoning is that as our gold stock has declined—and at the present time the relatively small amount of free gold, with the gold cover in effect—I think that what speculators are betting on is that somewhere along the line the United States will have to raise the price of gold to get out of this box. And, what in effect they are saying is if the United States does raise the price of gold it will be a pretty big increase, because they would not raise it by some small amount, since that would still leave open the expectation that they would do it again. What they are in effect saying is, somewhere along the line we are betting that the United States will raise the price of gold, let us say, to \$70 an ounce. And this the reason they are choosing to hold gold rather than dollars, because they expect to get a big profit on their gold holdings. I do not expect that the entire volume of our gold reserves is going out.

You see, the interesting thing is there is all sorts of crazy psychology in this. I agree with some of the things the chairman has said. Psychology seems crazy. But, it is there.

One of the things Europeans think is that the U.S. military has told the American Government that—we need \$10 billion or \$12 billion of gold simply as a war chest, in case we get involved in World War III, and so, they are betting we are not going to sell much more gold, that we will have an incentive to hold onto what we have, because we need it as a war chest. There is all of this crazy speculation. But, if you have that sort of thing, and—what could tip this off is that we may show in the first quarter a continuing rather poor balance-of-payments position. The pound may not look so hot. The pound and the dollar are tending to be tied together. What you might get would be two or three flurries where we lost \$200 million or \$300 million of gold. And, who is to say that the psychology of this thing is not going to be as bad as what happened to the pound in November.

Representative BROCK. When we talk about gold—let us not get too far afield from the balance-of-payments program as it has been proposed. I think you made one most pertinent point earlier in the discussion, when you said one reason they might pull this money out that is invested in our economy is that they might fear exchange controls. Now, that is a realistic fear, because the very proposals that were made by this administration on the first of January were the first and

second steps toward exchange control. That is the danger. That is where your psychological factor enters in a major degree.

I think the most damaging single thing this country can do is impose controls on overseas investment. This is the most profitable aspect of our entire international program. We simply must address ourselves to the public rather than to the private sector, in our international dealings.

Mr. O'LEARY. Let me just make this point. You cannot underestimate the nervousness that exists.

People keep calling me about what is going to happen. And I know on the day of the state of the Union message there was a rumor in the financial district that the President was going to announce that night that the price of gold would be increased to \$70 an ounce. This was a pervasive rumor. It was a crazy thing. My reaction was, How crazy can you get? But the fact is that there is an irrationality about this.

And within the last couple of weeks, there was a very strong rumor around in the financial community that the Canadian dollar was going to have to be devalued. There is a very nervous situation here. I do not think we ought to underestimate it. Part of the dimension is the very thing you are talking about.

Representative Brock. But, you do remember that their nervousness is largely a matter of private sector nervousness. The people who hold large quantities of dollars—some \$14 billion—which can be used to call gold—you are talking now about gold as a commodity itself—those dollars are held in central banks. You have only seven or eight central bankers that are in a position to call any quantity of gold from this country. These are awfully sophisticated men. They may reflect the psychology that exists in that country, but not to the extreme swings.

Mr. HART. They cannot quite ignore it. The central banker is a trustee. And, however much he may hope we can hold out, if he is afraid that he cannot take out what belongs to his constituents because somebody else will get there first, he may have to move.

Representative Brock. I am not arguing on the psychology of the tax increase. I have heard it expressed too many times to not admit it is there. But, I am saying I think the adverse psychological effect of our balance-of-payments program, the emphasis upon the private sector, investment, tax rebates and so forth, is equally adverse as the refusal to enact a tax increase.

Mr. O'LEARY. Absolutely.

I think we did the right thing in announcing the \$3 billion program. I supported it, even though I had some reservations about it. But, at the same time, I think you have to recognize that the ramifications of it are hard to figure.

I was in London at the time this was announced, and they were trying to figure out what the impact on Britain was going to be. To me it was a rather surprising line of reasoning. They said that the direct impact of controls over capital investment will not be very great, but the indirect effect will be very, very great. Their reasoning was that U.S. companies would now have to borrow heavily in the Euro-dollar market and thus drive interest rates up. The British argued that this would make the 8-percent bank rate there relatively

ineffective in pulling back funds and would hurt their chance to build their reserves through the high bank rate. This does not seem to have happened so far. The other thing they were afraid of was that the impact of our program would be deflationary for France and West Germany, and that the effect of this would be to hurt the British ability to build their exports up by sending goods to France and Germany. Their reasoning there was that the restriction on tourism would hurt the French, the restriction on direct investments would hurt them, and the same thing would be true in West Germany. And they reason also that these countries would be less willing to pursue expansionary policies, because they would be afraid that they would pull in too many imports from Britain and so forth.

Now, actually France and Western Germany have gone along and pursued relatively expansionary policies.

But this whole thing has all sorts of ramifications.

Our program, our January 1 program, could be the sort of thing that would really make it tough for the British to make their devaluation work.

Representative BROCK. I am more concerned that that program will require on their part—not encourage, but require, at least sub rosa retaliatory measures which will wash out any effect on our balance of payments. And, certainly—I heard it over there—we are going to have to take some action to protect ourselves, because the pound is in a critical condition already. We may have to devalue—without anything else.

Mr. HART. May I intervene a moment. When you say we were taking the first and second steps—the difficulty about this New Year's Day program, it seems to me, is that on its face it is unenforceable; and when you start calculating what measures it would take to transform it into an enforceable program, you do find you are moving a good way toward exchange control. When you talk about the possibility of retaliation, it is not so much retaliation against the program as it stands. But, if we decide to put concrete meaning into the program, we will have to do things which may be very painful abroad, and may set off a process of retaliatory moves.

Representative BROCK. As Mr. Moorhead said, controls beget controls. I think that is an excellent summary of the situation.

My time has expired. Thank you very much.

Mr. OLSEN. While investors seek high return, there are two considerations which go into investment. One is the rate of return and one is the risk. And when the risk becomes greater than the return, the investment is liquidated.

Chairman PROXMIER. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

Gentlemen, in addition to the tax increase, what should we do to improve our balance-of-payments position—or is your testimony that the tax increase, in your judgment, of itself would do the job for us?

Mr. HART. Could I make a distinction, sir, between the balance-of-payments situation and the monetary reserve situation.

The monetary reserve situation has some of the dimensions of a banking position exposed to the possibility of a run. Here we are thinking in terms of possible transfers of capital funds above all.

It is true that a few years ago the U.S. situation as international

banker was very secure, and that the erosion of that position has been the cumulative effect of the balance-of-payments situation in the meantime. However, it would be possible that we could get a strong improvement of our balance of payments in the next 6 months and be in a worse position as an international banker at the end of it, or vice versa. And, in particular, the proposition that we must strengthen our exports relative to our imports, in order to strengthen our position as international banker—it is not totally irrelevant, but it does not bite very strongly on this.

It seems to me that basically our position as an international banker, with the gold-exchange standard based on the dollar, is unworkable at the present time. The only real remedy for that is to internationalize the role of banker in the gold exchange standard. So long as we try to run it as a unilateral U.S. banking operation, we are getting into a more and more difficult situation; even if the import-export situation improved, we would still have this hazard on our hands.

It is plain that if we could score a dramatic improvement in the balance of payments, which people could be sure would hold several years, our position as a banker would be strong. But we have got into a nasty situation which has much the same characteristics as the internal American banking situation before the Federal Reserve. If the foreign central bankers change the form in which they hold their reserves, or if some of their customers choose to transfer funds out of the financial center into the periphery, then a change in the composition of reserves produced a shortage of reserves.

We have responsibility, as the central banker, toward the other countries in the gold exchange standard. They have no reciprocal responsibilities toward us. The Federal Reserve System was set up to be responsible as the trustee of the reserves—but the member banks also took on a responsibility to keep reserves there. They no longer had the privilege of changing the composition of the reserves, taking cash home into vaults, and leaving the holder of the central reserve short.

The dollar-exchange standard was workable only temporarily; we are reaching the end of its workability, and this would be true even if the balance-of-payments situation was going to show a rather substantial improvement.

Representative MOORHEAD. Professor Hart, that statement you just made has helped me better to understand this than anything I have heard before.

Mr. OLSEN. I have made some comments, previously, on how to improve the balance of payments. I would like to remark that, presently, we have two labor negotiation problems in the United States which are costing us a very substantial amount in terms of our trade-surplus position. One is the continuing strike in the copper industry, which is costing us somewhere in the neighborhood of \$750 million to a billion dollars in additional imports of copper on an annual-rate basis that would otherwise not take place. The second in the steel industry, where the unfortunate and almost absurd situation of delaying settlement until some time in August when the contract expires, is inducing an inventory accumulation which is pulling imports in from overseas, and is estimated to cost us somewhere in the neighborhood of \$500 million between now and midyear in additional steel imports.

What is likely to occur—even in the face of the control program—is that we may have some savings on capital account, we may have some savings on the tourist account, but we may see our exports run at a much slower rate than imports. Imports would run upward. So our current accounts surplus will shrink from last year's level, and we may very well have higher overseas expenditures by the Government. And the combined effects of these will offset whatever savings we may realize as a result of the controls. This is the unfortunate result of attempting to compartmentalize the balance-of-payments problem.

Representative MOORHEAD. Mr. Hart, let us see if I can put your statement into simpler language that I can understand. Our position, as I see it—the most dangerous one—is what I would call a balance sheet situation, that as banker we are making a profit in our banking operations, but we have been investing long term and borrowing short time to do it, so that we have a possibly dangerous liquidity situation. Is that right?

Mr. HARR. Well, one could put it in terms of the two partners in international financial relationships—the surplus versus the deficit country. One way of looking at the cumulative movement over recent years is that it reflects what is the matter with the capital market in Europe. The Europeans have been expanding their capital investment on a huge scale. They have been saving enough to finance it. But the European saver prefers to move into a creditor position. The European companies are not selling equities on a vast scale to their own people. Notice, we do not get a huge wave of people establishing investment trusts—either here or in Europe—to operate in the stocks of European companies. This is partly a testimonial to the alleged superiority of American management. It is partly a testimonial to the fact that American companies give the investor information which tells them where he is, and the position of the minority stockholder in the American company is much better protected than the minority position of the European company. The consequence is that U.S. firms become owners of equities in Europe, and Europeans become creditors toward the United States. The European draft toward creditorship is scored as a balance-of-payments deficit, and has pushed us cumulatively over the years into this unworkable world banker position.

To say this is all our fault because we are exporting capital is crazy. De Gaulle fumes about the movement of American capital, and a tendency of U.S. firms to take over French concerns. He should be worried over what is the matter with the French economy, that, though they are saving and investing enough, they cannot manage to make financial machinery to do their job, but get foreigners to supply the equity capital which is necessary for the expansion of the French economy.

The European governments really have an obligation to themselves, by their own standards, to create a situation as to capital flows, where their own new capital will finance their own enterprises, and they won't need our capital. The defects of the European capital market have really been at the root of the difficulty. It is not the commodity and service situation. It is not even Government oversea expenditure. It is the fact that the European capital market has not been doing its job. This is very hard to remedy from the U.S. side. And makeshift

controls on capital outflow from here are a very unsatisfactory remedy for this underlying trouble.

Representative MOORHEAD. Of course, if we could promote a program of persuading the Europeans to invest in the equities in our market, this would be one way.

Mr. HART. The European is apparently much more willing to invest in equities in American companies than in European companies, because the whole situation is so much more transparent, and he really has more confidence in the management—or at least in the management's relationship to him as the minority stockholder with no control.

Representative MOORHEAD. A further development of the International Monetary Fund along the line of the special drawing rights would be an important step toward internationalizing our position as a world banker. Is that correct?

Mr. HART. Well, I would call this very much of a half measure. It seems to me what is called for is that countries should hold their reserves through the International Monetary Fund. The IMF should come to hold a large fraction of the world's gold, instead of holding \$3 of \$4 billion, and it should be assured against a gold run. When one talks about reciprocal obligations, it would be absurd to say all the other central banks should accept obligations toward the Federal Reserve. But they could accept obligations toward an international reserve pool; this is compatible with their national dignity. If we could transfer the U.S. gold exchange liabilities to the International Monetary Fund, giving them long-term claims upon the United States in exchange, then we could have a workable situation. The articles of agreement of the International Monetary Fund could be amended so that every country, including the United States, was under obligation to hold a good part of its international reserves through the monetary fund. This is something which cannot be done through any national central bank as focus. And the dollar exchange standard, it seems to me, is about played out. It is a miracle it has lasted this long.

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. OLSEN. I only wanted to ask, if time permitted, if I could take minutes—

Chairman PROXMIRE. Take all the time you want.

Mr. OLSEN. Earlier, in your references to Mr. O'Leary, in commenting on the tax increase, and the slight slowdown in the second half of the year, I felt you reached a conclusion there. I would like to add to a point that Mr. O'Leary made in defense of his position, and I think partly in defense of mine, if I may.

Chairman PROXMIRE. Yes, indeed.

Mr. OLSEN. Forecasting quarterly patterns is an extremely difficult thing to do. With a forecast for a 12-month period—you can reach a measure of success. But a quarterly pattern is a greater guessing game than the year would be.

As it stands, we have a slowdown in the second half, but not nearly as great a slowdown as Mr. O'Leary has in his forecast for the second half, although we have the same figures for the full year as a whole. Actually, the forecasts we have put together, and I think Mr. O'Leary would share my view, if anything would tend to err on the low side, because we have the possibility that consumption, personal consumption, would break out on the high side. The consumer is in quite a

strong financial position in terms of his liquidity buildup, in terms of his slow accumulation of debt and rapidly rising income. We do not allow for a higher level of consumption than could actually occur. We could also have a breakout on the high side in terms of defense spending. The assumption made on defense spending has proved erroneous before. We could have a higher level of plant and equipment expenditure.

Chairman PROXMIRE. All these could be higher, too.

Mr. OLSEN. They could be. But the chances of them being lower are much less than higher—just because the character of these areas as they now stand, and based on past precedent, as well as theoretical application.

The other is that I feel that this time is not the time to err on the side of inflation. It is not a time to seek fine tuning of the economy at the present time. If we err, then the risk should be probably in over-restraint.

Chairman PROXMIRE. Rather have us err on the side of increasing unemployment?

Mr. OLSEN. I would even say that, if that is the risk. The assumption, for example, that overemployment, and that high rates of inflation somehow are less painful than unemployment, and a stable price structure, I find to be somewhat lacking in logic.

Chairman PROXMIRE. You see, you gentlemen and the administration are so concerned about an overheated, overexpanded economy at a time when we have grown so little, and at a time when the January figures are so mixed—and, if anything, discouraging. Now, the one figure that I hear those advocates of restraint latch onto is the unemployment figures. What does that figure consist of? Three and a half percent unemployment is low, it is true. However, this is accountable because 500,000 women left the work force, in some cases they figured they could not get a job, and, secondly, a much more significant figure, buried in the mass of unemployment data, is that hours of work per week dropped from 40.8 to 40.5, and that is as low as they have been in any year since 1962.

I submit this is a much more sensitive indication of the demand on manpower than you get from the gross overall unemployment figure.

Now, if this is the best we can do at the peak of 1968 fiscal boom, it seems to me that we really are not in the kind of stretched out, strained, overheated economy situation that so many establishment and administration economists are arguing.

Mr. OLSEN. I do not think we are yet at the peak of the boom. And you cannot take one month's figure and draw a conclusion for the whole year.

Chairman PROXMIRE. You say it is going to slow down from now on—at least, beginning in July or in August. You say your figures show that, and Mr. O'Leary's figures show it. Most everybody who has appeared, including the Council of Economic Advisers, agree the economy is going to slow down.

Mr. OLSEN. Our figures are dependent on the mechanical approach. It reflects the cessation of steel inventory accumulation, and the end of the automobile catchup phase. This is largely the effects we see in the second half. The second is—which I said earlier—if it is necessary

indeed to achieve some slack in the economy, even if you are not operating at peak capacity in terms of employment, and utilization, if you have an excessive rate of inflation, then it may very well require some even greater slack in order to alleviate that inflation, because—

Chairman PROXMIRE. Seven percent unemployment that we had in 1958?

Mr. OLSEN. No; I certainly would not assume that. I would certainly assume something a good deal less than that.

But, there is no question that inflationary expectations are a factor.

Chairman PROXMIRE. You see, it is no trick to reduce inflation by just letting the economy slow down, and increasing unemployment. The trick is, and the responsibility we have from the Congress 22 years ago, is to permit the economy to grow just as much as it possibly can, keep unemployment at a minimum rate, and slow down prices. To do that, we have to move that stubborn Phillips curve. To do that, we have to have effective wage and price policies. And this is what nobody seems to call for. Absent that we are in a position where we say—well, we have to have growing unemployment to slow down inflation; and why? Because the kind of people hit with unemployment are not up here testifying, and their representatives are not testifying, and many of them do not vote. But the people who favor restraint are outspoken, and pass over unemployment.

Mr. OLSEN. Yes. Every man who sets a price and every man who demands a wage sees that monetary expansion is running at an excessive rate, Government spending is running at a high rate, Government wages are being set at high levels. In other words, the leadership from Washington seems to suggest little concern with the inflation, and the inflation that lies ahead. And this pervades decisionmaking—even if you have some slack in the economy.

Chairman PROXMIRE. The President says this is our principal problem.

Mr. OLSEN. Yes; it is. But the inflation is here. And it is continuing.

Mr. O'LEARY. I just want to say one thing. I know you are anxious to close, and you have a session this afternoon. I would like to say I am glad that Leif made that statement, because, in my prepared statement, you will find I have stressed the fact that even though we see the economy turning down in the second half of the year, we think that the risks, generally, of escalation in Vietnam, of the consumer coming in more strongly, are on the side of a greater expansion.

Chairman PROXMIRE. Why not keep our powder dry. If we get escalation in Vietnam, then perhaps we will have to have a tax increase. And then I think the Congress would give it, and rather promptly. If you have a big escalation—obviously, you have that kind of need. But, if we have to vote on the tax increase—and unemployment is increasing, and if all the predictions are that we are going to have a weaker second half, and grow as you said, Mr. O'Leary, at a 2½ percent or 2.6 percent rate in the last half of the year—I just cannot understand, for the life of me, why we should increase taxes at that point.

Mr. O'LEARY. The only thing—

Chairman PROXMIRE. This is when we are going to vote on it.

Mr. O'LEARY. I am just as anxious as you are to have high employment and strong growth. And I would like to say something—I am

just as anxious as you are to see programs that deal with the important problems of our cities, and so forth. I would associate myself with what Al said. I am anxious to see employment high and strong growth. I think the only difference in view is that I think the whole record since mid-1965 shows we have temporized on this matter of using fiscal restraint—

Chairman PROXMIRE. Since what year?

Mr. O'LEARY. Since mid-1965. I think we have temporized in using fiscal restraint, and I think the risk is that unless we take some action here it is going to be just the same old question of a year from now saying we missed the boat on it. And I think we ought to have prompt action on the surcharge. I think the risks are not that we are going to turn the economy down so strongly, but if we do not have it the risks are greater in other areas. From the point of view of labor and job opportunities, the thing that worries me is that the course we have been on has built-in dislocations and structural problems in the economy which, in the end, I think, could be harder on labor than would be the case if we corrected them. One of the things we talked about here today—getting a better balance between the use of fiscal and monetary policy, getting some flexibility in the fiscal area is terribly important. I depart from my colleagues in a sense—I depart at least from one of them—I would be willing to take the program that President Kennedy announced of giving the executive branch some flexibility in setting tax rates. I think it is important that we get this flexibility. And, basically, I think this committee has felt that way over the years.

Chairman PROXMIRE. I do not want to prolong this hearing. I think you have made an excellent statement.

But, I think the trouble is that Congress is not going to do that. And, because of that—they are not going to repeal the surtax if they pass it. It is going to be allowed to run until the middle of 1969, and running, I am afraid, longer, with increasing unemployment. The prices are likely to continue to rise because we have planted a monetary bomb-shell.

