STATEMENT OF HON. DAVID M. KENNEDY, SECRETARY OF THE TREASURY, ACCOMPANIED BY CHARLS E. WALKER, UNDER SECRETARY, AND PAUL A. VOLCKER, UNDER SECRETARY FOR MONETARY AFFAIRS

Secretary KENNEDY. It gives me great pleasure to appear before your distinguished committee. I am accompanied on this occasion, as you have already stated, by Under Secretary Charls Walker, and Under Secretary for Monetary Affairs Paul Volcker. I understand that we are to concentrate mainly on domestic economic matters this morning. Your committee has already received testimony earlier this week from the Council of Economic Advisers and the Bureau of the Budget. Therefore, we will not attempt to review the economic and fiscal situations in great detail. Our prepared statements are fairly short. I will begin by giving you my own general appraisal of the current situation. The Under Secretaries will then comment briefly on specific issues in tax policy and debt management.

It is no secret that there are serious flaws in the economic picture. Strong inflationary pressures and an unsolved balance of payments problem require corrective action. But, there are also elements of great strength. American productive achievements in recent years have kept real income rising while also meeting the requirements of a rapidly expanding defense effort. Unemployment has been reduced to the lowest levels in nearly two decades. The dollar is strong and respected in the world in spite of recent inflationary trends and a deteriorating trade balance.

As a Nation, we are rich in material resources and responsive to the needs we see around us. Our conscience has been awakened to the existence of poverty amidst plenty and the need to make equality of opportunity a reality for all of our citizens. These heavy responsibilities must be met. To do so, the first priority must be to place the current expansion on a sounder and more sustainable basis. Otherwise, we run the risk of trying to do too much and end up by doing too little.

Any incoming administration encounters unsolved problems and we have our share. We have inherited a serious inflation. It is distorting the economy and weakening our international competitive position. If unchecked, this inflation will undercut the dollar at home and abroad. Already, rapidly rising prices have eroded the purchasing power of millions of Americans who counted on their government to provide sound money.

We recognize that there are risks in attempting to stop inflation too abruptly. If the economy were to be halted in its tracks, unemployment would rise prohibitively. Even though the inflationary psychology might be broken, the cost would be too high.

There are also risks in doing too little. Insufficient restraint would mean only a brief slowing down of the economy and no lasting reduction of inflationary pressures. Something very much like this occurred in 1967, when expansionary policies were pressed so vigorously as the economy slowed that the inflationary trend was never broken. As a result, inflation has built up a considerable momentum in recent years. The lesson is that the economy must be placed under firm restraint until there are unmistakable signs that we are headed back on a noninfla-