I would like to conclude by putting in the record an excellent editorial from this morning's Washington Post entitled "War, Inflation, and Taxes." It cites a very fascinating precedent in the early 1950's, when we found that fiscal policy did not succeed at all in stemming inflation, and—because it was monetarily responsible for doing so.

(The editorial from the Washington Post referred to follows:)

[From the Washington Post, Feb. 21, 1968]

WAR, INFLATION AND TAXES

Last week a member of the Joint Economic Committee asked Chairman William McChesney Martin of the Federal Reserve Board whether "some new Government machinery or technique" is needed to check inflationary pressures. He replied that new machinery would be less necessary if taxes are raised, but added, "I think we're going to need it anyhow . . . we're in a wartime economy." A spokesman for the Federal Reserve Board later explained that Mr. Martin does not favor mandatory wage and price controls, and so there is little to be said for belaboring that point. But his statements about a "wartime economy" and the efficacy of fiscal measures merit some scrutiny.

What is a "wartime economy?" There are no standard definitions. But operationally the term denotes a situation in which a substantial proportion of a country's resources is diverted to military use, a situation in which productive capacity is fully utilized and in which excessive demand generates inflationary

pressures. There is little doubt that the Second World War meets the foregoing specifications. In 1944, defense expenditures accounted for 41.9 per cent of the Gross National Product and 17.3 per cent of the labor force was in the armed forces. In 1952, at the height of the Korean War effort, defense programs absorbed 13.5 per cent of the GNP and 5.4 per cent of the labor force.

The demands imposed by the war in Vietnam are much smaller. In the fourth quarter of 1967, the entire defense effort—of which the Vietnam War accounts for less than half—absorbed only 9.2 per cent of the GNP and 4.3 per cent of the labor force. The Korean War, in which defense outlays rose from \$14.1 billion in 1950 to \$45.9 billion in 1952, a more than 200 per cent increase, placed strains upon our productive capacity and on the economies of other countries which had not yet fully recovered from the Second World War. But that has not been true of the Vietnam War, as is witnessed by the fact that there was a quasi-recession, a short-lived decline in the output of goods and service and a rise in idle productive capacity at the beginning of 1967.

Mr. Martin and other proponents of fiscal action assert that higher taxes will dampen inflationary pressures, but they seldom if ever review a highly relevant historical experience. With the outbreak of the Korean War in June 1950, President Truman appealed to the Congress for fiscal restraints and they acted promptly. Taxes were raised by \$9.3 billion in 1950 and by \$5.4 billion in 1951. As a result there was budgetary surplus—as measured in the national income accounts—at the annual rate of \$18.6 billion in the first quarter of 1951, the highest of the postwar period.

Surely Mr. Martin would approve of such resolute fiscal action. But what happened to prices? Despite the huge budgetary surplus, despite the imposition of mandatory wage-price controls in January 1951, consumers prices rose by 12.7 per cent between June 1950 and in July 1953 or at an annual rate of nearly 4.1 percent. Curiously, the price rise did not begin to level off until the second half of 1952, a time at which there was a large budgetary deficit.

The evidence suggests that fiscal policy had little if any effect on prices during the Korean War. What was relevant was monetary policy. In 1950–51, the stock of money was permitted to expand very rapidly—at an annual rate of nearly 5 per cent—and it was only after the growth of the money stock was slowed, at the end of 1951, that the inflation abated.

Mr. Martin and his colleagues, who now call for higher taxes while permitting the money stock to increase at an inordinately rapid rate, have something to learn from history.

Chairman PROXMIRE. I want to thank you gentlemen very, very much for excellent testimony. I want to apologize if my questioning seemed a little astringent. I did not mean to indicate a lack of respect. I have the greatest respect and admiration for all of you. You are very competent men.

The committee will reconvene at 1:45 p.m. this afternoon to hear four more eminent economists.

(Whereupon, at 12:45 p.m. the committee was recessed, to reconvene at 1:45 p.m. on the same day.)

AFTERNOON SESSION

Chairman PROXMIRE. The Joint Economic Committee will come to order. We are starting a little earlier than 2 o'clock—we are starting at 1:45—because one of our witnesses has to leave early. We want to move along as rapidly as we can. Other members of the committee will be here later, and the other witnesses I am sure will be along shortly.

Mr. Saulnier, we would appreciate if you could start off, and we will move in alphabetical order. It must be a rare occasion that Saulnier is first in alphabetical order.

STATEMENT OF RAYMOND J. SAULNIER, PROFESSOR OF ECONOMICS,
BARNARD COLLEGE, COLUMBIA UNIVERSITY

Mr. SAULNIER. It is a pleasure to be here, Mr. Chairman. I have a short statement which I will read—it will take only a few minutes.

I am sorry if there is alarm in what I have to say today, but the fact is, I am alarmed. And I feel sure I am not alone in this. It has been my observation in the past few weeks, both in the United States and in Europe, that thoughtful people are deeply concerned that, while the United States is caught in a kind of impasse between expenditure policy and tax policy, developments over which we have little control will precipitate a financial crisis with worldwide effects.

Trouble could come from either of two directions. It could be generated domestically, if failure to limit Federal spending and lift taxes were to invite an abrupt shift in monetary policy to a firmly anti-inflationary style. This happened in 1966 and it could happen again. With the help from fiscal policy a more gradual shift might be brought off successfully; but if it is done to offset a perverse and inflationary fiscal policy it will have to be severe and there is a risk—as we saw in 1966—of interest rate escalation, disintermediation, a drying up of the mortgage market, a sharp drop in stock prices, and general suppression of economic activity.

On the other hand, if monetary authorities try to work themselves out of the dilemma by continuing to expand the money supply at inflationary rates—hoping all the time that something will happen to permit a change in the script—the danger is that the contingencies, as the saying has it, will go against us and trouble will develop from the international side. The cutting edge would be a heavy drain on gold.

It is in this context that we must consider the economic outlook. The GNP numbers look reasonably good, but this is a year in which it will take a lot of doing from policy to make those numbers come true. Looking ahead, one gets the impression that, subject to certain reservations, everything will be all right in 1968 so long as the whole situation doesn't fall apart. What is needed is a formula for defusing what virtually everyone concedes is a highly explosive condition.

Basically, the risks are due to the impasse between expenditure policy and tax policy. The Joint Economic Committee would perform an enormous service if it could devise a formula for breaking this impasse. It might be done, it seems to me, if the committee were to propose a program along the following lines, especially if it made its proposals in a unanimous report:

(1) *Remove the gold reserve requirement against Federal Reserve notes*

Although this is only indirectly involved in the expenditure policy-tax policy question, I put it in first place because it is already at the top of the legislative agenda, and especially because it is urgently needed to avoid the gold drain which would otherwise be an immediate danger.

Failure to change the law would mean that, unless the requirement were suspended by the Federal Reserve authorities, the dollar, in all probability, would be inconvertible into gold within 2 years. But a suspension would not solve the problem. Unless the Federal Reserve

authorities were willing to use blatantly evasive tactics, suspension would, in time, seriously restrict their ability to fulfill their obligations under the Federal Reserve Act and the Employment Act of 1946. It would be only a matter of time—and I expect only a relatively short time—before such awkward arrangements would collapse and force us, quite possibly in an atmosphere of crisis, to do what we can do now in an atmosphere of relative calm.

So, I put removal of the requirement to hold gold as a reserve against currency at the top of my list. This is by no means all that needs to be done in the area of international monetary arrangements, but it is an essential first step.

(2) *Devise some means to put a reasonable ceiling on Federal expenditures*

I put this in second place because it is apparent that satisfaction on expenditure policy is a necessary precondition to action on tax policy.

Obviously, your committee must first decide whether the President's fiscal 1969 proposals for new obligational authority and expenditures, including net lending, are appropriate in the circumstances. I doubt that they are. It has been my feeling that fiscal 1969 spending should not exceed the level contemplated for fiscal 1968. It must be conceded that the budget goes a fair distance in that direction, when you consider that it contemplates expenditures that rise \$10 billion as compared with annual increases that recently averaged close to \$20 billion. But, it is hard for me to believe that it goes as far as one can properly and realistically expect it to go—again, in the circumstances. Moreover, the fact that it requests an increase of \$15.2 billion in obligational authority as compared with a \$3.9 billion increase in fiscal 1968 suggests that expenditures will soon rise sharply again.

My suggestion is that the Joint Economic Committee scrutinize the 1969 budget in the light of the economy's financial condition and propose realistic but tight ceilings for obligational authority and expenditures, possibly with special exception for Vietnam costs. The Appropriations Committees will study and act on budget specifics; this committee is in a unique position to supply guidance on budget aggregates.

If the committee feels the budget is right as it stands, it could say so. If not, it might clear the way for tax action by proposing the establishment of ceilings on expenditures and obligational authority in the manner provided for in section 138 of the Legislative Reorganization Act of 1946. I am sure the committee is familiar with the pertinent provisions of that statute. I suggest that you utilize the authority it gives the Congress to exercise restraint over itself in voting authorizations to spend and over the executive branch in making actual disbursements.

(3) *Propose the establishment of an independent, bipartisan commission on budget policy*

Another move that could clear the way for tax action would be for your committee to urge appointment of an independent, bipartisan commission to make recommendations on Federal budget policy. We have had a commission, and a useful one it was, reporting on the form

of the budget; what we need now is an independent appraisal on its substance. The commission would evaluate spending priorities and define the kind of budget that will enable the American people to finance their Federal Government without inflation and at a tax level that will not suppress economic growth.

Proposals to this end already have support from the administration. In his recent budget message the President wrote of such suggestions:

I urge the Congress to take prompt and favorable action in support of these proposals to cull out lower priority programs.

Secretary Fowler stated before the Ways and Means Committee, on November 29, 1967, that "the President is prepared to establish a special bipartisan task force of outstanding Americans to take a look at long-range Federal program priorities."

The Secretary's statement was seconded on that occasion by Professor Schultze, who is here today, and who was speaking then as Director of the Bureau of the Budget.

(4) Urge prompt enactment of the President's proposals for tax surcharges

When the committee has said what it believes is right on the subject of obligational authority and expenditures, it should strongly urge the prompt enactment of the proposed tax surcharges. And if what the committee says on expenditure policy carries persuasion, action on taxes should come soon thereafter. That would break the expenditure policy-tax policy impasse, which is the key to everything else.

There may be opposition to the surcharges on the ground that the economy is not sufficiently buoyant, but I can't think of anything more dangerously irrelevant than to debate this question on the basis of what happened last week to retail sales or to freight car loadings or to some other detail in the economic picture. One cannot exclude the possibility that the economy will get a new thrust from a sharp increase in defense spending, but, in the absence of that, the imbalances are such, and their implications for policy are such, that the most likely near-term prognosis for the economy is relatively slow growth—hopefully, with receding cost and price inflation.

This may come about because huge Federal deficits escalate interest rates and suppress private investment expenditures, especially on home construction. The crucial point is that \$20 billion budget deficits, back to back, clog capital markets, force interest rates up, slow economic growth, increase its vulnerability to international monetary pressures, and compromise monetary policy to the point where all one can expect is either a credit crunch or inflation that will ultimately correct itself in deflation and recession. Deficits of this magnitude are completely unacceptable and we should get down at once to the business of eliminating them.

(5) Urge that if recent developments in Vietnam and Korea require significantly larger defense expenditures, budgetary authority be requested promptly and a fiscal plan be proposed for financing these through additional expenditure limitations or still higher taxes, or both

One of the chief causes of concern in the country today is a feeling

that the budget has been made obsolete by recent happenings in Vietnam and Korea. There is little that one outside Government can say on these developments except that it is dreadfully dangerous to defray facing up to their fiscal consequences. The committee could usefully urge the administration to settle doubts on this critical question at the earliest possible moment. And the committee should signify in its report that if more money is needed it will support proposals that would raise it without increasing the deficit.

(6) *Urge a return to noninflationary money supply increases*

This committee typically deals with monetary policy and I believe it should go on record this year to point out that, as steps are taken to move the Federal budget back to balance, the Federal Reserve System should reduce money supply increases to a rate consistent with stable costs and prices.

There is room for controversy as to what constitutes a noninflationary monetary policy, but one in which the money stock rises 7 percent a year or faster—or nearly twice that rate when time deposits are included—is clearly destined to put persistent upward pressure on costs and prices. What is called for is not an abrupt move to monetary austerity; on the contrary, all that is needed is a start back to money supply increases more nearly consistent with cost and price stability. It is not deflation, and perhaps not even disinflation, that we need; only a retreat from excessive expansionism. This will probably involve annual money stock increases closer to 3 or 4 percent than to 7 percent. I suggest that the committee give its explicit support to such a policy.

The committee can be sure that a monetary policy of this character, jointly with an expenditure limitation and a tax increase, would be interpreted abroad as a powerful assist to our balance-of-payments program. Indeed, in the absence of such policies, few here or abroad will believe that the program can work, except through increasingly restrictive direct controls and increasing recourse to essentially protectionist devices. The result would be irritation everywhere, and a higher and higher risk that heavy gold drains will resume.

(7) *Propose removal of the 4½-percent limitation on contract interest payable on long-term Federal securities*

With the Federal debt rising as it is, and with interest rates as high as they are, I am amazed that this step—which is essential to give the Treasury the options it needs to manage the public debt in a noninflationary manner—appears not to be a part of the President's program. Nor do I find it mentioned in the Council's Economic Report.

Legislation on this point is needed more urgently today than ever before, and I suggest that the committee take the lead in sponsoring it.

(8) *Suggest a guideline that will permit a return to wage increase-productivity improvement balance*

One need not be an advocate of numerical wage guidelines, which I am not, to know we cannot operate our economy safely when labor costs are rising twice as fast as productivity is being improved. Yet, that is what is happening now, and the Economic Report says nothing better can be hoped for in 1968.

In the circumstances one might expect to find not only some firm

language in the Economic Report but some inventiveness on how to extract ourselves from a situation that is admittedly unsound. Instead, one finds (i) a discussion of the "inflationary bias" in labor markets at full employment in which the major emphasis is on market imperfections rather than on the cost-and-price-raising effects of persistently excessive aggregate demands; (ii) an explicitly defeatist attitude toward labor cost developments in 1968; and (iii) the view that it is "unrealistic" to expect labor to accept money-wage increase that do no more than compensate for increases in the cost of living.

The critical deficiency in this treatment of the guidepost problem is that it gives no guidance at a time when guidance is urgently needed. What is needed is a strong reaffirmation of the basic principle that overall price stability requires labor cost increases broadly equivalent to average productivity improvements and some formula by which—with partial recognition of cost-of-living increases in the interim—we can ultimately work our way back to a balance between average wage increases and average productivity improvements.

It would also be helpful if the committee pointed out that a non-inflationary policy with respect to aggregate demand is an absolute prerequisite to success for any program that hopes to preserve stability of unit cost and prices.

I believe it can be said with confidence that the legislative and administrative program outlined here, if put into effect, would have the following beneficial results:

It would promise a reasonable possibility of returning, without too much delay, to cost and price stability;

It would return confidence and a sense of stability to capital markets and promise a return to more stable interest rates;

It would greatly enhance the chances of success for our balance-of-payments program; and

It would virtually eliminate the risk of developments—domestic or international—that could precipitate a financial crisis.

On the other hand, a continuation of the impasse between expenditures policy and tax policy—with huge deficits persisting, back to back, year after year—has implications that are simply too grave to talk about.

I repeat that what we need is a formula that will get some action started, something that will break the impasse. And I can't think of anything more helpful to that end than a unanimous report from the Joint Economic Committee on the few issues—as I have tried to identify them in this listing—that are central and critical to everything else.

Thank you very much for this opportunity to appear again before this committee.

Chairman PROXMIRE. Thank you very much, Mr. Saulnier. I neglected, and I apologize, to identify you properly as the very distinguished and able and nationally known economist you are, a former Chairman of the Council of Economic Advisers in the Eisenhower administration, a distinguished professor at Columbia University—Barnard College, I believe.

Mr. SAULNIER. Yes; thank you, sir.

Chairman PROXMIRE. I have discussed this with Congressman Bol-ling, and he agrees; we are going to depart a little from the usual pro-

cedure, because Senator Miller, unfortunately, has to leave, and he asked for 5 minutes to ask questions now and then; he is going to have to depart for a meeting of the Armed Services Committee which he has to attend. So, we will get to the other three presentations immediately after Senator Miller finishes.

Senator MILLER. I thank my chairman for his usual deference. I do want to apologize to the other members of the panel for not being able to be here for their presentations. But I assure them I will read their papers very carefully.

Mr. Saulnier, I hope you don't mind my asking one question.

Mr. SAULNIER. Not at all.

Senator MILLER. I am concerned about this advocacy to remove the gold reserve requirement. I asked Secretary Fowler, the other day, what would happen if we did it. I understand that we might well run out of our free gold. But, when we get to a vote on this—and we may do so fairly soon in the Senate—Members of the Senate are going to have to ask themselves a question: Suppose I vote for this, suppose I vote against it. If I vote against it, what will be the results?

The Treasury, I do not believe, has yet furnished us a full reply to that question. I did have a chance to look briefly at your comment on this, and I notice that you say it would only be a matter of time before awkward arrangements caused by failure to suspend the requirement might collapse. But, it would amount to running out of free gold, and then saying to dollar holders overseas, "We are sorry, but we are not paying out any more gold at this time."

Now, what would be the impact of that? Have you thought through that possibility? Because we are going to have to do that in the Senate when we get to a rollcall vote on this.

There are some, you know, who think that maybe the results would be worse the other way—because, if the gold cover is repealed, then we end up with sort of a managed paper currency.

Mr. SAULNIER. Senator Miller, failure to lift this requirement would be a very unfortunate signal for us to be giving to the rest of the world at this time, and I think it would increase the likelihood of a gold drain.

I understand perfectly well that it is possible for the Federal Reserve System itself to suspend this requirement, and for a time one could get along with that I have described here as rather awkward arrangements—but the question is, How long would this condition be likely to prevail?

My guess is, not very long.

At a fairly early date, the Federal Reserve System would find itself in the position of having to post, really, very inappropriate discount rates, or else to adopt tactics of avoidance which would be quite unbecoming for the System and for our country.

I don't think anybody here or abroad would regard this as anything but a completely nonviable situation, and through a gold drain, we would quickly be brought to the point where the dollar would be inconvertible, not necessarily because we had run out of gold, down to the very bottom of the barrel, but because we had run down to that amount of gold beyond which losses would be regarded as inimical to the national interest.

At that point, Senator, the dollar would be inconvertible, and the gold bullion exchange standard would be finished.

Obviously, this is not the way to move into a reform of the international monetary system. It would seem to me a most awkward and dangerous way to move into that reform.

I believe we ought to be working for reform now on an entirely different basis.

Senator MILLER. And what would happen if we reached the point where the dollar was not convertible to gold, because we had run down to the limit of our free gold? That is what I am getting at. What happens then? I mean, what is the disaster? Some people forecast that if we remove the gold cover, we turn ourselves into a managed paper currency; that we are going to have runaway inflation, and that is a disaster.

Well, what is the disaster facing us, if there is a disaster, if we do reach that point? That's what I'm seeking.

Mr. SAULNIER. The developments could very well go something like this—and here, Senator, I would like to make it quite clear that I am not forecasting anything; I am offering an answer to a hypothetical question. And my answer is this:

If the dollar should become no longer convertible into gold for foreign governments and central banks, as it is today, then some steps would have to be taken to stabilize exchange rates of the various major countries of the world.

I do not myself believe that we could simply allow exchange rates in these troubled times to find their own level. It is hard for me to believe that a responsible government would do that.

So, some kind of ad hoc arrangement would have to be devised to give a reasonable degree of stability to exchange rates.

Now, that arrangement might last for a considerable period of time, but my guess is—and here I am pursuing to another stage my answer to the hypothetical question—that some more formal arrangements would be desired. I mean by that, Senator, some more formal international monetary system.

The next question that the experts and the political figures involved would face would be this: Is gold to play a role in the new system? Now, I do not know what the answer to that would be; conceivably it could be "No." In that case we would move into some kind of a paper-gold system. As has been said, almost anybody could define such a system on the back of an envelope, and a lot of people have. We could do this.

On the other hand, a paper-gold system requires such a high degree of international collaboration, and such a high degree of mutual confidence among nations, confidence that each will conduct its domestic affairs in a reasonable manner, that many people doubt we are prepared at this time to go on to a paper-gold type of system.

Now, if we don't, we will go to a gold system. And, if we go on to a system which incorporates gold, we are going to find, very quickly, that there is not enough gold, and there will be an increase in the price of gold. This will ultimately have rather serious inflationary implications for the world, because the people who have got gold now—and I am not talking about central banks or government, I am talking about private holdings, will have an asset valued at an

increased price, and if they monetize their assets you will have a very powerful inflationary factor in the world economy.

Now, that is the crossroads. Do you take the paper-gold route, or do you take the gold route? And, I would rather not, if you don't mind, Senator, discuss the probabilities of which route will be taken.

But let me just say that if you take the gold route, to pursue that a little further, my guess is that the first effect would be disruption and a paralysis to world trade as the arrangements were being put together, and that this would be followed by definite inflationary effects.

These are the consequences.

What I am anxious to see is that we avoid the conditions that will precipitate the gold drain that will start all of this. And I see no hope for doing that until somehow we can break, as I say, this impasse between expenditure policy and tax policy.

Senator MILLER. I appreciate that answer. I would just make this observation. If the Congress doesn't see fit to follow your very well reasoned recommendations here, it looks to me like it is just going to be a question of time before all of the free gold runs out, and we are going to be reached with that problem that you just outlined a little later—maybe another couple or 3 years. But, I think we are really just buying time right now.

I appreciate your going into this. It will be helpful, I am sure, in my consideration of what to do on this.

Mr. SAULNIER. If I may add one point, Senator. I personally believe that a failure to take this step—which, mind you, I recommend very reluctantly—that a failure to take this step will have the effect of bringing a lot closer to us the point at which we will become inconvertible, our dollar will become inconvertible, into gold.

Senator MILLER. I understand.

I thank the chairman very much.

Chairman PROXMIRE. Thank you.

Our next witness is a very good friend of the committee, and a man who has won the admiration and respect of the Appropriations Committees in the House and Senate for his remarkable ability as Budget Director, now a senior fellow of the Brookings Institution, and professor at the University of Maryland, Mr. Charles L. Schultze.

STATEMENT OF CHARLES L. SCHULTZE, SENIOR FELLOW, THE BROOKINGS INSTITUTION, FORMER DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. SCHULTZE. Thank you, Mr. Chairman.

Both the President's Economic Report and the hearings of this committee have primarily focused upon one central economic policy question.

Chairman PROXMIRE. If I may just interrupt for a minute. We do want to have the chance to ask questions. There will be other members of the committee here. If at any time you would like to abbreviate your remarks, the full remarks will be printed in toto in the record. But, go right ahead.

Mr. SCHULTZE. I shall take that as both permission and a suggestion.

Chairman PROXMIRE. Exactly the way it was intended.

Mr. SCHULTZE. As I indicated—the Economic Report of the President and this committee have focused on one major question. Among many others, I think one has stood out:

How should fiscal policy be designed over the next 18 months in order to moderate the recent acceleration of price increases and upward pressure on interest rates, while still preserving high employment and economic growth?

Now, in the context of present circumstances this question can be separated into two parts:

1. In the absence of a tax increase, the Federal budget deficit will exceed \$20 billion—and on a national income accounts basis, approach \$15 billion—for 2 years in a row. Is a substantially more restrictive fiscal policy called for?

2. If the answer to this first question is “Yes,” should a significantly larger part of that restriction take the form of expenditure reductions and a smaller part the form of tax increases, than has been proposed in the President’s economic and budget messages?

This way of posing the question quite clearly rules out the approach which one sometimes hears—“The economy is not strong enough to stand a tax increase. We do need, however, sharp expenditure reductions.” If an actually or potentially overheated economy requires more restrictive fiscal policy, then the particular combination of tax increase and expenditure reductions to achieve this end is indeed a legitimate question of policy. But, one cannot argue that the economy is too weak to stand the reduction in disposable income which a tax increase accomplishes, and at the same time propose a reduction in disposable income through the medium of expenditure cuts.

I. IS A RESTRICTIVE FISCAL POLICY NEEDED?

Let me turn then to the first question—whether or not a more restrictive fiscal policy is required in the coming year and a half.

Appropriate Federal fiscal policy decisions obviously depend upon the behavior of the non-Federal sectors of the economy. A large and growing Federal deficit may be temporarily called for when private demands are so weak as to threaten high unemployment and underutilized economic potential. In early 1967, as private inventory investment fell by the huge amount of \$18 billion during a period of only 6 months, the Federal budget deficit rose sharply—from \$3 billion in the last quarter of 1966 to \$15 billion in the second quarter of 1967.

This rise was much larger than the automatic growth in the deficit associated with the slowing down of the economy. In part at least, because of this swing in the deficit what might have been a recession turned out to be only a short-lived pause in economic growth.

Conversely, in periods when the level and rate of growth of demand for goods and services exceed the level and rate of growth in the Nation’s economic potential a reduced Federal deficit—or a surplus, depending upon the specific nature of this situation—will be called for.

Fiscal policy must be planned in advance. Moreover, the impact of that policy takes time to be felt throughout the economy. As a consequence, intelligent fiscal policy decisions hinge importantly upon a forecast of the future behavior of the major private sectors of the

economy. Even a decision to "do nothing" implies a forecast that the fiscal policy which results from "doing nothing," taken together with the expected behavior of the private sector in the economy, will bring the overall economic results we desire. And, in any event, it is literally impossible to "do nothing" in a fiscal policy framework. Expenditure decisions have to be made. Normal economic growth brings large annual increases in Federal revenues. If "doing nothing" means holding expenditures constant and keeping tax rates unchanged, then "doing nothing" will automatically result in a large change in the full employment surplus or deficit. We cannot, in other words, avoid forecasting, unless we wish to ignore the impact of fiscal policy decisions on employment, growth, and price levels.

Given the expenditures proposed in the President's 1969 budget and in the absence of a tax increase, the Federal deficit, on a national income accounts basis, would range in the neighborhood of \$13 to \$14 billion for both fiscal 1968 and 1969. Will such deficits lead to excessive aggregate demand, an acceleration of the rate of price increase, and a significant tightening of credit conditions? The answer to this question depends upon a forecast of the strength of demands in non-Federal sectors of the economy. If it appears likely that there will be a significant shortfall of private spending relative to the income which would be generated by a stable path of economic growth, then an offsetting excess of Federal spending relative to income will be necessary to balance overall demand against potential output, and prevent rising unemployment. Conversely, if private spending appears likely to approximate the level of private income generated by stable growth, then a substantial Federal deficit will generate an overheated economy and demand-pull inflation.

The administration's economic forecast foresees the latter situation. With the 10-percent surcharge, the extension of excise taxes, and the other proposed revenue measures—and a consequent NIA deficit for fiscal 1969 of about \$2½ billion—the Council of Economic Advisers forecasts a rise of almost 8 percent in GNP from 1967 to 1968. Roughly speaking, this would keep the rate of unemployment at about yearend 1967 levels, provide for economic growth about in line with the growth of economic potential, and offer a reasonable hope of some deceleration in the rate of price increase by yearend 1968.

This forecast, of course, implies that private demands relative to private income are strong enough to warrant a tax increase. Conversely, it implies that without a tax increase, and with a NIA deficit approaching \$15 billion, total demands for goods and services would substantially exceed economic potential, with consequent demand-pull inflationary pressures.

Instead of reviewing with the committee the specific components of the Council's forecast, I should like to approach the question of its overall reasonableness from several different standpoints.

1. Postwar surpluses or deficits in periods of full employment:

Do periods of full employment, once attained, typically require the support of large Federal deficits? Or, put another way, once full employment is attained are private demands typically so weak relative to full employment levels of income as to require a large Federal deficit if full employment is to be maintained? The short answer is "No."

Table 1 shows the Federal surplus or deficit during prior postwar periods of relatively full employment. With one exception, we have not seen NIA deficits during such periods. The only exception is the 1952–1953 period. Even here, the size of the deficit in relationship to GNP was significantly smaller than it was in 1967 and is projected for 1968, barring a tax increase. And this 1952–1953 period was followed by drastic reductions in defense expenditures consequent upon the end of the Korean War—so we do not know what the consequences of such deficits might have been.

TABLE 1.—FEDERAL DEFICITS OR SURPLUSES IN PERIODS OF HIGH EMPLOYMENT

Period (calendar year)	Unemployment rate (percent)	Federal surplus (+) or deficit (–) ¹ (billions of dollars)	Surplus or deficit as percent of GNP (percent)
1948.....	3.8	+8.4	+3.3
1952 and 1953 (1st half).....	2.9	–4.3	–1.2
1956 and 1957 (1st half).....	4.1	+4.9	+1.2
1965.....	4.5	+1.4	+0.2
1966.....	3.8	+0.3	-----
1967.....	3.8	–12.6	–1.6
1968 without tax increase.....	?	–13 to –14	–1.7

¹ National income accounts basis.

By themselves, of course, these statistics prove nothing. Starting from a period of full employment, private demands could of course weaken substantially, and call for a substantial Federal deficit in order to maintain full employment conditions. Yet, it is significant, I believe, that during the postwar era we have typically run budget surpluses in periods of full employment.

2. *The deficit in relation to the growth of GNP—and its consequences:*

Relating the Federal deficit to the absolute size of GNP misses its real meaning. The projected 1968 deficit of \$13 to \$14 billion is, after all, only 1½ to 2 percent of GNP. How can such a small relative magnitude be so important? But what is relevant to problems of economic growth, demand-pull inflation, and unemployment, is the increase in total market demand relative to the increase in economic potential. Starting from full employment, a rise in GNP of, say, \$10 to \$20 billion in excess of the rise in economic potential would have significant inflationary consequences, even though that excess rise were only 1½ to 2 percent of the level of GNP.

Looked at in this context, a \$13 to \$14 billion Federal deficit looms quite large in terms of the \$55 to \$60 billion rise in GNP which would be consistent with stable economic growth in the year ahead.

If we were facing a sharp reduction in one or more sectors of the economy, such a deficit might indeed be warranted—as the \$13 to \$15 billion deficit in early 1967 helped offset the precipitous drop in inventory investment which occurred during that period. Without attempting to forecast the specific movement in particular sectors of the economy, let us examine each of them to determine whether such a reduction may be expected, and whether, therefore, a large Federal deficit is a necessary prerequisite for maintaining steady economic growth.

Consumer demand.—The consumer saving rate rose sharply in 1967.

In the fourth quarter it stood at 7.5 percent of disposable income, compared to a 5.6-percent average during the prior 5 years. Some of the increase may have reflected consumers' desires to increase their liquid assets—since the ratio of household liquid assets to disposable income had declined in 1966.

But by the end of 1967, the liquid asset ratio had been restored to, and slightly above, its earlier level. With the consumer saving rate already at an abnormally high level, and with the liquid asset ratio having been restored, a further increase in the saving rate in 1968 seems most unlikely. Indeed, the chances for a decline in the saving rate toward more normal levels would appear a better than even bet.

In short, consumer behavior does not seem likely to be a source of economic weakness in 1968.

TABLE 2.—RATIO OF HOUSEHOLD LIQUID ASSETS TO DISPOSABLE PERSONAL INCOME, 1956-67

End of calendar year	Ratio	End of calendar year	Ratio
1956.....	0.788	1962.....	0.845
1957.....	.796	1963.....	.873
1958.....	.800	1964.....	.871
1959.....	.807	1965.....	.877
1960.....	.810	1966.....	.867
1961.....	.811	1967.....	1.879

¹ Preliminary.

Note: Liquid assets include currency, demand deposits, time and savings accounts, U.S. savings bonds, and short-term U.S. securities.

Source: Board of Governors of the Federal Reserve System.

Business fixed investment.—In 1965 and early 1966 business plant and equipment did appear to be rising at an unsustainable rate. But no sharp contractions followed. After a slight decline in the first part of 1967, plant and equipment investment has turned up again. All of the surveys of business plans indicate a modest but healthy rise in 1968. There is no evidence that this sector of the economy will be a major source of weakness in the coming year.

State and local spending.—State and local expenditures have been rising at a rapidly accelerating rate. Total State and local outlays rose by \$3½ billion per year in the last half of the 1950's, by \$5 billion per year from 1960 to 1965, by \$8 billion in 1966 and by \$10 billion in 1967. This increase shows no signs of decelerating.

Housing.—The housing recovery in 1967 was a major source of economic strength. That rate of increase will not be repeated in 1968. But the basic income and demographic factors affecting the demand for housing remain strong. Residential construction will be a major source of weakness in 1968 only if credit conditions tighten up significantly. A large Federal deficit could indeed bring this about. In the absence of a large deficit, however, there is no reason to look forward to a sharp fall in housing construction.

Inventory investment.—The abnormally high ratios of inventories to sales which built up in late 1966 and early 1967 have been eliminated. Inventory investment in the last quarter of 1967 may have been slightly higher than a long-term sustainable rate. But, unlike the situation a year ago, there is no evidence which would indicate that inventories will be an independent depressant in the economy during the year ahead.

In summary, failure to take restrictive fiscal action now means:

- running a NIA deficit of \$13 to \$14 billion for 2 years in a row during a period of full employment;
- running a deficit equal to more than 20 percent of the normal growth in GNP;
- despite the fact that in postwar years the American economy has not appeared to require large deficits to sustain full employment, once achieved; and
- in the absence of any convincing evidence that there are major weaknesses in the non-Federal sectors of the economy, which might warrant such extraordinary measures.

The major inflationary consequences of failure to take restrictive fiscal action would show up in late 1968 and in 1969. No matter what fiscal action is taken now, prices will likely rise by an annual rate of 3 percent or more in the next 6 to 9 months.

Prior advances in the consumer price index and lags in the response of wages and prices to economic conditions almost guarantee excessive wage and price increases in the period immediately ahead. But without appropriately restrictive fiscal action, we shall be building inflationary wage and price increases into late 1968, 1969, and even 1970.

A wage-price spiral, once started, tends to continue for some time after the initial conditions which got it underway are removed. If we fail to remove those conditions now, we are insuring price and wage problems for several years to come.

There are risks in any fiscal policy, including a policy of "doing nothing." But, it seems to me, that the balance of risks in the present situation overwhelmingly dictates taking restrictive fiscal action. In the face of past experience, it seems abundantly clear that the burden of proof should be on those who believe a large and continuing deficit is needed to offset pronounced weakness in the private economy. To date, no such evidence has been forthcoming.

There are those, Mr. Chairman, who believe it is the rate of change in growth in the money supply which is most important, and that essentially shortrun tax action has no impact on the economy. Not attempting to quarrel with that point of view, I might point out that in terms of the balance of risks, if I am right, and you fail to take fiscal action, the economy is in trouble. If they are right and you take fiscal action, little harm is done. Because by definition, the argument goes it is essentially not the shortrun tax action which will substantially affect the economy.

So, on a balance-of-risks basis, it seems to me that tax action is called for, or at least a restrictive fiscal policy is called for.

The overall excess demands generated by a continued heavy Federal deficit could be offset by a very restrictive monetary policy. And, this is, of course, a possible option. But a monetary policy restrictive enough to accomplish the same overall results as the 10-percent surcharge would impose most of the burden of economic stabilization on new homebuilding.

Moreover, an unbalanced stabilization policy of this kind would be less likely to avoid price increases than the more evenly distributed impact of a tax increase. Excess demands in areas other than housing would generate increasing upward price pressure. But the slack-

ening of demand for home construction—if past history is any guide—would not lead to offsetting price decreases.

In other words, an unbalanced stabilization policy—even though it leads to the same overall movement in GNP as a balanced policy—will have less success in restraining price increases.

II. EXPENDITURE REDUCTION VS. TAX INCREASE

Granted that a more restrictive fiscal policy is required, what form should it take? Many of the opponents of a tax increase argue that fiscal restriction is needed, but that it should be achieved by expenditure cuts, not by tax increases.

In the first place, the yield of the President's proposed tax measures in fiscal 1969 is \$13 billion. To assume that the 1969 budget could be reduced by \$13 billion is wildly unrealistic. Most of the reductions would have to come from the nondefense sector of the budget.

In making up the 1969 budget, the President and Secretary McNamara already reduced the appropriation requests of the military services by over \$20 billion. But, in the civilian budget, if we exclude interest, the social insurance trust funds, and veterans' pensions and compensation, we are left with only \$48 billion. Cutting \$13 billion, or 30 percent, from that total is clearly out of the question—particularly, since an important part of the \$48 billion residual represents programs like public assistance, Federal law enforcement, and air navigation services—which cannot realistically be pared significantly.

If it is unrealistic to substitute expenditure reductions for a tax increase, why not reduce expenditures by a lesser amount and accompany this with a tax increase, but one smaller than the proposed 10-percent surcharge? The answer to this, obviously, depends upon one's evaluation of the merits of the programs to be reduced as against the saving in tax burden. A few points might help put this possibility in context.

In the first place, as you know, virtually all of the expenditure increases proposed in the President's 1969 budget represent either outlays for national defense or increases in programs where payments are fixed by law. In fact, four items alone make up 95 percent of the increase—defense, social insurance programs, interests, and automatic Federal civilian and military pay increases scheduled for next July 1.

These cannot be reduced significantly. Consequently, cuts below the President's budget, would, in total, represent reductions below last year, rather than simply a moderation in the rate of increase.

In turn, if we ask ourselves realistically where such cuts would have to come, it is clear that a very large percentage of them would be concentrated in foreign aid and in the major social programs—education, health, poverty, manpower training, housing, and air and water pollution. With some exceptions, to be sure, other programs represent either workload items like the Internal Revenue Service and the Federal Aviation Agency, which cannot be cut significantly, or politically popular programs where cuts might indeed be proposed but have little likelihood of being enacted.

Large cuts in foreign appropriations would yield very little expenditure reductions in the next 18 months, given the long lag between appropriations and expenditures in this program. And the President's

budget submission for AID is already the lowest in many years. To gut that budget for the sake of perhaps two-tenths of a percentage point reduction in the surtax seems, to me at least, a strange inversion of priorities.

There are some who propose large reductions in public works programs. Wherever it is possible to reduce or stretch out construction programs, the President's budget proposes it. The real control over public works comes in the "new starts" provided each year. These have little effect on immediate expenditures, but do control the rate of outlays several years ahead. Realistically, however, the hope for major reductions here is, I submit, chasing a will-o'-the-wisp.

In every recent year the Congress—usually by a large majority—has substantially increased the new starts in public works programs—in fiscal 1968, from a proposed 9 to over 40. Holding up a tax increase while waiting for a cut in such programs will most assuredly not result in must fiscal restraint.

There is also a body of opinion which holds that failure to pass a tax increase quickly may make it possible to extract further expenditure reductions from the administration—after which some tax increase should be enacted. In my view this is a dangerous game of "chicken."

In the first place, substantial expenditure cuts were made in the fall of last year—and no tax increase was forthcoming. Second, while this game is being played, the continuation of large deficits is adding to inflationary pressures. Third, such cuts—perhaps \$2 billion to \$4 billion in magnitude—would substitute for several percentage points in the surtax.

This translates in several tenths of a percentage point relative to individual income. In a budget which is already tight, and in a situation where the Nation faces serious social problems—particularly in its large cities—I do not believe that major Federal social programs should be traded for the gain of a few tenths of a percentage point in after-tax income.

It is not as if Federal expenditures in recent years had been taking an ever-larger share of our Nation's income and output. Apart from the social security and medicare programs, this is not the case. Federal expenditures—excluding the social insurance programs—represented 16 percent of GNP in the late 1950's. In 1969, *including* 3 percent for the costs of Vietnam, they will account for 16.9 percent of GNP, and will have dropped sharply to 13.9 percent if we exclude Vietnam.

Social security benefits and medicare payments have indeed been rising as a percentage of GNP—from 3 percent in the late 1950's to 4.4 percent in 1969. But, whatever one believes about the desirability of these increases, they have been overwhelmingly approved by the majority of Congress. They scarcely constitute a reason for denying a temporary increase in taxes to help provide the needed fiscal restraint during a period of extraordinary defense expenditures. Indeed, were it not for Vietnam, Federal expenditures, including the rapidly rising social security benefits, would be a lower percentage of GNP in 1969 than in the late 1950's.

In summary, I think a sharp reduction in the Federal deficit is required to prevent excess demand inflation an undesirable tightening of credit markets, and a further deterioration in our balance of pay-

ments. It is clearly infeasible and unrealistic to provide the needed reductions in the deficit solely through expenditures reductions.

Finally, given the tightness of the President's 1969 budget and the gravity of the social problems which face the country, I do not believe a mixed strategy—some expenditure cuts and a smaller than 10-percent surtax—is warranted. The saving in lower taxes—amounting to several tenths of 1 percent on individual income—is not, in my judgment, worth the loss in public benefits from those programs which, realistically, would have to bear the burden of the cuts.

Chairman PROXMIER. Thank you, Mr. Schultze.

Our next witness is a very highly valued former member of the staff of the Joint Economic Committee, Mr. Norman Ture. He was a tax expert with this committee for a number of years. He is now the director of tax research at the National Bureau of Economic Research, Inc.

Mr. Ture, you may proceed.

**STATEMENT OF NORMAN B. TURE, DIRECTOR OF TAX RESEARCH,
NATIONAL BUREAU OF ECONOMIC RESEARCH, INC.**

Mr. TURE. Thank you, Mr. Chairman.

ISSUES IN FISCAL AND MONETARY POLICY IN 1968

I appreciate the opportunity to appear before the Joint Economic Committee and to present my views concerning the issues of fiscal and monetary policy in the United States in 1968.

Let me emphasize that the views I shall express are my own. They are not to be construed as a report of findings or conclusions by the National Bureau of Economic Research, Inc.

The central issue of fiscal and monetary policy, as I conceive it, is whether these policies should be focused on efforts to deal with short-term problems or longrun objectives. A few years ago, it appeared the latter was to be the major concern. The tax legislation of 1963-64 clearly and explicitly was aimed at a fundamental revision of the public financial framework for the U.S. economy. It was not, as is often claimed today by advocates of frequent, finely tuned fiscal and monetary adjustments for economic stabilization, concerned with any short-term deviations of the economy from the path of full employment with price level stability. President Kennedy, in the latter part of 1962, explicitly rejected an emergency tax reduction to avert or cushion the economic "pause" then observable which many persons feared would be transformed into recession unless some public policy action were taken. In promising tax legislation in 1963, he emphasized that he would seek basic structural reform intended to change the tax climate and to make it more congenial to those activities in the private sector of the economy upon which the growth of the economy fundamentally depends. The chairman of the Ways and Means Committee in the House confirmed and elaborated that purpose in his statement of September 16, 1963, when he characterized the reduction as the choice by the Congress of tax reduction in lieu of rapidly expanding Federal expenditures as the road toward a prosperous economy.

This concern with long-term objectives has been subordinated since

1965 by ad hoc efforts to treat economic disturbances which are deemed to be transitory in nature. It is the conviction, unsupported by fact, that fiscal and monetary instruments can effectively deal with these disturbances which accounts for the chaotic character of public financial policy in recent years.

The conflict between fiscal and monetary policy activism, fine tuning, or what have you, and the longer term focus of these policies is currently exemplified by the arguments concerning the temporary income tax surcharge proposal. The Nation is exhorted to adopt this measure as a means of dealing with the inflationary strains now in evidence and anticipated to strengthen this year. It is urged upon us as a means of preventing disorderly conditions in financial markets in the next several months. Surely it is not contended that failure to enact the surcharge will result in permanent disarray in these markets or perpetually rising interest rates. This marvelously versatile income tax surcharge is also needed, we are told, to overcome our balance-of-payments difficulties. Here, too, one must infer that the surcharge advocates have a temporary disturbance in mind, unless they believe that the temporary tax increase will, in some mystical way, effect a permanent remedy of our balance-of-payments problems. Finally, the surcharge is urged as a war-finance measure, to get us over the presumably temporary hump of Vietnam defense requirements.

On any one or all of these grounds, the income tax surcharge is not warranted. A temporary income tax surcharge is not likely to have any significant or predictable effect on the pace of expansion of aggregate demand this year. By the same token and for the same reasons, it is not likely to have any significant or predictable effect on the aggregate demand for financing and, therefore, on basic financial market conditions—although it might well change the composition of the total demands. By the same token, and for the same reasons, it is not likely to have any material or predictable effect on our balance-of-payments situation, though it might, on irrational grounds, affect the anticipations of foreigners holding dollar balances and alter their preferences as between dollars and gold. Nor should the surcharge be construed as a temporary war-finance measure, unless one chooses to overlook the budget realities.

On the other hand, enacting the income tax surcharge will have one clearly predictable effect. It will weaken the limited pressure now in force for constraining the ad hoc growth of Federal expenditures. It will thereby delay the day when the fundamental decision must be taken to put Federal expenditures and tax policies on an orderly long-term basis.

I should like to discuss somewhat more fully the arguments advanced in favor of the surcharge proposal before taking up an alternative approach to fiscal and monetary policy.

The income tax surcharge as a war-finance measure

In the conclusion of his 1968 Economic Report, the President observes:

The American people are giving their sons and brothers to fight for freedom abroad. At home we must support their sacrifice by preserving a sound economy. I believe that the American people will accept the cost of doing that—by paying an extra cent of each dollar of income in taxes . . . (p. 27).

The view that the proposed tax increase is required to defray the expenses of the war in Vietnam is, at best, merely a matter of perspective. The claim would be somewhat more credible or persuasive if nondefense expenditures of the Federal Government had remained at their 1965, preescalation level or even if they had grown moderately. But in fact, as table 1 shows, defense expenditures account for considerably less than half—\$30.2 billion, or 45.7 percent—of the officially estimated \$66.1 billion increase in expenditures—unified budget concept—between fiscal years 1965 and 1969. Nondefense expenditures, on the other hand, account for \$35.9 billion, or 54.3 percent of the increase.

TABLE A.—DEFENSE AND NONDEFENSE EXPENDITURES, FISCAL YEARS 1965, 1968, AND 1969

[In billions of dollars]

Expenditure	1965	1968	1969	Increase	
				1965-69	1968-69
Defense:					
Amount.....	\$49.6	\$76.5	\$79.8	30.2	\$3.3
Percent of total.....	42.5	54.0	43.7	45.7	25.5
Nondefense:					
Amount.....	\$57.1	\$93.4	\$103.0	\$35.9	\$9.6
Percent of total.....	57.5	55.0	56.4	54.3	74.5
Total.....	116.7	169.9	183.8	\$66.1	12.9

Source: The Budget in Brief (p. 68.)

More recent budgetary developments make it even more difficult to accept the characterization of the proposed surcharge as a war-finance measure. The estimated increase between the current fiscal year and fiscal 1969 in defense expenditures is \$3.3 billion, scarcely a quarter of the total increase of \$12.9 billion. Indeed, the proposed increase in expenditures for the health, labor, and welfare function alone is \$5.5 billion. Very much the same results are found in the NIA estimates.

In short, as between fiscal 1968 and fiscal 1969, it is not the proposed increase in defense but in nondefense expenditures which conceivably might provide the occasion for a tax increase. It is assuredly more consistent with the budget facts to characterize the proposed income tax surcharge as a welfare program finance measure. Similarly it would be more appropriate for the President to urge the Nation to pay an additional \$10.8 billion in taxes to meet the increased demands of non-defense programs, rather than invoking the sacrifices of young Americans in Vietnam as the occasion for this request.

The surcharge as a curb on the expansion of aggregate demand

Heavily stressed in the administration's arguments for the surcharge proposal is the contention that it is needed to repress an otherwise excessive increase in aggregate demand and accompanying increase in inflationary pressures.

The Council of Economic Advisers now forecasts a 1968 GNP of approximately \$846 billion, up \$61 billion from the current estimate of \$785 billion in 1967. This \$61 billion increment, it is forecast, will represent a gain of somewhat more than 4 percent in real output and an increase of somewhat more than 3 percent in the general level of prices.

On the basis of the past forecasting performance, the widespread

reluctance to base the tax action on the official estimates for calendar 1968 is quite understandable. As shown in table 2, the CEA's forecasts have missed the mark by a wide margin in 1964, 1965, 1966, and 1967.

TABLE 2.—APPRAISAL OF COUNCIL OF ECONOMIC ADVISERS' FORECASTS, 1964-67

(Dollar amounts in billions)

Year	Gross national product		GNP increase over prior year		Percent difference between CEA forecast and actual
	CEA forecast ¹	Actual	CEA forecast ¹	Actual	
1964.....	\$620.5-\$630.9	\$632.4	\$30.4-\$40.4	\$41.9	3.6-27.4
1965.....	665.6-675.8	683.9	33.2-43.4	51.5	15.7-35.5
1966.....	725.9-735.9	743.3	41.9-52.0	59.4	12.5-30.3
1967.....	² 790.9	785.0	47.6	41.7	14.1
	793.9- ³ 795.9	(⁴)	50.6-52.6		21.3-26.1

¹ Adjusted for subsequent revision in prior year's GNP.² CEA adjusted mean forecast, January 1967, with income tax surcharge effective July 1, 1967.³ CEA adjusted mean forecast, January 1967, without income tax surcharge.⁴ Preliminary.

The January 1964 forecast was interesting because it explicitly estimated the effect on gross national product of each month's delay in enacting the tax reduction. Allowing for the delay that actually occurred and for the revision in the measure of 1963's gross national product, the midpoint of the Council's estimate for 1964 missed the actual result by 15.5 percent. At the bottom of the \$10 billion range around their estimate, the error was 27.4 percent, while at the top it was 3.6 percent. The January 1965 forecast of the increase in gross national product in 1965 missed the actual outcome by not less than 15.7 percent or as much as 35.5 percent, depending on whether one refers to the upper or lower end of their estimate range. The January 1966 estimate was somewhat better; the error range was 12.5 to 30.3 percent. The early 1967 forecast, adjusted for the subsequent revision in the measured 1966 gross national product and with the 10-percent surcharge effective July 1, 1967, was a gross national product of \$790.9 billion. Without the surcharge, the actual outcome in 1967 is now estimated at \$785 billion. If one assumes the Council believed the July 1, 1967, enactment of the surcharge would have no effect on gross national product in 1967, their forecasting error was 14.1 percent. If, on the other hand, one interprets the remarks of former CEA Chairman Gardner Ackley last summer as holding that prompt enactment of the surtax would reduce the second half gain in gross national product by about \$3 billion to \$5 billion, then the January 1967 forecast erred by 21.3 to 26.1 percent.

The most recent testable forecast was presented by Dr. Ackley, before the Ways and Means Committee on August 14, 1967, and called for an increase of between \$29 billion and \$35 billion for the second half of the year, without the tax increase. While the actual result, an increase of \$32.5 billion—annual rate—came out very well, comparison of his estimates with actual results for the increases in major gross national product components leaves one convinced that the overall estimate was a lucky one.

For example, Dr. Ackley estimated an increase in consumption expenditures, in the absence of the proposed tax increase, of \$16 billion to \$18 billion. The actual increase was \$12.1 billion; the error in

the forecast was between 32.2 and 48.8 percent. Housing expenditures were forecast as increasing by \$3.5 billion; the actual increase was \$4.5 billion, an error of 22.2 percent. Incidentally, in commenting on this estimate, I suggested it was substantially on the high side, which shows you how meager are my qualifications as a forecaster. For plant and equipment expenditures, Dr. Ackley forecast an increase of \$1 billion. The actual change was \$2.5 billion; the error was 60 percent. Inventories increased \$8.7 billion compared with Dr. Ackley's estimate of \$1 billion to \$2 billion; he missed by 77 to 88.5 percent. For State and local governments, Dr. Ackley forecast an increase of \$4.5 billion; the actual increase was 9.8 percent less, \$4.1 billion. And for Federal purchases, the CEA estimated a second-half increase of \$0.3 billion to \$3.5 billion, or 11.1 percent to 122.2 percent above the actual (see table 3).

TABLE 3.—INCREASE IN GROSS NATIONAL PRODUCT COMPONENTS, 2D HALF 1967 COUNCIL OF ECONOMIC ADVISERS' ESTIMATE COMPARED WITH ACTUAL

[Dollar amounts in billions]

GNP component	Increase, 1967 2d quarter, to 1967 4th quarter		Percent difference between CEA estimate and actual ³
	CEA ¹	Actual ²	
Personal consumption.....	\$16-\$18	\$12.1	32.2-48.8
Gross private domestic investment:			
Fixed nonresidential investment.....	1.0	2.5	60.0
Residential investment.....	3.5	4.5	22.2
Change in inventories.....	1.0-2.0	8.7	77.0-88.5
Government purchases:			
Federal.....	3.0-6.0	2.7	11.1-122.2
State and local.....	4.5	4.1	9.8

¹ Hearings on President's 1967 Tax Proposals, Committee on Ways and Means, House of Representatives, 90th Cong. 1st sess., pt. 1, p. 88.

² Preliminary estimates by Office of Business Economics, Department of Commerce, Feb. 14, 1968.

³ Difference between Council of Economic Advisers' estimate and actual, divided by actual.

I think the Council deserves our heartfelt sympathy in this regard. Theirs is a thankless task. More's the pity, it's also a useless one. For even if the forecasts were vastly better than they are in fact, they would have little if any operational significance. To take the present case in point, even if the Council's current forecast of an excessive increase in aggregate demand without a tax increase were accepted as correct, there is little if any basis for confidence that the proposed tax increase would significantly affect the outcome.

The assertion that they would be effective is based on the assumption that private spending, by households and businesses, responds quickly to changes in the rate of expansion of private disposable income. Few economists, if any, would represent corporate spending decisions as affected at all by temporary changes in corporate profits after taxes, let alone quickly affected. Even fewer corporate decisionmakers would attempt to alter spending plans on the basis of changes in effective tax rates when these changes are designated as, and deemed to be, temporary. Even more implausible is the notion that the small changes in the timing of tax payments, involving no change in tax liabilities, have any noticeable effect on business spending.

In the case of households, there is a widespread consensus among

economists that current consumption decisions and behavior are not a function of the household's current aftertax income and that whether changes in current aftertax income result in changes in consumption depends on numerous other factors. While there is a continuing argument among economists concerning the determinants of consumption, there is much less disagreement about the proposition that temporary income tax changes are likely to have little near-term impact on consumption.

If no systematic and predictable relationship between changes in consumption outlays and in disposable income in the shortrun can be assumed, the argument for a temporary income tax surcharge on grounds of restricting the shortrun expansion of aggregate demand is of no force. Many new economists are disconcerted by the allegedly puzzling behavior of the personal-saving rate in the recent past and the evidence that, accordingly, the predictability of consumption changes by reference to income changes is much less than conventionally assumed. One would think this would at least give them pause in their advocacy of the surcharge.

Whether or not one finds the theory appealing, actual experience of the U.S. economy in the years since World War II affords no convincing evidence of a predictable relationship between changes in fiscal policy and in the pace of economic activity. Perhaps the least demanding test one might require of the view that there is such a relationship is that decreases and increases in the so-called "full-employment surplus" should result in speeding up and slowing down, respectively, of the expansion of GNP, within a reasonably short period of time. In fact, this test is failed at least as often as it is passed, based on quarterly data, lagged or unlagged, since the first quarter of 1947.

To take a couple of specific examples, between the last quarter of 1947 and the last quarter of 1948, the full-employment surplus was reduced by about \$12 billion, as the result of a \$5 billion tax reduction and a \$10 billion increase in expenditures. Surely this highly stimulative fiscal policy should have produced a sharply accelerated increase in total spending and output. As you know, however, the contrary was true; the economy experienced a sharp recession beginning in November 1948.

Currently, the favorite example of fiscal impact on the economy offered by the advocates of frequent tax changes for stabilization purposes is the tax reduction of 1964. It is perfectly true that aggregate demand increased strongly following the tax reduction. It is conveniently overlooked by fiscalists, however, that aggregate demand had also been increasing sharply for a year before the tax cuts went into effect.

In summary, the postwar experience affords no evidence upon which one could objectively conclude that income tax increases or reductions, per se, act promptly to curb or stimulate total demand in the private sector.

Failing the assumption that private spending will change quickly in response to a temporary change in the private sector's disposable income, the case for tax increases now, in order to slow the rate of expansion of total spending during the remainder of this year and the first half of next, is very weak, indeed. Even more feeble, on anti-

inflation grounds, is the case for acceleration of corporation tax payments. Whatever the other merits of putting the corporate business community more completely on a current payment basis, the mere fact of acceleration of corporate tax payments can hardly be deemed to be significant for the volume of corporate spending.

The income tax surcharge and the financial markets

One of the arguments advanced on behalf of the surcharge is that, in its absence, Federal borrowing requirements will place extraordinary burdens on financial markets, will send interest rates higher and higher, at the expense of housing, State and local government, and small business expenditures. Last August, the Secretary of the Treasury and the Director of the Bureau of the Budget predicted that failure promptly to enact the tax increase would send "interest rates sky high * * * shutting off the flow of credit to sectors such as the home mortgage market and small businesses." As Dr. Schultze put it, "The recovery in homebuilding from last year's setback would surely be choked off, and indeed, reversed."

Interest rates, to be sure, advanced strongly, particularly in the second half of the year. But residential construction, as already pointed out, also increased strongly through the year, substantially exceeding the Council's forecast. And State and local government outlays also rose more than the CEA had anticipated. Since the end of 1967, parenthetically, the upward movement in yields has slackened. Indeed, many of the rates have been drifting downward, at least into mid-February.

But if the tax increase had been enacted, as requested, would interest rates have risen less? Will its enactment now prevent further increases in interest rates?

The affirmative response is based on the assumption that the reduction in the Treasury's borrowing requirements consequent to a tax increase will not be offset by an increase in credit demands by others. But this, in turn, supposes that households and businesses will respond promptly to the tax increase by curtailing their spending. If this does not prove to be the case, and the burden of my argument is that it won't, then the likely result is an increase in private-sector demand for funds beyond the amounts which would be sought in the absence of the tax increase. In short, the reduction in the Government's financing needs probably would be matched by an increase in the private sector's. In the near term, say over the next year or so, the tax increase may well primarily serve to change the composition of credit demands; it is much less likely to change the total amount of financing sought by any significant amount.

Efforts to justify the tax increase as a means of holding back interest rate increases rest on very shaky theoretical grounds. On the basis of the evidence of the postwar years, the case is just as feeble. Presumably, greater fiscal constraints, either with the same or with a greater degree of monetary ease, should result in reduction in interest rates. By the same token, easier fiscal policy and tighter monetary policy should result in higher interest rates. Using changes in the full-employment surplus as the measure of fiscal constraint, one finds, in fact, that interest rates changed as would be expected on only one occasion in the postwar years when fiscal and monetary policies moved

in opposite directions. One also finds that interest rates rise after a significant acceleration in the growth of the money stock and level out or decline after a deceleration or contraction in the money stock, irrespective of fiscal developments. The administration's contention that tax increases are needed to hold back interest rates is not validated either by theory or by experience.

The surcharge and the balance of payments

It is always nice to have allies. When the domestic economy arguments in favor of the surcharge failed to gain enthusiastic acceptance, it was predictable that the old standby, balance-of-payments deficits and gold outflow, would be called upon to come to the rescue. The Nation is now assured that the temporary income tax surcharge is needed to preserve the strength of the dollar and to mollify our European critics. Let me grant that the latter's confidence in the international purchasing power of the dollar may be temporarily strengthened, on the same analytically and empirically unsound grounds as are adduced domestically, by a temporary income tax surcharge. It strains the credulity, however, that anyone who has observed the continuous deterioration in our balance of payments and shrinkage in our gold stock will believe that a longrun solution to these problems is to be found other than in a fundamental revision of our international payments mechanism. Fiscal jiggling, except insofar as one believes it will result promptly and more or less permanently in a significant disinflation—at least relative to our trading partners—is no substitution for freeing ourselves from the straitjacket of a pegged-dollar price for gold.

In brief, the argument advanced by tax-hike advocates is merely an extension of that offered with respect to the domestic economy. A temporary income tax hike presumably will so significantly depress the expansion of aggregate demand as materially to reduce the growth in our imports and will so significantly abate upward pressures on the prices of the goods and services we sell abroad as to materially increase our exports. I have already dealt with the frailty of the argument with respect to the near-term impact of a temporary income tax hike on household and business spending and will not trouble you with a restatement. The balance-of-payments argument for a tax increase is, at best, no better than the domestic economy argument. In fact, it is not as good, since it also relies on the assumption that both imports and exports are highly and promptly responsive to changes in the pace of expansion in aggregate demand, which in turn must be deemed to be highly and promptly responsive to temporary income tax increases.

In fact, the more proximate short-term relationship is between the trade surplus and changes in our prices for goods in international commerce relative to the prices for those goods among our trade partners. These relative price movements are not closely correlated in the shortrun with changes in fiscal magnitudes in the United States.

Surely nothing better illustrates the difference between a deliberate, carefully ordered, long-range approach in public policy and an ad hoc, fits-and-starts approach aimed at dealing with shortrun disturbances than the present proposals in connection with our balance-of-payments difficulties. The former public policy approach be-

gins with determination of policy goals. It seeks their clearest possible delineation, in order, among other reasons, to be able to assess their realism. It rejects those objectives which, no matter how gloriously labeled, lie beyond our present and prospective capabilities. Moreover, it appraises them in terms of their consistency with other aims of public policy and private aspirations. It then proceeds to the consideration of means, aiming always at maximizing results relative to costs, but always subject to the constraint that these means are consistent with society's values and preferences. Having determined aims and means for seeking them, the policy is not then subject to frequent suspension and reinstatement. This surely doesn't mean it's ignored nor that it is never modified, but stability is assuredly a great virtue of viable policy.

How would this prescription be applied today? The long-range balance-of-payments policy goal, which should assume precedence over more immediate concerns, is to achieve an international payments mechanism which (1) facilitates rather than impedes international commerce in goods and services and in resources; (2) allows for speedy adjustment to temporary monetary disequilibrium without requiring extensive shifts in real-resource use or extraordinary adjustments in total employment and output; and (3) facilitates rather than impedes resource adjustments to real- and basic-resource misallocation. Few economists, I am confident, would regard a national policy oriented to pegging the price of gold at \$35 per ounce as meeting these criteria.

It is difficult to understand how the goals of a sound international payments system can be attained by (1) the attempt to impede international capital movements by direct controls over U.S. foreign investment; (2) inhibiting tourism through a ponderous, redtape-laden tax; and (3) imposing discriminatory taxes on imports.

I am also confident that most economists would concur with the view that attaining the longrun objectives of our international trade policies requires a fundamental revision in our payments mechanism, not repressive stopgap measures which are inconsistent with our recent efforts toward freeing international commerce and which can only defer the time of decision. A wholesome first step toward achieving that necessary and inevitable revision would be for the Government to consider objectively and fairly the major alternatives to the present system, instead of rejecting out of hand any approach that would imperil rigid adherence to \$35-an-ounce gold.

A stable monetary policy

This committee, in its 1967 Economic Report, gave abundant evidence of its preference for stability in public policies oriented to long-term objectives in urging that the monetary authorities eschew erratic shifts in policy and aim instead at a steady growth in the stock of money. The wisdom of this prescription can hardly be better illustrated than by reference to monetary policy developments in the last few years. If we are seeking sources of the recent instability in the economy, why don't we at the least begin with the 2 years of extremely rapid expansion of the money stock, at an annual rate of 4 percent from June 1964 to April 1965, and then at an even more rapid pace, 6 percent, from April 1965 to April 1966. If one seeks a proximate

explanation for the extraordinary \$63.2 billion, or 9.7-percent increase in GNP between the first quarter of 1965 and the first quarter of 1966, why not start with this zooming money supply? If one seeks an explanation of the slowing pace of expansion of GNP—indeed, of the virtual leveling out of real GNP—from the last quarter of 1966 through the first half of 1967, why not look first to the screeching halt on monetary growth beginning in April 1966 through January 1967, when the money stock declined by 0.2 percent? And if we are now in for an excessive surge of aggregate demand and further inflationary developments, as we may well be, why not assign a substantial share of the responsibility for these unhappy prospects to the 7.3-percent increase in the money stock between January 1967 and January 1968—or the incredible 9.3-percent growth between January and July 1967?

Developments of the past year in monetary policy should confirm this committee in its preference for a rule of stable growth in the money stock. May I urge consideration for a parallel approach to fiscal policy?

A stable fiscal policy

That approach, I submit, calls for initiating the effort to get Federal Government activities and programs on a stable, long-term basis. Here, too, the longrun goals of these activities should be clearly delineated and rigorously appraised for their realism. Properly defined, the long-term trend requirements of these programs can be estimated and it is on the basis of such amounts, never on the basis of their first or current-year costs, that these programs should be authorized, rejected, or modified.

Given these long-term trends in expenditures, given the trends in the major components of national income, and given the tax structure, trends in revenues can be estimated. If the trend values of Federal expenditure programs, realistically estimated, accepted, and approved by the people of the United States and their congressional representatives, should be estimated as exceeding the trend amounts of revenues, then taxes should be increased deliberately, carefully, with due regard to fairness, simplicity, and in line with the economy's requirements and preferences for encouraging private effort and capital accumulation. If the trend growth in expenditures is estimated as falling below that of revenues, regular reductions in tax rates should be scheduled and implemented without interruption for meeting short-term deviations from trend.

Of course, conditions change and so, too, would the trend values of expenditures and revenues. When such changes rather than temporary deviations from trend "can be established," corresponding changes in expenditures and/or revenue programs would be called for. This is, in other words, no call for a straitjacket on Federal finance.

Neither is it a policy calling for rigid, annual budget balancing. Indeed, with such a policy, there would be no occasion for concern with whether the budget is balanced in any particular year. On the contrary, a balance in the budget in any year would be considered an uninteresting and inconsequential coincidence. Finally, to repeat, temporary deviations from trend in either expenditures or revenues

would not call for any compensatory action. Persistent deviations, on the other hand, would call for a reassessment and adjustment.

Although not articulated in this wise, the position of the Ways and Means Committee to date on the income tax surcharge may be interpreted, I believe, in this light. That committee's position, it seems to me, is an expression of a desire for conforming the public finances of the United States with the policy prescription enunciated in the early fall of 1963; that is, moderate growth in Federal expenditures coupled with periodic tax reductions.

It may well be that the Nation's preferences in this regard have changed since 1963-64. We may now deem it advisable for the Federal Government to extend and broaden its responsibilities without offsetting elimination or phasing out of longstanding programs. If so, this change in preference can be readily ascertained, if the issue is put to the Nation in these terms, rather than in terms of a budget arithmetic which seeks to assure us that a \$10.4 billion year-to-year increase in expenditures is scarcely any increase at all, or is attributable to Vietnam costs, or is required by existing—inferentially, unchangeable—legislation, and which fails to convey to us the costs of existing and new programs over a reasonable period into the future—at least, say, 5 years.

There is scarcely a sadder commentary on the present state of Federal expenditure policy than the fact that the Members of the Congress are each year surprised by the increase in outlays which “are required by existing legislation.” Yet, year after year, new spending programs are proposed and their enactment urged without any appraisal of their likely costs over their full lifetime or any significant part thereof.

If there is an occasion for a tax increase this year, then, it is for a permanent addition to Federal revenue potential to meet the Nation's preferences for a permanently increased path of Federal expenditures. Such an occasion, to repeat, may well exist. The real challenge for fiscal policy this year is to determine whether, in fact, it does.

Chairman PROXMIRE. Thank you.

Our last witness is Prof. Fred Weston, who is the UCLA economic equivalent of Gary Beban and Lew Alcindor, the gift of UCLA to this committee and other committees of the Congress. Mr. Weston is an outstanding forecaster and a fine witness. Happy to have you.

STATEMENT OF J. FRED WESTON, PROFESSOR, BUSINESS ECONOMICS DEPARTMENT, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

Mr. WESTON. Mr. Chairman, since my prepared testimony overlaps some of that of the first two speakers, I will summarize it in places. In places it rebuts inferentially the previous speaker, and there would be a temptation to elaborate on this, but I won't, since I presume there will be time during the discussion for this.

REVIEW OF THE ECONOMY SINCE MID-1967

When I last appeared before this committee on June 29, 1967, the committee was also at that time engrossed in the question of the tax increase. The economy had showed a decline in real terms between the

fourth quarter of 1966 and the first quarter of 1967. The growth during the second quarter of 1967 was quite small.

In view of the uncertainties of the economic outlook, many counseled a "wait and see" attitude on the increase. The view was, "Let us wait and see what happens to the economy in the third and fourth quarter of 1967."

Some of us who testified argued that while the past data were not impressive that an analysis of the unfolding trends provided the basis for prediction that the third and fourth quarters of the year would be very strong. On this basis some of us recommended the need for prompt enactment of the tax increase. These views were not persuasive.

The facts of the third and fourth quarters of 1967 are now in. What does the record show? The record shows an increase during the third quarter in the gross national product of \$16.1 billion and during the fourth quarter of \$16.4 billion. These quarterly increases represent a rate of growth of an order of magnitude of \$65 billion per year at an annual rate. This compares with the Council of Economic Advisers' forecast of a growth of \$60 billion for all of 1968, from \$785 billion to \$845 billion, on the assumption of a relatively prompt imposition of the 10-percent surtax.

Clearly, the \$65 billion annual rate of growth during the third and fourth quarters of 1967 exceeded the real capacity of the economy to expand output. As a consequence, price increases as measured by the GNP price deflator, which increased only about one-half index point between the first and second quarters of 1967, accelerated to double the rate of price increase between the third and fourth quarters of 1967.

So we missed one boat last year. However, just because we made an error last summer, does not necessarily imply that adopting the correct policy something more than a half a year late, is the sound thing to do. In fact, as the events of early 1968 began to unfold, in my own mind I had been moving to embrace the view that having waited this long to adopt the tax increase, to take any action now would represent a policy of "too much, too late."

THE CASE AGAINST A TAX INCREASE

The case in support of this position is a formidable one, and must deserve the most careful consideration. It begins by analysis of the outlook for individual components of GNP.

One.—Capacity utilization in manufacturing during December 1967, was at about an 85½ percent rate. With the Federal Reserve Index of Industrial Production down slightly for January, indications are that capacity utilization will be down to about 84½ percent for the month of January 1968.

The McGraw-Hill survey, released November 10, 1967, indicated that preliminary plans for capital spending in 1968–1969 were for an increase of 5 percent over the amount spent during 1967. This survey also indicated that business anticipated a 5-percent increase in the prices it would have to pay for new plant and equipment during 1968, so that additions to plant and equipment during 1968, in real terms, was expected to be the same as in 1967.

This is a favorable factor in that with the increase of the level of

the economy generally and in the sales of business firms, with plant and equipment spending at a plateau, the utilization rate would rise somewhat. However, this would represent minimal stimulus to gross national product from plant and equipment investment by business.

Two.—The outlook has also been clouded for consumer spending. Consumer expenditure expectations softened somewhat in January. Auto sales have not held up to the 9.3 million forecast for 1968, but the interpretation is uncertain because of the Ford strike during December and the rolling General Motors strikes during January.

With relatively high interest rates and the tightening money supply, it is difficult to make a case for more than 1.4 million housing starts during 1968. Since so many of the other durable consumer goods are related to new household formation, the outlook for increased spending on consumer durable goods generally must also be subject to reservations.

Three.—Government spending is reduced. The budget estimates for fiscal 1969 indicate an increase of \$10.4 billion versus \$20 billion for fiscal 1968. This represents an increase of about half the fiscal 1968 rate.

Four.—A strong case can be made that exports will be down rather than up. If the British devaluation is to have any of the results expected for it, one can only expect that U.S. exports to Great Britain should decline. The acceleration in price inflation in the United States during the last half of 1967 does not help our position in export markets, either.

But, even if strong economic recovery in Western Europe, and price inflation in Western Europe, redressed somewhat some of the unfavorable price trends that developed during the past year, no one can seriously make a case that if net exports did not turn down, they would turn up by very much.

Five.—The stimulus from inventory strike hedge buying will be over by midyear. Thus, the standard forecasts for 1968, for the year as a whole, of about a \$60 billion increase in gross national product allocate a considerable portion of the \$60 billion to the first two quarters of the year and less to the second two quarters.

Thus, it is argued that the major impact of any tax increase would come when the stimulus from inventory investment had subsided, in fact, would come when business would be faced with the necessity of working down inventories. In short, the tax increase would come when the inventory impact on the economy would be negative rather than positive.

Six.—Monetary policy during most of 1967 had been relatively easy. Hence, monetary policy could be tightened thus doing whatever job needed to be done during the first half of 1968. Indeed, some argue in more general terms that the mix of U.S. monetary and fiscal policy must parallel that of Europe. In Europe, when meaningfully measured, it is argued that fiscal policy has been relatively easy and monetary policy has been relatively tight.

Thus, particularly in relation to balance-of-payments considerations, monetary policy should be relatively tight so that we do not have adverse money market flows in response to interest rate differentials between the United States and Western Europe.

Seven.—It is argued further that if it is judged that fiscal policy

is relatively too easy, if a projected deficit of \$16 billion to \$18 billion without the surtax imposition constitutes too great a stimulus to the economy, this can be avoided by reducing Federal expenditures. This view holds that the spending side of the budget can and should be cut, that Government expenditures have been increasing at too fast a rate, anyhow.

Eight.—Finally, the clincher in this case refers to the fact that despite price increases of about 3 percent during 1967, the public is generally opposed to a surcharge imposition at the Federal level in the attempt to restrain price increases. Congressmen receive reports from their constituents indicating that State and local taxes are already up, and their constituents indicate they are opposed to a Federal tax increase on top of the tax increases taking place at the local level.

It appears that with the uncertain economic and international outlook, consumers have postponed purchases of autos and other durables and have increased their savings rate. It appears that consumers would prefer to readjust their purchases and standard of living in the face of rising prices.

Consumers would appear to prefer to control their destiny. Consumers feel that somehow they can adjust to price increases that have been taking place by perhaps changing the mix of the purchases and making some durable items "do" longer. A tax increase, however, provides the consumer with no such discretion. This is an extra burden of outlays that he must bear.

This set of reasons opposing the tax increase at this time at the Federal level presents a very formidable system of logic. Both economic and political considerations appear to be overwhelmingly against a tax increase at the present time.

Yet, as I analyzed the data and trends and reasoned about economic developments in preparation for this presentation, some disquieting and persistent reservations continued to gnaw at me. I began to feel that Congress sometimes acts like some business firms. Sometimes both Congress and some business firms are too much influenced by events of the recent past, the present, and the prospective immediate future. Furthermore, in the world in which we live there is always uncertainty. And when the stakes are so great, uncertainty must be assessed in terms of minimizing the most unfavorable set of possibilities.

Like some businesses, Congress tends to adopt policies based on events that appear to be at the moment the most likely, or on actions that in the near term, appear to involve efforts that are less unpleasant or strenuous.

But intermediate and longer term developments may bring in their train consequences that are the opposite of current expectations. An effective Congress, like a successful business, must anticipate developments, not react to events after they occur.

POSSIBLE ADDITIONAL REQUIREMENTS FOR NATIONAL SECURITY

Let us, therefore, look at some of the realities of life in connection with economic developments. The forecast of \$8 billion for fiscal 1969 was based on the assumption of raising \$10 billion from the surtax. If no surtax is imposed, the deficit rises. The increase would be less than \$10 billion, considering the stimulus to the economy.

On the other hand, costs to the Federal Government would go up with the greater price inflation resulting from not having the surtax. Therefore, a reasonable assumption is that the deficit would be in the range of \$18 billion without the surtax.

Now we come to the crux of the matter. We are waging a war on many fronts, both internationally and domestically. Internationally, it is only necessary to mention Vietnam, North Korea, continued tension in the Middle East, revolution and the threat of revolution in Latin America, the Berlin situation in Western Europe which, for the moment, appears to be quiescent, and problems of working out an effective NATO in Western Europe.

In such an environment of international tension, the only conclusion that can be drawn with confidence about the outlook is a considerable range of uncertainty. Any sober assessment of the world today must allow for a \$3 billion to \$7 billion increase in defense and security expenditures. To do otherwise is to read news events with one eye closed at a time.

Besides, the uncertainty factor does not even take into consideration some of the very important longer run considerations in the U.S. national position. Before Vietnam erupted, we were quite concerned about the row-of-domino effect to U.S. prestige if the U.S.S.R. made achievements in space that were dramatically superior to our own.

And, in addition to prestige considerations, the military potential of orbiting space vehicles must also give us pause. Even the implications of space expenditures for their technology fallout and implications for longrun productivity growth in the American economy deserve more careful assessment than they have received.

These developments, which for the moment tend to have been ignored to the point where space expenditures for 1969 have been cut by almost a half billion dollars, will have greater significance in the long run than whether or not we make a successful stand at Khe Sanh.

The point is, in such an uncertain world, not to consider the strong possibility of an increase in defense and security requirements is unrealistic. Furthermore, with at least one active war going on, the requirements of war are inherently unpredictable and uncertain. And when the choice becomes one of reverses for lack of necessary manpower and equipment support versus maintaining a target budget situation, the target budget situation must become a war casualty.

ANALYSIS OF BUDGET ALLOCATIONS FOR DOMESTIC PROGRAMS

That is the international aspect of the outlook. Now, let us turn to the domestic side. We have many struggles going on in our domestic economic, political, and social cultures. Many of these are inherent in the urbanization, impersonalization, and loosening of family ties in our society.

This Congress has responded to the need for alleviating insecurity associated with old age and with the increased medical care requirements of increased longevity. We have recognized the economic and social necessities of providing disadvantaged groups with more equal opportunities.

An important aspect in this area is aid which may raise the abilities of the low-productivity groups. Such expenditures have significant

longrun productivity contributions to make, both in terms of contributing to the greater rate of growth of our economy as well as to social and political progress and stability.

The relevant numbers in this regard are quite revealing. Of the \$7.1 billion projected increase in nondefense outlays for fiscal 1969, \$4.2 billion represent increased social security and medicare payments. This leaves \$2.9 billion. Of this, interest and pay increases amount to \$2.5 billion, leaving less than half a billion to be accounted for out of total Federal outlays of over \$186 billion.

And of the almost total \$7.1 billion nondefense budget outlays we have accounted for, almost all of these increases and outlays are caused by the past price rises that have taken place in the economy and represent an attempt to maintain the position of these various groups in real terms.

Furthermore, cuts and reforms from the original budget proposals of last autumn represent reductions of \$2.9 billion including cuts of roughly a half billion for NASA, atomic energy, and other advantaged technology-, space-, or defense-related activities, and another half billion in connection with support to education.

I will not dwell upon the former, since I have already discussed its implications, nor will I discuss the latter since I am debarred by potential vested interest considerations.

But, the numbers alone, and their rough breakdown, provide a clear outline of the basic relationships. Certainly a cut in the budget is theoretically better than a tax increase of the same magnitude. But my careful reading of the August budget review hearings indicated to me that it was the representative of the Bureau of the Budget who was carrying the load of analysis and response to general challenges.

I have not heard nor seen from this Congress or this committee, or any other committees of the Congress, specifies as to where the budget cuts could be made. I have not seen a list of items for cuts that have been recommended or proposed to the Bureau of the Budget and which proposals have been turned down or not followed.

The rituals that I have observed being performed remind me of the hostility games that I see in the toy shops. The hostility games provide the opportunity of throwing darts at your favorite public figures. Various committees of the Congress have been playing their own hostility game. There are two groups of players engaged in the game. Those whom I shall designate wearing the blue jerseys continuously ask for cuts in the budgets but do not specify where, how, or when. The other group of players, whom some see in green jerseys, criticize the administration for not spending more on its Great Society programs.

And yet, these have not provided responsible leadership in helping to make a case for a tax increase that would be necessary to finance the expanded programs which they are urging.

The hostility dartboards in the toy shops may perform a useful function in relieving some frustrations growing out of a complex urban society and uncertainty in a world in which the growing pains of readjustment of power distribution take place in international society. But the Congress runs some great risks in playing its own dart game. These risks are economic and security risks for the Nation, and represent political risks for Members of Congress.

POTENTIALLY EXPLOSIVE ECONOMIC EXPANSION PRODUCTS

To explain the basis for the foregoing general propositions, let me depict briefly an alternative analysis of the outlook in contrast to the eight-point analysis previously outlined.

One.—During the first half of 1968, heavy inventory buying will accelerate as strike deadlines approach.

Two.—Plant and equipment spending plans were formulated when the outlook for 1968 continued to be relatively uncertain. The initial impact of rising sales with no real increase in capacity will be to reduce unused capacity.

Yet, there is little excess capacity outside of the manufacturing sector, which accounts for less than one-third of GNP generated. With greater capacity utilization, with a leveling in the rate of increase in unit costs, corporate profits during the first half of 1968 could continue their fourth-quarter recovery. It is easy to visualize, under such circumstances, a spurt in plant and equipment spending by business.

Three.—With an increase in plant and equipment outlays, with a Government deficit of some \$18 billion, without a surtax, and with a continued labor shortage, it is difficult to envisage the growth of aggregate demand not resulting in continued price increases.

With a continuation of price rises, consumer anticipatory buying of automobiles and other durables, could be triggered as price increases accelerate during the first half of 1968.

Four.—All of the above was within a domestic economy on the assumption of no change in required spending on international wars and domestic programs.

(A) But international security requirements could potentially cause increases in spending of \$4 to \$7 billion, as indicated above.

(B) In addition, additional financing for programs dealing effectively with urban unrest and related problems, may be viewed with increased urgency as time goes on.

(C) Furthermore, with tightening of the financial markets, the pressures to "do something" for sectors adversely affected.

If all three of the eventualities listed under (A), (B), and (C) occur, the forces on the economy may at that time be recognized as leading inexorably to price increases of a magnitude that cannot be countenanced. In such circumstances, a tax increase might then come, but it would clearly then be too late to undo the damage underway.

Even if points (B) and (C) are discounted and only point (A), the international aspect is considered, the consequences could be serious. General price increases in the magnitude of 5 to 6 percent annual rate would be inevitable. There would be a worsening in our balance-of-payments position, both in the short run by stimulating imports, and in the long run by worsening relative price trends in the United States versus the other developed nations in the world.

Recognition of these adverse developments would, because of the well-known lags, undoubtedly require an over-reaction to reverse the process. Another financial crunch would be unavoidable, its dimensions uncertain. The worsened balance-of-payments position would undoubtedly bring in its train a further quickening or rising protectionist sentiments.

Protectionist actions would certainly invite defensive actions by foreign countries, retaliation, an increase of world tensions, with further dissipation of the valuable benefits of international exchange and the efficiencies and economies of a world division of labor.

In the domestic economy, there would even be more proposals for direct price and wage controls. Such further interferences with the operation of the price system which is one of the great strengths of our enterprise economy would be catastrophic. The imposition of direct price and wage controls would also be economic nonsense in the face of the inadequacy of fiscal and monetary measures during late 1967.

POLITICAL REPERCUSSIONS

And, what would consumer reactions be to continued price increases of an order of magnitude of 5 to 6 percent as compared to the sporadic 3-percent increases experienced during recent years? The public cannot blame business and labor forever for such price increases. At some point, the central responsibility of the Congress and its powers in influencing aggregate demand through fiscal policy will receive recognition.

Congressmen face a very great risk that the same public which has been urging against a tax increase in recent months will turn against their representatives for failing to anticipate the developments described. They will regret that their representatives did not provide leadership in avoiding developments that resulted in the highly regressive tax of inflation.

Such price increases would doubtless lead to further pressures for wage increases. In addition, such a price inflation represents increased costs to the Federal Government and increases in spending that exceed the increments to Federal spending increases of the type to which vociferous objections have been made in connection with the budget proposals for fiscal years 1968 and 1969. The resultant is certainly a very unattractive spiraling.

Have I overstated the case for the tax increase? I think not. The undesirable consequences are so great and the existing margin for error is so small, that the resulting risks to the economy are greater than Congressmen may appropriately expect their constituents to bear.

Leadership must be exercised to persuade our constituencies that the risks of no tax increase are too great to be continued to be carried. We must persuade them that it is in their own self-interest to make the difficult, but realistic choices at this time. If we wait until the facts are upon us, the actions will then be too late.

A WAR TAX AND A WAR ECONOMY

Must we give pause because of fears of recession after midyear? I do not believe that it is credible that a recession can develop in an economy on a war footing carrying on a \$35 billion to \$45 billion war in addition to other defense expenditures of the same order of magnitude.

If there were such indications of a softening of the economy after midyear, the war tax surcharge could readily be removed by Congress.

This is a limited war economy and it calls for a limited war tax. This war tax is required not just to deal with the power readjustments east of Suez, but, in addition, to maintain social equities in a democratic society and to contribute to longrun economic growth and stability.

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

We convened at 1:45 p.m. because Mr. Saulnier has to catch a plane. For that reason, I am going to give up my time to the minority for questions. Professor Saulnier will have to leave shortly. Then I will yield to Congressman Bolling.

Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Gentlemen, may I express my appreciation to you for your fine discussions and statements that you have made here this afternoon which render a real contribution to the effort that we have to put forth to do our job here.

Mr. Saulnier, I regret I did not hear your statement. I glanced through it hurriedly, but I do have some questions that I would like to ask you dealing with the balance of payments.

Would you support imposition of a temporary import surcharge or a system of border taxes?

Mr. SAULNIER. I would very much hope, Senator, that any system of border taxes could be avoided. I can say this: In Europe today, rightly or wrongly, the thing that is regarded as important in signifying whether we are going to do the things that will make our balance-of-payments program work is the tax surcharge.

Now, one may say this is not sound reasoning on the part of our European friends. But, it is their point of view. I think I can say without any hesitation that a continuation of this impasse which we have now, a failure to act on taxes, will be interpreted in Europe as meaning that we are not prepared to do the things that are necessary to correct our balance-of-payments problem and will expedite the day when a new drain on gold will put the fat in the fire.

Senator JORDAN. Thank you.

To what extent do you believe that the present balance-of-payments program would adversely affect countries already in weak payment positions, and is it not likely that the program will further weaken the British pound and thus indirectly put more pressure on the dollar?

Mr. SAULNIER. I don't think there is any question but what our program will complicate the British problem. And, I don't think there is any question but what it means that certain things have got to be done abroad, specifically, on the continent, which might not otherwise be done.

I mean by that that the major countries there are going to have to stimulate their economies rather more than they might otherwise do, considering that they currently have cost and price inflation problems of their own.

But I can tell you this, Senator, in my observation, and I was in Europe for 2 weeks up until about 10 days ago, and I am leaving this room today to go back there tonight, that in Europe there is full and complete readiness on the part of central banks and governments to do the things that will make our program work. All they expect is that we give the right signals, ourselves.

And the right signal, from their point of view, as they see it, has to do with taxes. We can argue this as long as we want, but that is a fact of the situation.

That is why I have made the suggestions outlined in my statement. They are, shall I say, tactical suggestions. They are suggestions on how to break the impasse we are in and get some action on spending and taxes.

Senator JORDAN. Primarily based on the necessity for a surtax at this time?

Mr. SAULNIER. That is correct.

But, what I am suggesting here calls for both expenditure limitation and tax increase.

Senator JORDAN. The proper blend of both.

Mr. SAULNIER. That is correct.

Senator JORDAN. Doctor, the American program to curtail new U.S. investment outflows to Europe will probably lead firms to make heavy demands on European capital markets.

Do you see the possibility that European funds now invested in the United States might be returned to Europe to help satisfy these and other demands for funds, thus offsetting the gain from the investment curves?

Mr. SAULNIER. I do not see that, Senator, as an immediate problem. My reason for that is that I believe the Western European central banks are going to take steps to ease their credit markets over there which will obviate this capital movement that you mentioned, and indeed they have already done so.

Senator JORDAN. Mr. Chairman, I believe I had better share the time with my colleagues here because of the shortness of Dr. Saulnier's time.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. I thank my distinguished colleague.

I am very happy to welcome Dr. Saulnier.

Dr. Saulnier, if taxes are raised, what would be appropriate monetary policies for this country? Should the growth of money and credit be about the same? Should it be less or greater than it is now?

Mr. SAULNIER. I would hope, Senator Percy, that given agreement here on an expenditure policy, and given a tax increase, and given also no need to take this budget apart and put in a good many more billions of dollars with some more taxes to meet a situation in Vietnam, which I grant is giving quite a lot, but given these things, I would hope that as the budget deficit is reduced, with Treasury financing requirements lower, the Federal Reserve System will find itself in a position to move money supply increases back from the present 7 percent level to a level consistent with stable costs and prices.

However, I hope they do not undertake to do this overnight. They have got to do it over a period of time, and I would be prepared to see them take 2 years to do it.

It is just that I would like to see them get back on a trend of money supply increases that is consistent with stable prices.

Senator PERCY. Dr. Saulnier, the President's economic message virtually overlooked or avoided any detailed discussion of the effect of the war in Vietnam on the economy of this country. In fact, the first 261½ pages it was not mentioned. Only in the last paragraph, and

a couple of lines, was the war mentioned and then it was to deemphasize its effect by saying that it only constituted 3 percent of our GNP.

Do you feel that part of our inflationary problem, part of our prosperity, full employment that we are enjoying now is attributable to Vietnam and, if so, how significant a factor is Vietnam in stimulating the present economy?

Mr. SAULNIER. I don't think there is any question, Senator, but what it is an enormously important factor.

Layered on top of a Federal program of expanding nondefense expenditures, it has produced a condition of obviously excessive aggregate demand.

Now, whether the excessiveness of demand is due to Vietnam or to the nondefense expenditures is really, it seems to me, not something that it is very profitable for us to debate at this point. The two things are there. We have these deficits. They are causing all kinds of trouble. I think they are going to cause more. I would just like to see us move to eliminate them.

Senator PERCY. On the balance-of-payments problem, the Government has asked industry to forgo investment abroad, which we know is going to be, in the long run, exceedingly harmful to our competitive position and our worldwide position and to our balance-of-payments position, eventually, asking the American people or the American public to, for the first time in our history, really, in relatively normal times, to restrain their travel abroad, and yet a great part of our balance-of-payments problems to a degree today comes from, let us say, the possibility of a steel strike, steel imports in anticipation of such a strike that are dramatically increasing, a copper strike which is now costing us a billion dollars of gold at an annual rate. The strike is continuing, which is crippling to our national interest.

If we are in such a critical stage with our balance of payments, and we certainly are, we must ask this country to forgo its future because of the crisis at the present; isn't there something we should do to take extraordinary measures in appealing to labor and industry to stop these crippling strikes that are so dangerous to the national interest now?

Mr. SAULNIER. I could not agree with you more.

As I have indicated in my statement, Senator Percy, I was really very much disappointed in the Economic Report's treatment of this problem this year. I would be the last to argue that all of this vast stockpile of problems which we have accumulated is going to be solved if we were just to raise taxes. It is not going to be. There is a lot more on the agenda. Some of the things you have mentioned would be very high on my agenda.

Senator PERCY. Lastly, do you think it would be wise for the President to request voluntary arbitration in such cases which are in the national interest and which have such an effect on our balance of payments just as if it would be a matter of war production which is the same degree of importance?

Mr. SAULNIER. Well, we have a statute on the books, the Taft-Hartley law, which allows us to act in the case of work stoppages that are damaging to the national interest. I am not altogether happy with that statute. I had to live with it, if I may say so, for 116 days when

I was chairman of the Council of Economic Advisers, when the steel industry was shut down tight.

It was not until then that we could prove that there was a national emergency. I think it would be a good deal easier now, with half a million men fighting in Vietnam, to prove some of these things. I would like to encourage the administration to make an effort to prove them.

Senator PERCY. Thank you very much, Mr. Chairman, and Dr. Saulnier.

Chairman PROXMIRE. Congressman Bolling?

Representative BOLLING. I understand Dr. Saulnier has to leave.

Mr. SAULNIER. I am embarrassed, Mr. Bolling, by the fact that I do have to, but I have a connection to make in New York.

Representative BOLLING. I understand that very well. I appreciate your being here because I have valued your testimony for many years.

Mr. SAULNIER. Thank you.

Chairman PROXMIRE. I want to say, as chairman, too, we very much appreciate your coming, Dr. Saulnier. You have made a fine contribution. I haven't had a chance to question you because I thought I would defer to the minority.

Mr. SAULNIER. Thank you very much.

I hope that the committee will be able this year to produce a unanimous report on the key issues.

Chairman PROXMIRE. We will try.

Mr. SAULNIER. I honestly think this might be the key to breaking the impasse, thank you.

Representative BOLLING. Mr. Chairman, I have a rollcall going on that I have to get to but I should like to make a couple of comments before I leave.

I have never heard a more stimulating panel. I think all the papers have been excellent and I very seldom say that. I particularly enjoyed Dr. Schultze's comment on the game of chicken.

I particularly enjoyed your comment, sir, on the political risk of inaction by politicians. I happen to be one who favored a tax increase long before the administration indicated it was for one. I was for one in January 1966.

To Mr. Ture I would like to say that one of the things that disturbed me greatly when I found myself still for a tax increase—and I learned that he was the one of eight before the Committee on Ways and Means who opposed the tax increase—was the fact that he was the opponent but he is a long-time friend and associate.

I also remembered another thing that disturbed me even more than his position and that was that at the time when the present chairman of the Committee on Ways and Means was getting—I would hope—an education, as all of us do on this committee, in general economics by serving on the Joint Economic Committee, that the tax expert for the Joint Economic Committee was Norman Ture. But, now I understand your position and the reason for it, I believe, that I have no desire to argue with your technical data except in one small respect.

I happen, as you may remember, to have been well aware of the fact that the late President Kennedy was a member of the Joint Economic Committee, that while he was not a very regular attender he knew more about what went on before us than most of the other Members and that

he very consciously knew what he was doing when he made the recommendation that you commend and with which I agree and which is the last part of your paper.

The reason that I am so relieved by your testimony is that I now understand what I conceive to be a miscalculation in it, a major one, but a legitimate one. The one kind of expenditure that the Congress finds totally uncontrollable is the expenditure for any war to which the United States has committed itself.

There has never been a time in our modern history when the Congress of the United States has cut a dime, to my knowledge, out of the request by a President when we have troops in the field fighting, and the shift that has taken place has been a shift in domestic spending.

If we did not have the extra \$30 billion roughly that the figures would indicate is involved in Vietnam on an annual basis, we would not only have a balance, we would be having the tax decrease that you suggest was implied in the 1963 policy. So, I find myself largely in agreement with much of what you say but for that one reason in disagreement with your conclusion except for the fact that I heartily agree with the last three pages of your statement. I am a very relieved man for from my point of view all of the experts were then unanimous.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Would you like to reply?

Mr. TURE. Before Mr. Bolling leaves, I want to thank him for his commendatory remarks. I think there is scarcely any misapprehension but for a shade, perhaps.

I would agree wholeheartedly, Mr. Bolling, with your proposition as to the Vietnam expenditures. They do account for a substantial part of the total Federal expenditures.

I have no basis, however, for disputing your opinion as to whether or not it is possible for us to repress the growth of other Federal expenditures. But if, in fact, it is the preference of the Congress and the country not to do so, then we ought to finance these expenditures, not because we are trying to even out a short-term deviations—

Representative BOLLING. I do not even disagree with that.

Chairman PROXMIRE. Congressman Bolling has to make that rollcall.

Mr. Ture, I would like to find out first if I properly understand your position which is somewhat different than I anticipated it was before you appeared today. You feel, as I understand it, that it is a mistake to use taxation, or indeed fiscal policy, as a device for economic stability; that is, as a conscious device, we should not temporarily increase or decrease taxes or temporarily increase or decrease spending in order to achieve stability. Is that correct?

Mr. TURE. Shortrun stabilization, yes; precisely. I think the Federal Government should get out of the business of trying to stabilize the economy in the short run.

Chairman PROXMIRE. You do feel that nondefense spending has been rising too rapidly and that it should be retarded. Without going into all the details of the budget, this is a matter of long-standing commitment.

Mr. TURE. Let me modify that statement, sir.

Chairman PROXMIRE. Yes.

Mr. TURE. As an economist, I have no opinion to offer. I point out merely the fact that nondefense expenditures have been rising very

rapidly. Personally, not in a professional capacity, but in terms of preferences of how I want the world to work, I am concerned about the rate of expansion of nondefense items.

Chairman PROXMIRE. No. 3, you take the position that a temporary tax, announced as a temporary tax—it might go into effect July 1, 1968, expire July 1, 1969—is not going to have much effect on spending anyway and it is not going to have very much effect on inflation or interest rates; in your view, is that correct?

Mr. TURE. That is correct.

Chairman PROXMIRE. That does change from what I thought was your position and I think it is a very sensible position although it is not mine.

I would like to ask you to see if you can put on another hat temporarily, hypothetically.

If you did believe in using fiscal policy for stabilization purposes, would you under these circumstances feel it would be sensible now, given all the economic data, to pass a surtax? Would you vote for a surtax under those circumstances, for the kind of surtax which has been proposed, a temporary surtax?

Mr. TURE. With that very rigorous constraint you impose, sir, I think my answer would be "Yes."

Chairman PROXMIRE. You would?

Mr. TURE. Yes.

Chairman PROXMIRE. I am sorry to hear it. I have been trying to elicit somebody who agrees with me since these hearings began and I struck out.

Mr. TURE. Let me elaborate the answer just a shade.

If I, in fact, believed in the efficacy of fiscal policy in affecting the pace of expansion of aggregate demand in the short run, I have a feeling that the outlook for 1968 is probably on the exuberant side and this would follow several years of an extremely rapid pace of expansion of total demand in excess of production capability as is evidenced by the rate of increase in the general level of prices, and again if I were such a believer I think I would find it appropriate to try to curb the pace of expansion for the remainder of this year.

Now, I infer from everything I have heard today and read in the newspapers and heard in repeated statements from the administration and from Members of Congress that it is not feasible to try to curb Federal expenditure growth, to use the expenditure side of the budget as an efficient fiscal device for that purpose. So, if I were a fiscalist and did have this judgment about the pace of expansion—

Chairman PROXMIRE. I want to relieve you of any feeling you cannot cut any spending.

Would you like to do that?

Mr. TURE. Yes.

Chairman PROXMIRE. And you think that you could recommend a reduction in the budget which would be, in effect, a substitute for the surtax as far as economic consequences are concerned?

Mr. TURE. Surely.

Let me elaborate that reply, too. I would have to profess that my answer would again be not as an economist but as a citizen. I would

express preferences for reducing or eliminating particular programs I do not care for.

Chairman PROXMIRE. Thank you.

Now, I would like to ask both Mr. Schultze and Mr. Weston the following:

It seems to me that both of you gentlemen are expecting a surtax to do too much; that it will cure everything from falling arches to dandruff, as they say. It seems to me that it is going to do one of two things, at best.

It will either reduce the gross national product, reduce the number of jobs, reduce income and in doing so reduce prices, in which case it will not reduce interest rates very much and it will not reduce the deficit very much. If it does these things, it reduces income and prices and so forth, and it is not going to bring in as much revenue.

Or, on the contrary, it may reduce interest rates and stimulate housing and get about the same effect in the GNP and we had two very competent economists this morning who thought this is what would happen; it would not make any difference in GNP if you had an increase in taxes, but you would have a different mix; you would have more housing and less of other things.

If you did that, it would reduce the deficit because you would raise more money with it and it would reduce interest rates, as I say, but it would not accomplish what the President indicates is his principal purpose, which is to reduce prices.

Mr. SCHULTZE. The first thing I would like to do is disassociate myself from any belief that the surtax is as much magic in the fiscal field as a lot of people seem to think with regard to the rate of expansion in the money supply.

Admittedly, it is not going to cure warts. There are a lot of things it won't do. If I have been overenthusiastic, so be it. It is not magic medicine.

I think it will, nevertheless, accomplish major public policy purposes.

Let us start, for the moment, whether you accept it or not, start as a base from which we can make changes, with the Council's forecast of the economy without the surtax in effect—a \$60 billion-odd rise in GNP between 1967 and 1968. What would happen if you did not have the surtax?

Mr. Ture will quarrel with this, but for the moment I will forget that, and give you my two options.

They in a sense come out fairly close to yours, Senator, but the meaning is different.

One possibility is a very permissive monetary policy, such that without a tax increase you would maintain housing construction fairly close to what it would be with a tax increase by extremely permissive monetary policy.

This would mean a much more than \$60-billion expansion in GNP, a larger rise in prices, et cetera. So, one consequence of this would be a very large rise in the economy over and beyond the \$60 billion forecast by the Council. In turn, this would mean the deficit would not increase by the same amount as simply the amount of the tax.

In other words, you would not go from an \$8 billion deficit to an \$18 billion deficit, because you would have had expansion in the economy.

That is one alternative line of development in which failure to enact the tax would mean substantially higher prices and incomes. Or, to put it conversely, the tax increase would have reduced prices and incomes from what they otherwise would have been.

Chairman PROXMIRE. The failure to enact will increase prices and incomes and revenues.

Mr. SCHULTZE. And revenues. You would not have had the deficit equal to the \$8 billion which you would get with the tax, plus you would not lose the full \$10 billion of the surtax, because the impact of failure to pass the surcharge would percolate through the economy in higher income.

Chairman PROXMIRE. Conceivably, if you have the reverse of the 1964 tax cut, you might even get a revenue situation which would be the reverse. You might, without increasing taxes, get more revenue than if you did increase taxes.

Mr. SCHULTZE. I doubt that; but let us assume it is a possibility. You would do it at the price of inflation.

If you kicked off a big enough inflation, yes, it could happen. I don't think you would kick off that big inflation. The only reason you would get back those revenues that the tax would bring in is that you have had a big enough expansion and inflationary expansion in the economy to generate inflationary rises in incomes and higher tax revenues.

So, you might end up with the same deficit with or without a tax, but at a heck of a lot higher price level.

I don't think that would happen; but this is what would be necessary—

Chairman PROXMIRE. This would be one possibility. It makes a pretty enthusiastic assumption on what this temporary 10-percent surtax is going to do to spending.

Mr. SCHULTZE. May I come back to that in a moment?

The second alternative possibility is that without a tax increase. Federal Reserve policy would be very much more restrictive, housing construction would fall off very substantially, you would not get a significant inflationary push of the economy as a whole, because you have taken your major adjustment out on housing.

That is the other extreme of the two possibilities.

The actual world would probably fall somewhere in between. One possibility would be a much larger rise in income and a very permissive monetary policy. The other would be not much more growth in GNP, because a very restrictive monetary policy would have pulled down housing.

I think the essence of Mr. Ture's point is, if I may express it, that the spending of consumers and business is very insensitive to temporary changes in income.

Now, I would fully agree that spending of consumers and businessmen is not anywhere near as sensitive to temporary changes in income as to permanently expected changes in income. I agree with that.

Where Mr. Ture and I disagree is that he pushes it to an extreme point.

I would make one other proposition with respect to this. Between 1964 and 1965 and 1969, Federal expenditures, including Vietnam, as a percentage of GNP rose by about 2 to 3 percentage points. They went from something like 19½ percent GNP up to 21½ percent of GNP.

I suspect that Mr. Ture, himself, had this been presented to him as a possibility, would have indicated, yes, you do need a tax increase under these conditions.

The difficulty is whether you have a long-term increase in Federal expenditures as a percentage of GNP, substantially of the order of 2 percent, 2½ percent. Now, the difference here is that the increase, this 2 to 2½ percent, it attributable to Vietnam, and we say—God hope that we are right—that it is temporary.

Query: You have an increase in expenditures relative to GNP of a substantial magnitude, which you think is going to be temporary.

If it is going to be temporary, then, according to Mr. Ture, don't have a temporary tax increase to get after it. I think that is where the difference comes down to.

Chairman PROXMIRE. My time is up.

Senator JORDAN. Please go ahead, Mr. Chairman.

Mr. TURE. Shall I respond?

Chairman PROXMIRE. Yes; then, Mr. Weston.

Why don't you respond, as long as you were directly asked by Mr. Schultze? Why don't you reply, clarify your position?

Mr. TURE. Very briefly, Mr. Schultze, I think your point is well taken.

My case is, fundamentally, that the occasion for a tax increase at this point is not being properly stated. I don't know whether there is such a case, because I cannot forecast the likely course of Federal expenditures over a period of time sufficiently long to make a major change in the revenue structure desirable.

If we forecast that expenditures should and will continue to rise during that period, I think that is a reasonable basis for requesting a tax increase.

I wish the President would put it to the country exactly that way. I wish that he would state that since Congress has voiced approval of a wide range of programs, defense and nondefense and since the prospects for quickly terminating the conflict in Vietnam and not getting into similar conflicts elsewhere so that we will be able to reduce our defense outlays, is remote, the likely course of Federal expenditures, given these assumptions over the next 5 years or so, is such that we will not be able to finance them with the present tax rates and will run huge deficits.

That, I think, would be a perfectly reasonable way for him to go to the country. I think it would then be a reasonable way to state the issues.

Do we want the other nondefense programs curbed, or do we want them, and are we willing to pay for them?

Mr. WESTON. That leads directly to what I wanted to say.

It seems to me that it is unfortunate that the basic policy decision hinges on how you label the policy change, temporary versus perma-

nent. It seems to me that in one sense it is impossible to describe whether it is going to be temporary or permanent.

The point is that you have in fact had some fundamental changes in spending policy with regard to the aged, medicare, the disadvantaged, in terms of the Economic Opportunity Act. But Congress passed these things. You have this legislation. It is a fact.

I think even within Mr. Ture's framework, he may not agree with them as a private citizen, they don't fit into his value system, but they do represent, it seems to me, fundamental changes in spending policy which have been enacted by Congress.

In addition, you have a world in which, as I indicated, there appear to be fundamental power shifts taking place. At least we are involved in a war in Vietnam, whether we want to call it that or not, whether we like being there or not.

But, given these as facts, they present us with an economic outlook that we are all in agreement with here, involves the necessity for something on the revenue side.

Again, regardless of what you say about monetary policy, it involves the necessity of something more on the revenue side.

To disagree with this policy because it has been labeled by some as temporary, seems to me irrelevant. I think it is impossible to put that kind of label on.

The point is, you need it, and we delayed having it for some time. Whether it has been justified in the past, in terms of fine tuning or not, the point is that there is at least an intermediate term change in the level of spending taking place.

The second point, the point, Senator Proxmire, that you apparently keep coming back to, is that it would be better if we cut expenditures.

What you are saying is that it would have been better if the Congress had not passed these other forms of legislation.

As I say, realistically, I do not see it at all feasible to reduce spending of the order of magnitude required to do the job.

Chairman PROXMIER. I sure want to come back to that, but my time is up.

I yield to Senator Jordan.

Senator JORDAN. Thank you, Mr. Chairman.

Well, it is quite obvious and refreshing, I believe, to observe that economics is not yet an exact science.

Mr. Schultze, it appears that in this year, 1968, we might have serious labor disputes; several contracts are coming up for renewal. If this occurs, how do you believe it will affect the economic outlook and desirability for a tax increase, and, second, how close are we to wage and price control?

Mr. SCHULTZE. Answering the second first, I hope we are a very long way from it.

You know, one has to pick one's evils, and I would put wage and price controls pretty high on my list of evils. I would stand a lot of others before that.

That does not mean under no circumstances would you want them, but I would say you would have to have an awful lot of evils facing you before you picked that.

Point No. 2, with respect to how a steel strike would affect the economy, I hesitate to be very precise with the committee on it. It seems

to me it is the kind of thing that to give a very meaningful, short-run answer, and that is what we are dealing with, you need to do a lot more work on what the implications are than I have done.

I will say this, that barring a catastrophically long strike—and I don't know what time period I would put on catastrophic—I think experience would show it primarily would affect, giving everything else in the economy, the timing of developments within the year, rather than the fundamental strength with which you end the year.

Some years ago I did a little work on looking at the impact of steel strikes in particular on the economy, taking periods when we had them. As a general proposition, I would say they tended to effect very short-term changes, not longer term changes, when you end up.

So, from the point of view of the domestic economy, it clearly would affect the pattern of the year. You would be very strong for a while, in anticipation of it, very weak for a while, during it, and then make up.

From an international standpoint, from the point of view of the balance of payments, it could be, at least a relatively long steel strike could be, I think, very damaging, because it would, I think, switch long-term procurement from domestic to foreign steel on the grounds, strangely enough, of security of supply, which we might not be able to get back again.

So, in short, from the domestic standpoint, it would affect the pattern of the year, not the way you end the year up. From a national standpoint, I think it could be fairly difficult. I think it could hurt.

Mr. WESTON. I would like to add a comment to that.

Senator JORDAN. Please do.

Mr. WESTON. To go back, in connection with your question to Mr. Saulnier, about in circumstances such as this, where it is difficult to reach decisions in negotiation by voluntary arbitration, it seems to me again this takes specific things out of perspective.

In an environment where you have excess aggregate demand, and workers seeing their real income position eroded by substantial price increases, this does in fact make it very difficult to negotiate an appropriate wage settlement, because the counterpart is if you get wage increases that protect the real income position of workers, the consequences of this is that if they are not passed on in various degrees, that business firms in turn don't earn their cost of capital, so you get pressures on prices as a consequence.

It seems to me that it is inappropriate to take out of context the difficulties of reaching viable settlement in an atmosphere of excess aggregate demand.

It seems to me that you work first at the remedy at its source, and that is to bring aggregate demand into balance.

This is a necessary first step before considering a range of specifics, like voluntary arbitration and wage and price controls and other interferences with the operation of the price system.

Senator JORDAN. Thank you.

Mr. Ture, I would like to hear especially from you on this.

Mr. TURE. I simply would like to make a comment on what Professor Weston observed.

That is, it is first clear in this discussion among the three of us—I regret Dr. Saulnier is not here to participate—it is perfectly clear that what distinguishes among us here is that Messrs. Schultze,

Weston, and Saulnier happen to believe in the effectiveness of changes in taxes and expenditures in the short run in determining the level of gross national product and economic activity.

I used to believe that, too.

I think that is what Mr. Bolling was alluding to.

I do not find factual support for that belief. Therefore, it is an article of faith, it seems to me, unsupported by the data about the economy in the postwar period.

There have been numerous attempts to examine changes in fiscal magnitudes and see what happens to changes in the economy. Those tests always come out the same way. There is no close relationship.

Now, I think that is what is meant when Professor Weston says that an economy in which aggregate demand is excessive, we have to bring it back in line in order to make any kind of incomes policy viable.

I think the latter part of his statement is correct. That is to say, in trying to impose wage-price guideposts with a wage rule of 3.2 percent when prices are rising at the rate of $3\frac{1}{2}$ or 4 percent per annum, is just foolish.

Indeed, the guideposts could be made to work, it could only be in a context where they don't have to work, where it is not necessary, where you don't have to rely on them.

The dispute I would have with Professor Weston—

Senator JORDAN. They only work when they are not needed, when the pressure is not on. That is what you are saying?

Mr. TURE. That is right.

Mr. WESTON. I would like to comment on that, too.

In terms of the evidence that Mr. Ture presents in his paper, a portion of which he gave orally, as well, his tests of the efficacy of fiscal policy were sorely inadequate in that he simply related some changes in fiscal policy to overall economic magnitudes.

There are large numbers of other factors influencing GNP than fiscal policy. To ignore these, and to attribute causality, one to one causality, when you measure the influence of one factor and not holding a large number of other factors constant, it seems to me is not a valid test, and is not a sufficient basis upon which to draw the conclusions which he drew from the evidence that he presented.

The second point is really a part of the first.

I am anticipating, of course, what he is going to say about the first.

I want to say, with regard to the second, that I think he is incorrect in characterizing my position, and I think a number of other positions, that changes in tax and expenditure policy in the short run can provide an exactly counterbalancing influence in the economy.

The argument that I have made is that these changes certainly have not been temporary. They have not been half-year or one-quarter changes. This has been a persistent excess demand situation that we have been facing since Congress passed laws reflecting a different expenditure policy toward old age, medicare, et cetera, and since Vietnam defense expenditures have been rising.

This has not been one quarter or half a year. This has been a persistent pattern, and it is about time we do something on the revenue side in response to it.

And second, that even when you have expectations of quarter-to-

quarter changes, it makes sense to adopt policies in the right direction, in the face of the outlook that you perceive.

Again, here, I think that the evidence he presented on the Council's ability to forecast the future was not really a fair test.

Senator JORDAN. Now, Mr. Ture, for rebuttal.

Mr. TURE. Let me first concede fragmentary points wherever I possibly can.

Indeed, the tests that I refer to do not establish a case, nor are they intended to. The burden of proof rests upon those who advocate that certain actions be taken because they confidently expect certain results will follow from those actions.

All I say is that if in fact you test whether or not with those actions that have been taken in the past, the results that are expected follow, you find that the evidence indicates there is no reliability in the outcome at all.

So you may build econometric models from here to Sunday, and indeed that is what you generally do in order to establish this point. The very fact is that if you make a scatter diagram showing changes in the fiscal parameters, and either lag one quarter, lag two quarters, lag three quarters, lag four quarters, changes in gross national product, it looks to you as if you are seeing a snowfall, no relationship exists.

Let me say on the contrary, I don't want to then be put in the position of saying that there is indeed a simple explanation for changes in aggregate demand. I make that statement as a precautionary observation, because I am now about to adduce a relationship as a substitute.

If in fact you plot changes in the stock of money, and lag the changes in gross national product, you see a very close fit in the data.

Senator JORDAN. Mr. Chairman, my time is up, but it looks like Mr. Schultze wants to get in on this.

Mr. SCHULTZE. My only point is on the business of testing fiscal policy against subsequent changes in GNP.

It is like the doctor giving antifever medicine, and it is not quite fully successful. Every time he gives the medicine, you notice that the patient's fever comes up.

Mr. TURE. You have to have exactly the right dose?

Mr. SCHULTZE. No, not the exact, right dose. What I am saying is all you have to do is posit the point that the fiscal policy in general has been applied during the periods when it should have been applied, but not quite enough, and you get precisely the results Mr. Ture got.

Point No. 2, with respect to the stock of money, the basic problem is the cause and effect problem, whether the stock of money is rising because other elements in the economy are causing it to rise, or vice versa.

I might point to the last time we had a problem somewhat like this. The only time in the postwar period where it appeared to be necessary to raise taxes was during the Korean period. This is the only tax increase we have had in the postwar period, since 1948, anyway.

It turns out at that period of time you had the situation in which the stock of money was rising at a very slow pace, and you had a big inflation, followed by the fact of an increase in the rate of growth in

the stock of money. Yet, inflation was cut off because you introduced some substantial fiscal policy.

That is the one other time in the postwar period where taxes were actually raised. You can see the impact on the economy, where you can't with the stock of money.

Mr. TURE. Mr. Chairman, may I comment very briefly?

Chairman PROXMIRE. Very interesting colloquy.

Mr. TURE. I will comment by calling your attention to what I think is an extremely interesting and enlightening editorial in this morning's Post.

I think, one, that editorial clearly suggests the absence of the kind of relationship between changes in fiscal magnitudes and changes in GNP which fiscalists assume.

Chairman PROXMIRE. I am so glad you referred to the editorial. We put it in the record earlier.

I see Mr. Schultze wants to comment, also.

Mr. TURE. I would like the opportunity to check your observation of fact, Mr. Schultze, but I think the rate of increase in the money stock during this period was—

Mr. SCHULTZE. I got my source of the money stock from Milton Friedman's book. I dug into the book to see his comment during that period.

Let me give you the numbers, first.

The point is made in the editorial, if I might borrow it for the moment, that—

The evidence suggests that fiscal policy had little if any effect on prices during the Korean War. What was relevant was monetary policy. In 1950-1951, the stock of money was permitted to expand very rapidly—at an annual rate of nearly 5 percent—and it was only after the growth of the money stock was slowed, at the end of 1951, that the inflation abated.

From June 1950 to June 1951, the stock of money rose by 4.4 percent. Consumer prices rose by 8.8 percent.

During the next year, the stock of money rose by 5.7 percent. Prices, on the other hand, slowed down substantially, to 2.4 percent.

As Professor Friedman himself in the book points out, when he is discussing money, it was the rise in velocity associated with the speculative boom which meant that even the relatively modest increase in the money stock was accompanied by a rapid growth in income.

This is one period when the money supply relationship does not work. This is the other period in the postwar years when you needed a big tax increase, when it did work, and when as a matter of fact the very modest growth in money stock was accompanied by big inflation, precisely because you had a big pouring in of defense orders and a speculative boom.

You did not see it in the deficit. It did not show up in expenditures for some time.

Mr. TURE. The assertion that it did work is not to be found in the facts.

I don't know what it was that impelled me last evening to ask my research associate to draw up a graph showing the quarterly money stock, using the conventional measure of money stock, figures that come out of the Federal Reserve Board, for the years 1947 through 1967.

I am sure you would not be able to see this, sir, but this represents the last quarter of the year 1949. Each one of these intervals is a full year of four quarters.

It seems to me, Charlie, that you get a very rapid rate of expansion in money stock during this period.

Mr. WESTON. May I comment on this as an impartial observer?

Like Mr. Ture, I was trained at the Chicago school, but I guess it did not take completely. To try to draw a conclusion about rates of change from material plotted on arithmetic paper seems to me is fruitless, No. 1.

No. 2, the money stock growth is the resultant of demand-and-supply influences.

The Fed does not determine the growth in the money stock unless the Fed is able to anticipate, with a degree of economic prescience not given, that would not be admitted by the people who generally argue for monetary policy; that is, for example, the increase in the rate of reserve availability by 3 to 4 percent a year during the Korean War period would certainly result, because of the velocity factor referred to, in a greater impact from the money side than the 3- to 4-percent increase in the reserves made available.

So that applying the money supply approach involves a much greater degree of forecasting, but it seems to me it would be unfortunate if we let preoccupy us this argument between the relative validity of monetary policy and an exaggerate demand approach to the efficacy of economic policy.

Realistically, for either to work effectively involves some ability to forecast economic future.

I think the fact that is so clear here is that we have had a fundamental shift in spending policy by the Federal Government, both in domestic programs related to the aged and the disadvantaged and in response to heightened international tensions.

These call for a response on the revenue side. I think it is impossible to characterize whether the response on the revenue side is going to be temporary, or what degree of permanence.

But I think the aggregate demand impact of this behavior, these fundamental changes in Federal spending policy, are very clear, and the appropriate countermeasures are called for.

Senator JORDAN. Mr. Chairman, my 10 minutes are up.

Chairman PROXMIRE. I would like to come back later to that notion that the increase in spending is something written in the sacred laws of the land now, and that there is nothing we can do about it.

I do not think Members of Congress accept that.

I think it is not throwing darts at a board, or being politically opportunist, to suggest that there are specific areas where we can cut, and cut deeply.

Before I do, however, I would like to ask both Mr. Weston and Mr. Schultze if you would not agree that there is a distinct possibility that in the latter half of 1968 the economy may not expand at the rate which you projected for the whole year.

This morning we had a very eminent forecaster from Edie & Co., Mr. O'Leary, highly respected, who projected a \$61 billion increase in the gross national product for the whole year, without a surtax.

It was interesting how he broke it down, however; \$19 billion in each of the first two quarters; \$14 billion in the third quarter; and \$13 billion in the fourth quarter.

Now, I calculated that the increase in the last half of the year, therefore, would be at a 2½ percent rate, in real terms, because he assumed that there would be a 4 percent increase in prices.

Now, this obviously is going to mean that the economy is going to slow down. It is going to mean that we are going to have increased availability of manpower and factory capacity.

Under these circumstances, and in view of the politically realistic fact that Mr. Schultze recognized the other day, when he said, as I understand, that probably the best hope for a surtax from the political standpoint is the first of July—would this not hit us at exactly the wrong time?

You make the case that we are a little overheated now—the figures for January suggest we are not, but at any rate, we are more overheated now than we are going to be in the last half of the year.

So, aren't you gentlemen who advocate a surtax proposing a policy measure that is going to increase unemployment, slow down the economy, reduce growth at the wrong time, at the time when we don't have an excess of demand, indeed, we have a deficit?

Mr. WESTON. I would like to respond to that.

I considered that possibility in my statement of eight points.

As I indicated in my presentation, I think this is a formidable set of arguments, and does deserve very careful consideration. My answer would be that, given a sustained period of excess demand, which is broad in its train, price increases of a magnitude that would cause a number of problems—

Chairman PROXMIRE. May I interrupt?

Do you really argue there was excessive demand in 1967, the whole year, with the growth at 2½ percent, far below any economist I have heard say we should have?

Mr. WESTON. Again, it is the same situation. The first half of the year, you had very little growth. It all came in the second half.

It was the same argument presented against the tax increase in June: The first half was weak, and, therefore, let us not have the tax increase, because the second half might not recover enough.

So, now, here we are, the second half was very strong, the first half of 1968 looks very strong, but let us not do anything because the second half of 1968 might not be as strong.

My answer there is that in a period when you have persistent excess demand, that you should take some action. This is a risk that you can run—

Chairman PROXMIRE. You did not have excess demand in the first half, of 1967. It is not, as you say, a long-term excess. You earlier said in the first half of the year we had a weak economy. Now we don't.

Federal spending was reduced sharply in December of 1966. In March, the President restored that spending, on the ground that the economy was slowing down. In that first quarter we grew at the rate of 1 percent.

There was not excess demand then; was there?

Mr. WESTON. No.

Chairman PROXMIRE. You can hardly argue that this is a permanent excess demand. Permanent for 6 months; most forecasters argue you are not going to get excess demand at the end of the year.

Mr. WESTON. Both monetary and fiscal policy have impact on the economy. You have a monetary policy that went into effect particularly in the second half of 1966 that produced the crunch of August 1966.

Chairman PROXMIRE. We always have all kinds of things.

I am saying as a matter of fact we had deficient demand from January to May and June 1967.

Mr. WESTON. Excessive demand in the first half of 1966, and deficient demand in the first part of 1967 was in response to the excess demand in the first part of 1966.

The only thing we are arguing for here is that it would have been better to have had a better mix with better monetary-fiscal policy during 1966, which would not, therefore, produce the fear of softness in 1967, which produced in action in the face of excessive demand that came upon us in the second half of 1967.

I do not think it is necessary to argue whether monetary policy is more effective than fiscal policy. I think either will work, if you appropriately measure them in terms of the environment in which they are promulgated at the time.

My point is that certainly it is true that because of the very tight monetary policy that you had dramatized in August 1966, you had an impact in early 1967.

Here again, in part because of this, you had relatively weak monetary policy in the latter half of 1967, because of the fear of producing another situation as had been, produced—

Chairman PROXMIRE. Of course, I would argue you have much too loose a monetary policy—an excessively loose monetary policy—throughout 1967. It is monetary policy that should be corrected.

Monetary policy has been so loose they have been pumping money into the economy at a 7-to-9 percent rate. So you come back and say this is an indication of excessive demand that has to be cured by fiscal policy.

Mr. WESTON. I agree. I referred to that in my presentation, both monetary and fiscal policy in the latter half of 1967 had been puny, really, in comparison to the aggregate demand situation.

The basic point is, however, that on the fiscal side, given that you are in at least one war, and given the state of international tensions, and given this in relationship to domestic programs that have already been enacted, and to which we are committed, unless Congress changes this, that the risks are all on the side of inaction, if you do not do anything about the surtax.

Chairman PROXMIRE. The fact that we are in war seems to me is a significant moral argument. But not an economic argument.

We pointed out this morning that the impact of defense now in terms of GNP is less than in 1956, less than in 1958 or 1962. In an economic sense, we are not in war economy. The war is not taking so much production out of the economy that we have to impose a tax to balance that.

It is true in World War II, and the Korean War, but it is not true at the present time.

Mr. WESTON. If you put the total budget together, as Mr. Schultze

indicated, there has been a rise of defense and nondefense expenditures in total.

Chairman PROXMIRE. This is why I wanted to mention that although Mr. Schultze, of course, disagrees with me, and he is the ablest advocate, I am sure, that one could find—I feel very, very strongly that we could cut a billion dollars more out of the space program.

I think we can cut \$5 billion or \$6 billion out of the public works program, including cutting the roadbuilding program, sharply. I do not think this would be a bad thing. I think it would be a good thing.

We have done this kind of thing before. The President slowed down the public works program very greatly in December 1966 to March 1967, and he can do it again.

I think we can withdraw four to six divisions in Europe.

These are specific cuts, not a matter of throwing darts. These are matters that I think could be cut without hurting our antipoverty program, or educational effort, our investment in human resources that pays off so fast.

The public works program is so fantastically inefficient in our Government.

Let me give you one quick example. The Defense Department requires a return or discount rate, depending on how you want to figure it, of 10 percent on all their projects, except the Corps of Engineers. There they are only required to have a $3\frac{1}{4}$ percent or one-eighth percent return.

It is a mistake. It is wrong. What can you do about it? The President can do what President Roosevelt did, what President Truman did, which is to say we are going to stop this kind of program at the present time.

This is the kind of thing that you can shift rapidly.

Mr. SCHULTZE. I just wanted to make one technical point.

Whatever one feels about public works, and as a Budget Director I have had my feelings, too, you are not going to cut them sharply in a hurry unless you literally want to leave dams half built.

Chairman PROXMIRE. I would.

Mr. SCHULTZE. There is a difference in judgment.

Chairman PROXMIRE. How did the President do it from December 1966 to March 1967? He saved \$3 billion at an annual rate.

Mr. SCHULTZE. Looking at the total amount of the expenditures, the expenditure cut of the \$3 billion was relatively small in public works.

Moreover, I think in all realism, I would insist whatever success you are going to have in reducing the impact of this program, it is going to be ruined by trying to go at it by leaving projects half built.

I think that would politically ruin any good you might do in terms of stricter criteria on your new projects.

Chairman PROXMIRE. We did this in World War II.

Mr. SCHULTZE. Sure, in World War II. I admit in World War II, you would do it, but this is not World War II. There is a big difference.

Chairman PROXMIRE. Did we slow down in the Korean War? We are slowing down now.

Mr. SCHULTZE. Are we slowing down?

Chairman PROXMIRE. We are being asked by the President for \$10.2 billion for public works for fiscal 1969 which is more than we spent last year. It has gone up each year in the last 3 years.

Mr. SCHULTZE. In the first place, it is what you define as public works.

Chairman PROXMIRE. It is 10 times what it was 30 years ago.

Mr. SCHULTZE. In every case, the rate of construction is being held to the minimum without stopping work in process.

The key thing I want to get across is that the real place you can get at public works is in the new starts, and politically speaking, if you want to get some restraint on the economy, I don't care whether you agree with that or not, you will not. Every year, in the last 3 years, the President has sent up a very, very thin new start public works bill, and every year it is doubled, tripled, or quadrupled.

I am not putting blame on anybody. I am saying if you are looking for a realistic way of putting restraint on the economy, however desirable it might be to keep pressing at this one or the other, it is not going to do it.

I am not arguing you could not cut technically. Of course, you could.

Chairman PROXMIRE. This is asking a lot of the President. This is a sensitive area. It is an area where Senators and Congressmen are elected or defeated.

I think if the President takes a firm position, we are going to cut back on public works. We must stop everything we possibly can. I think it is going to be respected, in the present atmosphere. That is the attitude of the chairman of the Ways and Means Committee, the attitude of so many people in the Congress.

Mr. SCHULTZE. My comment is that you would not get much expenditure reduction right away. No matter how the President has pushed on this in the past, and he has on the new start end of it, it has not done any good.

Mr. TURE. Mr. Weston a few moments ago made reference to the policy mix question.

Referring to the monetary crunch in 1966, he uses that for the explanation for the slowing down of economic activity in the first half of 1967, in response to your probing. In the same period of time, during which the monetary crunch was going on, that is to say, a zero rate of expansion of the money stock, in fact, some very miniscule decline, this was a period when the national income accounts surplus moved from a surplus of 3.2 to a deficit of an equal amount, and the full employment surplus change was about the same.

It is obvious in that period of time that highly expansionary development in fiscal policy did not preclude, did not prevent a material slowing down in the basic economic activity.

I do not want to offer any of these things as really strictures, as absolutely firm precepts about what does what in the economy.

Part of the exchange we had a few moments ago was attributing to me a firmer view about the nearness of the relationship between changes in the money stock and changes in GNP that I would really subscribe to.

Let me simply say on the basis of the entire war experiences, including this nice recent chunk of it, do not predicate the surtax that is proposed on the basis of a short-term constraint on the increase in aggregate demand.

Chairman PROXMIRE. You see, Mr. Ture, what you are suggesting to the committee, which is very interesting, and I just wish other mem-

bers were here—I will do my best to discuss it with them—is so far-reaching that I am very skeptical that I will be in a position to persuade a substantial number to accept it.

We have a modified Friedman approach on monetary policy, 2, 3, and 5 percent for the Democrats, and 2 and 4 percent for the Republicans.

Now you are suggesting a Ture approach on fiscal policy which would neutralize fiscal policy the same way.

The trouble is, you make us feel so impotent to cope with whatever may happen in the economy. In other words, you are telling us that we ought to simply rely on automatic stabilizers, but it is hard for the Members of Congress to sit by and watch people be thrown out of work, or watch inflation ruin too many people without any action at all, saying there is nothing you can do about it.

It is a kind of Herbert Hoover approach.

Mr. TURE. We might see how good the past performance in economic stabilization policy has been.

Chairman PROXMIRE. Maybe Herbert Hoover was right.

Mr. TURE. I think the problems you would have to cope with under what I am posing to you are vastly greater, vastly more serious, and vastly more deserving of your attention than the shortrun economic stabilization.

Chairman PROXMIRE. That is right, but shortrun economic stabilization is important, too.

Mr. SCHULTZE. During this period when fiscal policy was ineffective, we had an \$18 billion drop in the rate of inventory investment, and \$5 billion drop in rate of consumption spending caused by a change in the consumer saving rate.

In that same period, the economy did pause, but to say that facing an \$18 billion drop in rate of inventory investment in two quarters, and a \$5 billion autonomous drop in consumer spending, which is a \$23 billion drop, and all you got out of it was essentially a pause, to say that this, therefore, shows that fiscal policy which was expansionary was ineffective, seems to me to miss the point.

I am not saying this automatically indicates this was the fiscal policy, and not the monetary policy. This does not allow you to change between the two. You cannot use the fact that the economy did slow down during the period when fiscal policy was becoming more expansive.

Mr. TURE. Following the period. The slowdown in economic activity was not coincident with the change.

Mr. SCHULTZE. It was coincident, and one quarter late.

Mr. WESTON. A minor theme on this musical number.

We seem to be playing a number of themes that do not all come at the same time.

With regard to the three areas where you suggest tax expenditure cuts might be made, Mr. Schultze has already commented on public works, and indicated this really boils down to being a decision on which Congress bears at least a considerable measure of responsibility.

Chairman PROXMIRE. I agree with that.

Mr. WESTON. With regard to cutting down military expenditures in Western Europe, I certainly agree with this proposal, except that it is the whole complex of military-diplomatic considerations, and again.

it is outside the control of a single group, and it is something which has been proposed. I proposed it myself for years.

Chairman PROXMIRE. We have to persist in these things. After all, this is not all congressional decision. Congress did pass a resolution in 1950 raising the number of divisions from two to six.

We have a resolution pending in the Senate that some of us are co-sponsoring to reduce it from six to two divisions.

It is a proper recommendation of this committee, as a matter of balance of payments, and the budget, to support a reduction.

Mr. WESTON. With regard to the space expenditures, my own feeling is that the longrun productivity is very substantial, but that is debatable.

Let us concede in the second and third areas I would say fine; let us continue our efforts to cut there, but since we have had persisting aggregate demand, aside from a pause, and with the outlook being one where the risks are very great of continued excess demand, of really greater proportions, particularly when the international situation calls for an increase of more than \$3 billion in 1969, in defense outlays, that success in the second and third areas would help make any surtax imposition relatively more temporary than it otherwise would be.

It does not mean that efforts in this direction should be diminished in any degree.

Chairman PROXMIRE. I wish you were right. I wish we were all that logical.

We concede that the surtax should be repealed. I ask you three gentlemen. I asked witnesses to come up and give me an example of a tax that had been repealed before its expiration date. No one has been able to find one, or communicate with me after they appeared. Apparently there has not been such a case.

If the surtax is needed, if the restraint on the economy is enough, it will continue, it will be reenacted.

If we have a combination of rising prices, which could very well be because of the cost-push situation, I think we have had much of that in the past, and increasing unemployment, it might still be very difficult to persuade Congress, under these circumstances, especially if we have a deficit, to repeal the surtax, in which case it would be a perverse element in our economy, and would slow growth and create unemployment.

It would be very, very hard to get rid of it.

Mr. WESTON. This is equivalent to the argument; let us not do something that is needed now because we might keep it when it is not needed.

Chairman PROXMIRE. We are not going to do it until July 1. We will not do it on the 1st of March, or 1st of April or May.

You have not tried to rebut the argument which Mr. O'Leary made, that the economy is going to slow down the first of the year, when the inventory accumulation of steel is worked off.

Mr. SCHULTZE. No. 1, it is always more difficult to see the further out you go, not all the time, but very often, in forecasting, that "second half."

Second, and more importantly, if GNP rises by \$19 billion a quarter,

as Mr. O'Leary would predict, then you need a slow rate of growth thereafter for a short period of time.

That is a \$76 billion increase. You would need some slowing down thereafter.

Finally, it seems to me there are two other points:

One, we are in a particularly fortunate position to hedge our bets. All of the demographic and income statistics that I have seen, as they relate to housing, would indicate there is substantial room for expansion in housing demand, given the situation where you could pursue the monetary policy and make it possible.

If you are wrong on the surtax, you do have an out here to keep the economy moving, which at other periods of time you might not have.

You are particularly fortunate so that you can hedge your bet, and it does not cost you very much. You have a good bet hedger here.

Finally, without attempting to forecast individual items, to continue this \$15 billion deficit for 2 years in a row, even if you can't pick out precisely how it is going to hit particular sectors of the economy, it seems to me the burden of proof must be on those who say the private economy is so weak that you need this kind of deficit for 2 years in a row.

Chairman PROXMIRE. As you know, I prefer to reduce spending instead of a surtax.

Mr. Brock, would you like to ask some questions?

Representative BROCK. No. I am sorry. I have been involved in the gold-cover debate which we just passed.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. No, Mr. Chairman.

This has been a very stimulating panel. I think I should not impose on them more. I have many questions. Indulge me just one question.

In order to attain full employment and reasonably full utilization of plant capacity, what do you regard as a tolerable degree of inflation?

Mr. SCHULTZE. I am not sure.

I got into an argument about this last night, as a matter of fact. I don't think that is a question that can be answered in the abstract. I think you have to ask in a given year, and in a given situation, in a particular situation.

Right now, I would say 3½ percent, because I know that just for the next 9 months to get the rate of price increase much below that would take very drastic unemployment.

Senator JORDAN. Do you regard it as tolerable in these circumstances?

Mr. SCHULTZE. In these circumstances, mainly because the actions that would have to be taken to pull that down substantially are a lot greater now than they might very well be under other circumstances.

If you ask me in 1969, or 1970, however, given time to gradually taper off, then it seems to me you could then have reasonably high employment with a much lower rate of price increase, not zero, but maybe 2 percent.

It depends on the particular circumstances of the particular time, exactly how much inflation it seems to me will go with it.

We have a bit built in right now, and even a more restrictive fiscal policy than the President proposed, even a more restrictive fiscal policy would not affect the rate of price increase that much, in the next 6 to 9 months.

Therefore, you have to put up with it for a short period of time, unless you want to take very drastic measures increasing unemployment.

Now, the further out in time you go, the more nearly you can have your cake and eat it, even though you will get some inflation, I suspect, with high employment.

I can't give you an easy answer to it. It depends on the circumstances of the time.

Chairman PROXMIRE. Mr. Ture?

Mr. TURE. I would associate myself with fragments of what Mr. Schultze has stated.

One fragment is to the effect that prices today are lagged responses to events that occurred in the past.

Chairman PROXMIRE. How much of a lag?

Mr. TURE. I do not know if they are systematically distributed. I don't have the remotest notion of how to answer your question, sir.

I think from one sector to another—

Chairman PROXMIRE. Can you give us a variation, 3 months to 6 months?

Mr. TURE. Some prices are much more quickly—

Chairman PROXMIRE. Overall, they lag by how much? Can you give any estimate at all?

Mr. TURE. I could give you an estimate, but it would have no worth at all.

I would say a year and a half. Please don't rely on that for anything whatever.

Chairman PROXMIRE. Is it more than a year, less than 2 years?

Mr. TURE. You asked about an index that is peculiarly weighted, a structure that consists of all sorts of in-puts. I am not qualified to respond.

But there is a lag. Given the fact that there is some substantial lag between events and their reflections in the level of prices, that is one fragment of Dr. Schultze's statement I certainly would agree with. I don't think you can do anything at all about it in the next 3 months, or 6 months, or 9 months, short of actions so ferocious and so drastic, so vigorously changing the anticipations of the economy that you would not reasonably say it is worthwhile to do that.

To project in the future, I don't know what the relationship is between the rate of increase in the general level of prices and the rate of resource utilization. What your question provoked was a searching around in the cobwebbed recesses of my mind, to see if I can bring out anything by way of a hypothesis, a really good, reliable, appealing hypothesis, about any kind of stable relationship between rates of resource utilization and rates of increase in the general level of prices.

I know that there are people who think that there are such rela-

tionships. They don't hypothesize them. They simply describe them statistically.

Chairman PROXMIRE. Doesn't the overwhelming majority of the economic profession think it has something to do with the Phillips curve that describes this phenomenon, or not?

Mr. TURE. I haven't taken a poll, sir, but I am sure that your impression is correct, that a great number of economists do in fact believe that there is some hidden functional relationship between the rate of resource utilization and the rate of increase in wages and unit labor cost and in prices.

I find the hypothesis behind that relationship is scarcely articulated. I find it an enormously unappealing notion.

Mr. SCHULTZE. I suspect that economists would generally agree on either extreme of the Phillips curve.

By that I mean with very substantially excessive demands, a combination of the level and rate of change, you get significant price increases. With very excessive unutilized capacity, you are very unlikely to get price increases extending over any period of time. But, it is the whole area in between these extremes about which we don't know too much.

Mr. TURE. But, you will have price increases from the past.

Chairman PROXMIRE. It seems to me that underscores the point that the surtax is not going to affect demand sufficiently to get much of a change in prices. The whole point of the surtax, as the President described it, is to stem inflation. Now you say there is a lag to it, so there is serious question whether it has any effect or not.

Mr. SCHULTZE. One-half of that statement I would subscribe to. Namely, it wouldn't have much effect for the next 6 to 9 months. That is not awful important.

The other half, that I would not subscribe to, is that it would not have any effect. I do agree the effect will be a lag effect.

Chairman PROXMIRE. At any rate, it will be after the election, which explains perhaps Republican enthusiasm for it.

Gentlemen, thank you very, very much for a spirited and exciting and interesting presentation.

The Joint Economic Committee will stand adjourned.

(Whereupon, at 5:10 p.m., the committee adjourned, to reconvene at the call of the Chair.)